



CITY OF KIRKLAND
Department of Finance & Administration
123 Fifth Avenue, Kirkland, WA 98033 425.587.3100
www.kirklandwa.gov

MEMORANDUM

To: Kurt Triplett, City Manager

From: Tracey Dunlap, Director of Finance and Administration
Tom Mikesell, Financial Planning Manager

Date: September 8, 2014

Subject: PUBLIC HEARING ON REVENUE SOURCES FOR THE 2015-2016 BUDGET

RECOMMENDATION:

City Council hold a public hearing on revenue sources for the 2015-2016 Budget.

BACKGROUND:

This is the first of three scheduled public hearings on the 2015-2016 budget (two of which are required by statute). This first public hearing addresses revenue sources. The second and third public hearings on the 2015-2016 Preliminary Budget are scheduled to be held on Monday, November 3rd (pending Council approval) and Tuesday, November 18th.

General Fund Projections

The City Council's last full briefing on the City's financial outlook was at its May 30, 2014 retreat. At that time, the forecast projected a \$1.12 million gap between ongoing revenues and expenditures in 2015-16, assuming the discontinuation of one-time service packages approved in the 2014 mid-biennial budget process. Since that meeting, the General Fund revenue and expenditure projections have been updated to reflect current information, including:

- An assessment of revenue collections under current economic conditions;
- New information on contractually and/or statutorily derived rates; and,
- Basic budget information supporting current service levels as submitted by departments in August.

This updated financial projection provides the basis for budget meetings with the City Manager's Office, which are currently in progress. The 2015-2016 budget is being developed under the following principles:

- Stay steady given the long-term revenue outlook:
 - Temporary REET use for maintenance and operations that ends after 2016;

- Prepare for the end of the State annexation sales tax credit in 2021;
- Continue to budget sales tax on a one-year lag and set aside a portion of sales tax revenue growth toward one time uses.
- Service packages will be viewed in the context of reprioritizing or trade-offs. Said another way, proposed additions will be evaluated in the context of whether they can be supported by new revenues or through reductions in lower priority programs;
- Setting aside funds toward unfunded capital needs rather than spending available General Funds solely on operations; and,
- Keep non-personnel expenditure cost growth to zero, with the exception of known external contractual obligations or other expected cost increases (e.g., fuel, utilities) that cannot be offset by savings elsewhere.

Based on this updated information, we now project \$2.3 million of available General Fund revenue in the 2015-2016 biennium (\$1.7 million in 2015 and \$0.6 million in 2016) to fund additional expenditures as discussed later in this memorandum. These funds are in addition to any one-time resources that will be available at the end of 2014, which will be determined based on the year end estimates that are currently under review. Main factors driving the shift in the financial projection include:

- Higher sales tax revenue collections in 2014 than forecast, which adjusts the forecast base used for both 2015 and 2016 – \$5.2 million biennial revenue increase (\$2.6 million in 2015 and \$2.6 million in 2016);
- Higher than forecast revenues from development licensing and permitting in 2014 are projected to continue at similar levels in 2015 and 2016 (\$1.6 million biennial revenue increase) which will either be used for resources to meet workload or set aside in reserve;
- Higher than forecasted costs for internal service charges and expenditures for external services, including NORCOM and liability insurance payments to Washington Cities Insurance Authority. (\$1.7 million higher costs); and,
- Assumed reserve replenishment of one-percent of General Fund revenue, resulting in a total of \$1.6 million of the projected 2015-2016 operating revenues being set aside toward the reserve target.

Below is a more detailed discussion of current revenue and expenditure assumptions and a calendar of next steps in the budget process.

Revenue Assumptions

The current 2015-2016 projection is based on a number of revenue assumptions, including:

- **Reserves** - No use of general purpose reserves in 2015-2016;
- **Property Tax** - 1% optional increase each year and 1.0% annual growth in new construction property tax. The new construction estimate for 2015 will be updated when information becomes available from the King County Assessor;

- **Sales Tax**
 - General Fund 2014 sales tax revenue is projected over at 8.2 percent ahead of 2013 actual results. Year-to-date total sales tax collections through August are 9.4% ahead of 2013 (See Attachment A for the August sales tax report);
 - No increase in sales tax is projected for 2015, reflecting the policy-based one-year lag; and,
 - A 4% increase in sales tax is budgeted in 2016, based on similar forecasts from King County and the Washington State Economic & Revenue Forecast Council.
- **Annexation Sales Tax Credit** – Support from tax credit is projected to remain at 2014 levels in 2015 and 2016;
- **Utility Tax**
 - Electric and Gas collections are projected to grow 1% in 2015 and 2016, reflecting uncertainty in future utility rate trends and weather-related consumption patterns; and,
 - Cable tax and telecommunication utility taxes are estimated to increase 1% per year in 2015 and 2016.
- **Business License** - 1% growth per year is assumed in Revenue Generating Regulatory License fees;
- **Development-related revenues** are estimated to remain at their 2014 level through 2015 and 2016. It is worth noting that the current projections do not assume any revenue changes as a result of the ongoing fee study being considered by Council, nor do they assume new revenues from Park Place and Totem Lake development projects;
- **Interest earnings** have been adjusted to reflect the continuing decline in interest earnings rates.

These assumptions are based on the revenue trends through June 30, 2014 as noted in the second quarter 2014 Financial Management Report (see Attachment B), collections experience through August, and current economic projections. Further refinements in revenue estimates may occur throughout the budget deliberation process as new data becomes available.

Expenditure Assumptions

The updated projections also reflect the following expenditure assumptions, including:

- **Full Staffing** - All the ongoing positions budgeted in 2014 are budgeted in 2015-2016;
- **Excludes One-time Service Packages** - There are a considerable number of one-time expenditures budgeted in 2013-2014 that likely will be considered for continuation in the 2015-16 budget process. As mentioned in the May forecast memo, the continuation of all of the current services would cost about \$3.2 million per year. These costs are not included in this forecast, and are detailed in the following table.

Projected 2015-2016 Costs of One-time 2013-2014 Service Packages

One Time Costs	2015				2016		
	Temp. FTE	Wages & Benefits	Other Costs	Annual Total	Wages & Benefits	Other Costs	Annual Total
Finn Hill Staffing Overtime/Benefits	-	518,176	-	518,176	545,363	-	545,363
Senior Financial Analyst (Fire)	1.0	116,536	7,316	123,852	123,113	7,316	130,429
Police Support Associate	0.75	63,363	13,550	76,913	67,027	13,550	80,577
City Clerk Public Disclosure Analyst	1.0	87,868	7,316	95,184	92,918	7,316	100,234
PW Deputy Director - Superintendent	1.0	157,207	7,316	164,523	165,938	7,316	173,254
Temporary Development Engineer	1.0	122,182	7,316	129,498	129,053	7,316	136,369
Development On Call/OT Funding	-	156,234	-	156,234	164,148	-	164,148
Temporary CIP Outreach Coordinator	0.5	65,862	-	65,862	69,550	-	69,550
Temporary Assistant Planner	1.0	96,348	-	96,348	36,590	-	36,590
Temporary Building Inspector	1.0	115,267	7,316	122,583	121,775	7,316	129,091
Health Benefits Analyst (HR)	1.0	103,005	7,316	110,321	108,847	7,316	116,163
Neighborhood Traffic Control (Streets)	0.5	60,422	551	60,973	63,822	551	64,373
Energov Support Position (IT)	1.0	113,899	2,900	116,799	120,333	2,900	123,233
Senior Applications Analyst (IT)	1.0	138,650	2,900	141,550	146,397	2,900	149,297
IT Network Security Staffing (IT)	1.0	138,596	2,900	141,496	146,340	2,900	149,240
GIS Analyst (IT)	0.5	43,803	-	43,803	46,147	-	46,147
Design Specialist (IT)	0.75	67,560	-	67,560	71,436	-	71,436
<i>Subtotal Staffing Costs</i>	13.00	2,164,975	66,697	2,231,672	2,218,798	66,697	2,285,495
State Legislative Advocacy Series		-	48,000	48,000	-	48,000	48,000
Municipal Court Security		45,449	-	45,449	47,867	-	47,867
KPC Operating Support		-	34,000	34,000	-	34,000	34,000
Human Svcs Option 2/Time Bank Funding		-	45,814	45,814	-	45,814	45,814
ARCH Housing Trust Fund		-	315,000	315,000	-	315,000	315,000
BABS Subsidy		-	110,000	110,000	-	110,000	110,000
Development Prof./Contract Svcs		-	67,000	67,000	-	67,000	67,000
<i>Subtotal Non-Staff Costs</i>		45,449	552,814	598,263	47,867	552,814	600,681
Total General Fund		2,210,425	619,511	2,829,936	2,266,665	619,511	2,886,176

REET Flexibility:							
Parks Operations and Maintenance		127,821	24,881	152,702	127,821	24,881	152,702
Street Grounds Tech/Laborer		105,804	-	105,804	111,897	-	111,897
<i>Subtotal REET Flexibility</i>		233,625	24,881	258,506	239,718	24,881	264,599
Grand Total		2,444,050	711,392	3,155,442	2,506,383	711,392	3,217,775

*Supported by Development fee revenues

- **COLA Reserve** – All collective bargaining agreements will be open in 2015, with the exception of Police non-commissioned, which opens in 2016. A reserve has been set-aside for potential annual raises of 2% per year in anticipation of settling those contracts.
- **Debt Set-Aside** - Approximately \$0.4 million per year resulting from debt retiring at the end of 2014 is included as a placeholder in the 2015-16 budget in anticipation of offsetting the loss of the annexation sales tax credit in 2021. These funds can be used for one-time needs in 2015-2016;
- **Health Benefit Inflation** - The forecast assumes a 7% increase in benefits costs, the majority of which is for health plan premiums. The result of any modification to the

City's health plan are not included at this time, but are expected to be reflected in the preliminary budget;

- **Reserve Replenishment** - Continuing planned reserve replenishment of one-percent of General Fund revenue results in a total of \$1.6 million of the projected 2015-2016 operating revenues being set aside toward the reserve target level based on the Council's reserve replenishment principles as adopted by resolution (R-4900);
- **Current Services Levels** - No new one-time or ongoing service packages are reflected. The City Manager is currently reviewing services package requests submitted by departments and his recommendations will be reflected in the preliminary budget; and,
- **General Fund Capital Contribution** - No additional General Fund contribution to the Capital Improvement Program is assumed.

As with the revenue assumptions, these will be subject to refinement during the budget process.

Budget Process

A balanced preliminary budget, reflecting the City Manager's recommendations, will be available to the City Council and the public on October 21. The following list includes this and other significant dates in the 2015-16 budget process.

- October 21 – 2015-2016 Preliminary Budget provided to the City Council/public
- October 28 - Finance & Administration Committee budget update
- October 30 – Council Budget Work Session (3-9 pm)
- November 3 (Monday, pending Council approval) – Additional budget study session and public hearing
- November 10 (Monday) – Additional budget study session (if needed)
- November 18 – Public hearing on the Preliminary 2015-2016 Budget and preliminary 2015 property tax levy
- December 9 – Adoption of 2014-18 CIP Update, 2015-2016 Budget, and final 2015 property tax levy



CITY OF KIRKLAND
Department of Finance & Administration
 123 Fifth Avenue, Kirkland, WA 98033 425.587.3100
 www.kirklandwa.gov

MEMORANDUM

To: Kurt Triplett, City Manager

From: Tracey Dunlap, Director of Finance & Administration
 Kyle Butler, Budget Analyst

Date: September 8, 2014

Subject: August Sales Tax Revenue

August sales tax revenue is **up 12.6 percent** compared to August 2013. **Year-to-date** revenues are **up 9.4 percent** compared to the same period last year. Results this month reflect retail sales activity in June, due to the two month lag in reporting sales tax data.

Comparing August 2014 to August 2013

Comparing collections from August of this year and last year reveals economic trends and provides insight into business sector performance.

2013-2014 Sales Tax Receipts by Business Sector-Monthly Actuals

Business Sector Group	August		Dollar Change	Percent Change	Percent of Total	
	2013	2014			2013	2014
Services	182,653	208,485	25,832	14.1%	13.3%	13.5%
Contracting	227,369	259,983	32,614	14.3%	16.6%	16.9%
Communications	34,803	42,386	7,583	21.8%	2.5%	2.7%
Retail:						
Auto/Gas Retail	324,981	360,541	35,560	10.9%	23.7%	23.4%
Gen Merch/Misc Retail	154,469	171,639	17,170	11.1%	11.3%	11.1%
Retail Eating/Drinking	125,050	136,333	11,283	9.0%	9.1%	8.8%
Other Retail	187,723	201,633	13,910	7.4%	13.7%	13.1%
Wholesale	66,792	76,332	9,540	14.3%	4.9%	5.0%
Miscellaneous	65,569	84,715	19,146	29.2%	4.9%	5.5%
Total	1,369,409	1,542,047	172,638	12.6%	100.0%	100.0%

August sales tax collections this year are \$172,638, or 12.6 percent higher than August 2013. Over 20 percent of the August increase is in the auto/gas retail sector, and the contracting sector accounts for 19 percent of the growth over last August. Every major sector gained ground this August over last year.

- The **services** sector is **up 14.1 percent** compared August 2013, or about \$25,800, largely due to increases in professional/scientific services, admin support, and accommodation services.
- The **contracting** sector is **up 14.3 percent** compared to last August. This is significantly higher growth than the City experienced last month, when it came in at just 2 percent. This month's contracting revenues are more in line with this year's upward trend.

- The **communications** sector (telecom services) is **up 21.8 percent**, or about \$7,600.
- Retail sectors are collectively up 9.8 percent compared to the same month in 2013 or about \$78,000.
 - The **auto/gas retail** sector is **up 10.9 percent**, or \$35,600, continuing a four month rebound since March 2014, which saw the first decline in this sector in over two years. This is the largest monthly increase in this sector since February 2014, topping last month's strong growth.
 - **General merchandise and miscellaneous retail** are **up 11.1 percent** over August 2013, or about \$17,200.
 - The **retail eating/drinking** sector is **up 9 percent** compared to August 2013.
 - **Other retail increased 7.4 percent**, or about \$13,900, compared to August 2013.
- **Wholesale** is **up 14.3 percent** compared to August 2013, or about \$9,500. Items in this category include food wholesale, medical equipment, computer equipment, sporting and recreation equipment, and industrial equipment.
- The **miscellaneous** sector is **up 29.2 percent** versus August 2013, or about \$19,000. This is largely related to a sales tax refund by the State in 2013 in the unknown sector and solid growth in the manufacturing and finance & insurance sectors in 2014.

Year-to-Date Business Sector Review

Year-to-date sales tax totals are useful for comparing revenues received so far this year with last year's totals from the same period. This information gives us a broader context of how a sector is performing as the year goes on. Through the end of August, sales tax is **up 9.4 percent** compared to last year.

City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January-August		Dollar Change	Percent Change	Percent of Total		Percent of Change
	2013	2014			2013	2014	
Services	1,376,603	1,482,658	106,055	7.7%	12.8%	12.6%	10.4%
Contracting	1,736,874	1,859,008	122,134	7.0%	16.1%	15.8%	12.0%
Communications	294,163	339,092	44,929	15.3%	2.7%	2.9%	4.4%
Retail:							
Auto/Gas Retail	2,697,120	2,893,501	196,381	7.3%	25.1%	24.6%	19.3%
Gen Merch/Misc Retail	1,300,899	1,354,378	53,479	4.1%	12.1%	11.5%	5.3%
Retail Eating/Drinking	883,180	950,626	67,446	7.6%	8.2%	8.1%	6.6%
Other Retail	1,401,906	1,593,636	191,730	13.7%	13.0%	13.5%	18.9%
Wholesale	510,720	554,686	43,966	8.6%	4.7%	4.7%	4.3%
Miscellaneous	559,413	749,402	189,989	34.0%	5.2%	6.4%	18.7%
Total	10,760,878	11,776,987	1,016,109	9.4%	100.0%	100.0%	100.0%

Sales tax revenues for retail sectors are up 8.1 percent collectively compared to 2013, an improvement over the revenues through last month.

- The **general merchandise/miscellaneous retail** sector is **up 4.1 percent** compared to last year.
- The **auto/gas retail** sector is **up 7.3 percent** compared to last year. Vehicle sales have grown in strength over the past four months, and are beginning to account for a higher percentage of the City's overall sales tax growth, something that formed a major part of the growth seen in 2013.

- The **retail eating/drinking** sector performance is **up 7.6 percent** compared to the same period in 2013, an increase of \$67,400.
- Other retail is **up 13.7 percent** compared to 2013 due to strong increases in a number of categories particularly food and beverage retailers, online retailers and building & garden stores.
- The **services** sector is **up 7.7 percent** compared to last year. Year-to-date revenue in most subsectors have grown moderately.
- **Wholesale** is **up 8.6 percent** compared to last year, an increase of \$44,000. Following declining revenue in February, wholesale revenues have improved steadily over the past six months, and now accounts for the same percentage of the City's total sales tax revenue as it did in August of 2013.
- The **communications** sector is **up 15.3 percent** compared to last year, due to broad growth amongst the wireless and cable providers within the category.
- The **contracting** sector is **up 7.0 percent** compared to 2013. Contracting was among the largest growth sectors in the City through the first half of 2013, but slowed later in the year. A sharp decline in January 2014 meant the year started significantly below the 2013 number, but contracting sales have grown over the last five months to amounts higher than 2013.
- The **miscellaneous** sector is **up 34.0 percent** due to a large payment that has been previously reported as well as increased revenues from the statewide pool - which is how the State distributes improperly coded revenues out to local jurisdictions. Most of this increase happened in January 2014, and the year-on-year percentage increase has been slowly declining each month since then.

National and Regional Economic Context:

The **Consumer Confidence Index** increased from 90.3 in July to 92.4 in August. This is the fourth straight month of improvement, following decreases in March and April, the index is now at its highest point since before the recession. According to Lynn Franco, Director of Economic Indicators at The Conference Board: "Consumer confidence increased for the fourth consecutive month as improving business conditions and robust job growth helped boost consumers' spirits. Looking ahead, consumers were marginally less optimistic about the short-term outlook compared to July, primarily due to concerns about their earnings. Overall, however, they remain quite positive about the short-term outlooks for the economy and labor market."

The Bureau of Labor Statistics reports that, on a seasonally adjusted basis, the state unemployment rate was 5.6 percent in July 2014, down from 7.0 percent in June 2013. The **Seattle/Tacoma/Bellevue unemployment rate** increased from 5.0 percent to 5.2 percent from June to July 2014. Both these figures are below the nationwide unemployment rate for July of 6.2 percent. The relatively low unemployment rates should be interpreted with some caution, since some analysts have argued that the declining unemployment rate is due at least in part to falling participation in the labor market and "underemployment", rather than strong employment numbers.

Statewide **housing construction** was near the forecast for the second quarter of 2014, with 37,200 units being permitted compared to a forecast of 37,400 units. The construction trends have been regularly below forecast for single family homes and above forecast for multifamily housing units.

Regional home prices underwent a mild decline in May, according to the S&P/Case-Schiller Home Price Indices. Seattle area home prices had risen for 29 consecutive months, but saw a decline of 0.2 percent in May. However, Seattle home prices are still 9.3 percent higher than the previous May and 26.2 percent higher than the November 2011 low point.

Statewide **car sales** have been volatile in the first five months of 2014 but have been turning in strong months as of late, which mirrors the trend in Kirkland's sales tax collections. Car and light truck sales

totals of 290,800 vehicles in July reached a new post-recession high, which was 5.7 percent higher than July 2013.

Conclusion

As we come toward the end of the third quarter, sales tax numbers remain strong. The numbers for August show that Kirkland's economy is seeing more strength from smaller sectors, although the City's revenue base still relies on the big ticket sales that auto sales and contracting provide (which together account for 40.4 percent of all sales tax revenues). These sectors are historically more volatile than other sectors, and are susceptible to market changes. However, other sectors have continued to grow compared to 2013, and wider economic indicators generally suggest that growth will continue in the coming months.



Financial Management Report as of June 30, 2014

AT A GLANCE:

Using canine friends to help clean up Juanita Creek (page 2 sidebar)

Most revenues increased over 2013 during the first half of 2014 (page 3)

Sales tax revenue growth continued into 2014, slowing at first, but accelerating into the second quarter (page 5)

In the wider economy the housing market continues to improve and inflation rises slowly (pages 7-8)

Inside this issue:

Expenditure Summary	2
General Fund Revenue	3
General Fund Expenditures	4
Sales Tax Revenue	5-6
Economic Environment	7-8
Investment Report	8-9
Reserve Summary	10-11

Summary of All Operating Funds: *Revenue*

- General Fund** revenue ended the second quarter of 2014 **3.7 percent ahead** of the same period in 2013, an increase of \$1.53 million. Higher than budgeted revenues from retail sales tax and building permits, along with higher property tax collections in the first half of 2014 were primarily responsible for the increase. Revenues finished the first half at **53.9 percent of budget**. A more detailed analysis of General Fund revenue can be found on page 3, and details on sales tax revenue begin on page 5.
- Water/Sewer Operating Fund** revenue through the first two quarters was slightly higher than in 2013, **up 1.8 percent**. At the end of the first half of the year, revenue was **45.9 percent of budgeted** revenue, due to water sales being under 50 percent in the first half of the year. Water sales are traditionally higher in the second half of the year so it is likely these categories will reach 100 percent of budget by the end of the year.
- Surface Water Management Fund** revenues at the end of June were **50.6 percent of budget**. Revenues during the first half of 2014 were **4.4 percent lower** than in 2013, primarily because of a Department of Ecology grant and internal wage reimbursements received in 2013.
- Revenue through the second quarter of 2014 in the **Solid Waste Fund** was **50.1 percent of budget**. This is **3.3 percent higher** than in 2013. Revenue was higher across residential, commercial and multi-family properties.
- Overall, in the first six months of 2014 utility funds revenues were **up 1.0 percent** compared to the same period last year, and finished the quarter at **48.2 percent of budget**.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	6/30/2013	6/30/2014	% Change	2013	2014	% Change	2013	2014
General Gov't Operating:								
General Fund	40,993,722	42,523,596	3.7%	77,699,996	78,890,220	1.5%	52.8%	53.9%
Other General Gov't Operating Funds	11,968,460	12,681,296	6.0%	23,452,132	24,628,836	5.0%	51.0%	51.5%
Total General Gov't Operating	52,962,182	55,204,891	4.2%	101,152,128	103,519,056	2.3%	52.4%	53.3%
Utilities:								
Water/Sewer Operating Fund	10,976,581	11,170,646	1.8%	24,234,608	24,342,543	0.4%	45.3%	45.9%
Surface Water Management Fund	5,012,867	4,790,143	-4.4%	9,224,823	9,460,539	2.6%	54.3%	50.6%
Solid Waste Fund	7,703,637	7,961,012	3.3%	15,954,564	15,875,727	-0.5%	48.3%	50.1%
Total Utilities	23,693,085	23,921,801	1.0%	49,413,995	49,678,809	0.5%	47.9%	48.2%
Total All Operating Funds	76,655,267	79,126,693	3.2%	150,566,123	153,197,865	1.7%	50.9%	51.6%



City calls in the dogs to help sniff out bacteria clues in Juanita Creek

Talk about your dynamic duo. A Border collie named Molly and an Australian cattle dog named Crush put their noses to work recently to help find sources of human bacteria in and around Kirkland's Juanita Creek. The pair teamed up to sniff close to 100 water samples taken from Juanita Creek and several of its branches. The sniff test included uncontaminated water samples, samples known to contain animal bacteria, and those obtained in and nearby Juanita Creek.

The Juanita Creek Watershed feeds into Lake Washington at Juanita Beach Park – a popular summer swimming area.

Why is the City trying such a unique investigative technique? Because truly, the nose knows. The dogs can detect, through scent, the presence of human fecal bacteria. This tells the City that sources of contamination are most likely due to leaking septic tanks or improper connection of sanitary sewer systems to the Creek. These sources present a greater risk to human health than bacteria from raccoons, geese or other animals.

Also, the service is cost effective. Molly and Crush sniffed closed to 100 samples in a two-day test, each sniffing the same row of samples for quality control. When they smelled human contamination, they sat by their dog handler. The results are being tested by King County's Environmental Lab and are expected in the coming weeks. If laboratory tests confirm the dogs findings, future testing can use just the dogs, resulting in greatly decreased costs for detecting problems.

Staff from the City's Water Quality Program will follow up with property owners where the contamination source was detected.

Summary of All Operating Funds: *Expenditures*

- **General Fund** expenditures finished the first half of 2014 **up 8.1 percent** from 2013. Actual expenditures finished the second quarter at **48.3 percent of budget**. A more detailed analysis of General Fund expenditures by department is found on page 4.
- **Other Operating Funds** actual expenditures were **up 15.2 percent** compared to the first half of 2013, mostly due to higher expenditures in the Information Technology and Fleet funds. Information Technology expenditures were higher largely because of higher computer replacement costs in 2014. Similarly, Fleet costs were primarily higher because vehicle replacement costs were higher in 2014 than 2013. Both of these expenditures are higher some years than others and do not necessarily represent a trend of higher spending.
- **Water/Sewer Operating Fund** actual expenditures finished June **7.6 percent higher** than in 2013. The majority of these additional expenditures were because the City paid two months metro sewer charge in January 2014, after not paying in December 2013. Therefore, the city effectively paid for four months during the first quarter of 2014. Additionally, dues and memberships are paid in full in January, and the combination of these two factors means expenditures are usually higher in the early part of the year. This has proven true so far in 2014 as first quarter expenditures were higher than the second quarter, and the City expects this number to continue to normalize as the year continues. Expenditures at the end of June 2014 were **53.1 percent of budget**
- **Surface Water Management Fund** expenditures through June 2014 were **4.4 percent higher** than the same time in 2013, due to a small increase in personnel costs between years. Despite this increase there is still a vacancy in the Surface Water fund, which meant that expenditures through June were **lower than budgeted at 45.4 percent** of the yearly budget.
- **Solid Waste Fund** expenditures were **16.6 percent higher** during the first six months of 2014, compared to the same period in 2013. This increase is due to an expected increase in the cost of the waste disposal contract. As this increase was expected and all other expenses were also in line with budget, expenditure finished the first two quarters of 2014 at **50.0 percent of budget**.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	6/30/2013	6/30/2014	% Change	2013	2014	% Change	2013	2014
General Gov't Operating:								
General Fund	34,806,688	37,623,726	8.1%	74,472,577	77,902,014	4.6%	46.7%	48.3%
Other General Gov't Operating Funds	8,356,144	9,625,809	15.2%	20,615,814	20,935,475	1.6%	40.5%	46.0%
Total General Gov't Operating	43,162,832	47,249,535	9.5%	95,088,391	98,837,489	3.9%	45.4%	47.8%
Utilities:								
Water/Sewer Operating Fund	10,162,874	10,937,171	7.6%	20,909,022	20,601,544	-1.5%	48.6%	53.1%
Surface Water Management Fund	2,761,110	2,882,586	4.4%	6,546,354	6,353,316	-2.9%	42.2%	45.4%
Solid Waste Fund	6,723,024	7,840,680	16.6%	15,374,063	15,668,380	1.9%	43.7%	50.0%
Total Utilities	19,647,008	21,660,437	10.2%	42,829,439	42,623,240	-0.5%	45.9%	50.8%
Total All Operating Funds	62,809,840	68,909,972	9.7%	137,917,830	141,460,729	2.6%	45.5%	48.7%

General Fund Revenue

- **Sales tax** revenue allocated to the General Fund through the second quarter of 2014 was **9.7 percent higher** than it was during the same period of 2013. This was higher than budgeted at **56.6 percent of budget** because sales tax is budgeted on a one year lag. A detailed analysis of total sales tax revenue can be found starting on page 5.
- **Property tax** finished the first quarter at **52.9 percent of budget**. Most property tax payments are receipted to the City in April and October, therefore this number will be close to 100 percent of budget by the end of the third quarter.
- **Utility tax** collections finished June 2014 **up 2.0 percent** compared to 2013. This is slightly above budgeted levels at **52.6 percent of budget**.
- **Other taxes** actual revenue was **50.6 percent of budget** at the end of the second quarter of 2014. This is a **6.2 percent increase** compared to the same period in 2013, and is the result of small increases in gambling, admissions and some smaller tax revenues.
- The **revenue generating regulatory license fee** was **7.5 percent higher** than the first half of 2013. This increase means revenues were ahead of the budgeted amount at **62.3 percent of budget**. This tax is charged to employers on a per-employee basis, and fluctuates based on the timing of when businesses submit their payments, as well as the number of employees at each business, therefore a strong performance in the first half may not recur in the second half.
- The **business licenses (base fee) and franchise fees** were **3.9 percent** higher than the same period in 2013 and finished the quarter **ahead of budget at 52.7 percent**.
- **Development-related fee** revenues were collectively **down 8.2 percent** in the second quarter of 2014, because **plan check fees** were **down 33.0 percent**, while **Engineering Services** collected **21.2 percent less** than in the same period in 2013. This was partially offset because **Building Structural and Equipment permits** were **up 7.0 percent**, following a large permit application for the Google expansion project received in January. Despite this decrease, development related fee revenues were still ahead of budget for the first half of the year. Collectively **development fees** were at **65.8 percent of budget** at the end of the first quarter, with **Building, Structural and Equipment permits (42.7 percent), Engineering Services (87.3 percent), and Planning fees (66.9 percent)** all being ahead of budget half way through the year. Only **Plan Check fees** were behind with **33.0 percent of budget** collected through the end of June.
- **Fines and Forfeitures** were **down 1.2 percent** compared to 2013 and were slightly **behind budget expectations at 48.8 percent**, due to low traffic infraction penalties. Traffic infraction penalties are not receipted in January, so the budget is collected in 11 months from February to December, therefore this category will likely be close to budget by year end. Current trends suggest this will be true as receipts through the second quarter were closer to budgeted revenues than they were at the end of the first quarter.
- **Miscellaneous** revenue was **up \$128,900, or 23.8 percent** from 2013 and was **ahead of budget at 88.1 percent**, largely due to an insurance recovery payment in 2014.

General Fund revenues ended the second quarter \$1.43 million higher than in 2013 (including interfund transfers), largely due to continued growth in sales tax and development activity.

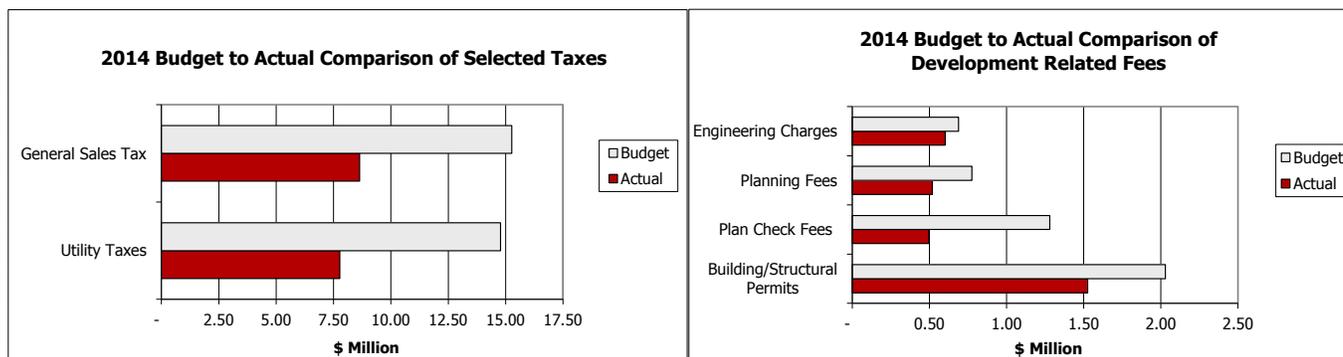
The General Fund is the largest of the General Government Operating funds. Primarily tax supported the fund accounts for services such as public safety, parks and recreation, and community development.

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development-related fees.

In 2014 about 428 of the City's 556 regular employees were budgeted within the general fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	6/30/2013	6/30/2014	% Change	2013	2014	% Change	2013	2014
Taxes:								
Retail Sales Tax: General	7,875,995	8,637,061	9.7%	15,057,904	15,263,571	1.4%	52.3%	56.6%
Retail Sales Tax Credit: Annexation	1,754,329	1,616,935	-7.8%	3,415,626	3,415,626	0.0%	51.4%	47.3%
Retail Sales Tax: Criminal Justice	865,714	925,375	6.9%	1,634,287	1,666,973	2.0%	53.0%	55.5%
Property Tax	8,675,613	8,966,959	3.4%	16,619,200	16,953,959	2.0%	52.2%	52.9%
Utility Taxes	7,624,293	7,772,988	2.0%	14,618,866	14,779,443	1.1%	52.2%	52.6%
Rev Generating Regulatory License	1,363,264	1,465,874	7.5%	2,328,005	2,351,285	1.0%	58.6%	62.3%
Other Taxes	511,173	543,115	6.2%	1,063,975	1,073,303	0.9%	48.0%	50.6%
Total Taxes	28,670,380	29,928,370	4.4%	54,737,863	55,504,160	1.4%	52.4%	53.9%
Licenses & Permits:								
Building, Structural & Equipment Permits	1,426,647	1,526,370	7.0%	2,013,727	2,029,631	0.8%	70.8%	75.2%
Business Licenses/Franchise Fees	2,177,511	2,263,296	3.9%	4,193,597	4,295,440	2.4%	51.9%	52.7%
Other Licenses & Permits	258,721	268,442	3.8%	317,128	330,001	4.1%	81.6%	81.3%
Total Licenses & Permits	3,862,880	4,058,107	5.1%	6,524,452	6,655,072	2.0%	59.2%	61.0%
Intergovernmental:								
Grants and Federal Entitlements	17,720	46,501	162.4%	198,622	104,421	-47.4%	8.9%	44.5%
State Shared Revenues & Entitlements	479,162	557,347	16.3%	1,033,781	1,237,172	19.7%	46.4%	45.1%
EMS	-	-	N/A	884,645	884,645	0.0%	N/A	N/A
Total Intergovernmental	496,882	603,849	21.5%	2,117,048	2,226,238	5.2%	23.5%	27.1%
Charges for Services:								
Internal Charges	2,665,088	2,836,648	6.4%	5,396,481	5,717,970	6.0%	49.4%	49.6%
Engineering Services	763,762	602,180	-21.2%	951,385	689,483	-27.5%	80.3%	87.3%
Plan Check Fee	740,923	496,711	-33.0%	1,082,220	1,279,914	18.3%	68.5%	38.8%
Planning Fees	494,608	518,773	4.9%	848,164	775,550	-8.6%	58.3%	66.9%
Recreation	760,811	838,555	10.2%	1,160,300	1,160,300	0.0%	65.6%	72.3%
Other Charges for Services	1,044,246	1,028,904	-1.5%	2,210,020	2,190,907	-0.9%	47.3%	47.0%
Total Charges for Services	6,469,438	6,321,770	-2.3%	11,648,570	11,814,124	1.4%	55.5%	53.5%
Fines & Forfeits	953,005	941,540	-1.2%	1,928,925	1,929,999	0.1%	49.4%	48.8%
Miscellaneous	541,136	670,024	23.8%	743,138	760,627	2.4%	72.8%	88.1%
Total Revenues	40,993,722	42,523,596	3.7%	77,699,996	78,890,220	1.5%	52.8%	53.9%
Other Financing Sources:								
Interfund Transfers	99,780	-	N/A	402,008	270,323	-32.8%	24.8%	N/A
Total Other Financing Sources	99,780	-	N/A	402,008	270,323	-32.8%	24.8%	N/A
Total Resources	41,093,502	42,523,596	3.5%	78,102,004	79,160,543	1.4%	52.6%	53.7%

General Fund Revenue *continued*



General Fund Expenditures

General Fund Department Expenditures	Year-to-Date Actual			Budget			% of Budget	
	6/30/2013	6/30/2014	% Change	2013	2014	% Change	2013	2014
Non-Departmental	683,205	677,435	-0.8%	1,657,558	1,393,673	-15.9%	41.2%	48.6%
City Council	260,778	286,833	10.0%	403,932	403,932	0.0%	64.6%	71.0%
City Manager's Office	873,968	944,631	8.1%	2,064,111	1,911,468	-7.4%	42.3%	49.4%
Municipal Court	1,041,851	1,108,450	6.4%	2,249,404	2,299,621	2.2%	46.3%	48.2%
Human Resources	614,844	673,375	9.5%	1,263,257	1,451,068	14.9%	48.7%	46.4%
City Attorney's Office	665,205	672,647	1.1%	1,371,489	1,384,479	0.9%	48.5%	48.6%
Parks & Community Services	3,258,178	3,491,898	7.2%	7,453,991	7,661,403	2.8%	43.7%	45.6%
Public Works (Engineering)	2,045,394	2,312,185	13.0%	4,756,261	5,079,098	6.8%	43.0%	45.5%
Finance and Administration	2,321,199	2,368,618	2.0%	4,590,803	4,839,597	5.4%	50.6%	48.9%
Planning & Community Development	1,637,798	1,862,933	13.7%	3,753,152	3,871,077	3.1%	43.6%	48.1%
Police	11,089,181	11,644,978	5.0%	22,804,767	24,478,109	7.3%	48.6%	47.6%
Fire & Building	10,315,086	11,579,745	12.3%	22,103,852	23,128,489	4.6%	46.7%	50.1%
Total Expenditures	34,806,688	37,623,726	8.1%	74,472,577	77,902,014	4.6%	46.7%	48.3%
Other Financing Uses:								
Interfund Transfers	2,720,335	1,744,400	-35.9%	11,513,698	3,706,808	-67.8%	23.6%	47.1%
Total Other Financing Uses	2,720,335	1,744,400	-35.9%	11,513,698	3,706,808	-67.8%	23.6%	47.1%
Total Expenditures & Other Uses	37,527,024	39,368,125	4.9%	85,986,275	81,608,822	-5.1%	43.6%	48.2%

Comparing 2014 and 2013 expenditures:

In the first half of 2014, excluding interfund transfers, General Fund expenditures were **8.1 percent higher** than 2013, although this increase was budgeted for as expenditures were slightly below budget with **48.3 percent** of budgeted expenses spent through the end of June.

Across the General Fund most of the \$2.82 million increase in expenditures were personnel related. A number of temporary, as well as some ongoing positions, were added during the 2013-14 Mid Biennial process, which accounts for a portion of the increase, while normal personnel increases make up the majority of the rest. Together salaries and benefits have increased \$1.32 million. Significant expenditure changes are highlighted below; for departments not highlighted below, increases were largely due to personnel costs.

First half General Fund expenditures (excluding "other financing uses") were 8.1 percent higher than they were in 2013.

- Actual expenditures for the **City Council** were **up 10 percent** compared to 2013 and finished the second quarter at **71.0 percent of budget**. Expenditures are ahead of budget because most of the City's dues and memberships are paid from the Council budget, and these are paid in full in January. Expenditures are higher than in 2013 because of the community survey, which was budgeted and carried out in 2014.
- The **City Manager's Office** finished the first half of 2014 **8.1 percent higher** than in 2013. This is partly due to personnel costs, but also because of higher professional services spending in 2014 related to Kirkland 2035 efforts. This increase in expenses was anticipated, so the City Manager's office finished the first quarter at **49.4 percent of budget**.
- Public Works** General Fund expenditures were up **13.0 percent** due to new positions added in response to high demand for permit applications. These additional expenditures were budgeted for and

Continued on page 5

Financial Management Report as of June 30, 2014

have been mitigated by other staffing vacancies in the department, including the Maintenance Center Superintendent position, which was vacant until the middle of April, meaning Public Works finished the quarter at **45.5 percent of budget**.

- **Police** expenditures finished the first six months of 2014 at **47.6 percent of budget**. This is slightly below budget, with 50 percent of the year complete. The area with the lowest expenditures compared to budget was professional services, particularly Care Custody of Prisoners costs for inmate medical and laundry. These costs are not necessarily spread evenly throughout the year, therefore savings in the first half of the year do not necessarily indicate expenditures will finish the year under budget.

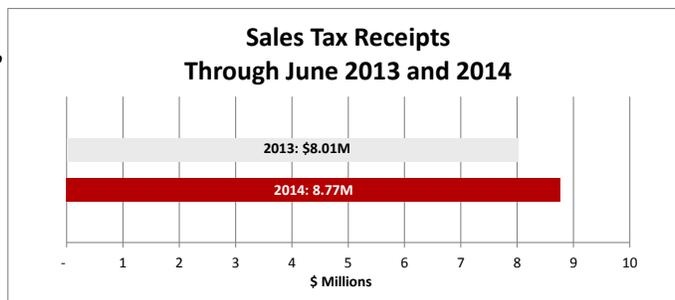
Summary of Fire District 41 Funds	
2014 Revenues & Expenditures	
Beginning Balance	5,223,879
Investment Interest	\$ 10,391
Expenditures:	\$ 31,113
Current Balance	\$ 5,203,157

- Expenditures for the **Fire & Building Department grew 12.3 percent** over the second quarter of 2013. This increase is related to higher personnel costs as positions were added to deal with the increased workload from development services activities that has resulted in higher contract work and overtime costs (which are offset by revenues). As these expenses were anticipated, the department's expenses finished the second quarter at **50.1 percent of budget**. A summary of Fire District #41 funds is shown in the table to the right. Currently these funds are dedicated to the consolidated fire station capital project.
- The budget for **Interfund transfers** is lower than in 2013, because there were a large number of transfers budgeted for the Public Safety Building in 2013. Not all transfers budgeted for the Public Safety Building in 2013 were made, so these will be made in 2014, pushing 2014 transfers over 100 percent of budget. As interfund transfers are known and planned expenses actual expenditures should equal 100 percent of the biennial budget.

Sales Tax Revenue Analysis

The total in this section contains \$135,000 that has been passed to the Street Operating Fund so far in 2014, therefore the total is \$135,000 higher than the sales tax figure in the General Fund Revenue table on page 3.

First quarter general sales tax revenue was **9.5 percent** higher in 2014 than 2013. This growth in revenue was concentrated across the retail sales categories, with vehicle sales making up the largest single increase. Sales tax revenue received through June was from sales between November 2013 – April 2014.



Review by business sectors:

- **Contracting was up 6.6 percent** through June compared to 2013. Contracting was among the largest growth sectors in the City through the first half of 2013, but slowed later in the year. A sharp decline in January 2014 meant the year started significantly below the 2013 number, but consistent growth through the other five months of 2014 lead to overall growth through for the first half of 2014.
- Sales tax from the retail sectors was collectively **up 7.9 percent** compared to 2013.
- The **auto/gas retail** sector was **up 6.2 percent** in the first quarter of 2014. Although auto sales continued to be higher than they were in 2013, sales slowed in March for the first time in two years, and the rate of increase has slowed overall.
- **General merchandise/miscellaneous retail** sector was **up 2.8 percent** in 2014 compared to 2013.
- The **retail eating/drinking** sector was **up 7.1 percent**, an increase of \$45,800, compared to the first half of 2013.
- **Other retail** was **up 16.1 percent** compared to the same period last year due to strong increases in sales from building & garden stores, food and beverage retailers, and online retailers.
- The **services** sector was **up 8.7 percent** compared to 2013. Year-to-date revenue in most subsectors grew moderately. The exceptions to this were: professional scientific, which was higher due to new companies reporting revenue; and other information, where 2014 revenues were skewed upwards as a single taxpayer paid multiple months at once.
- **Wholesale** was **up 4.9 percent** compared to last year. Similar to contracting and auto sales, one month in the first quarter of 2014 posted lower sales than 2013, in this case February, but growth in the other five months meant positive growth for the year so far.
- The **miscellaneous sector** was **up 40.4 percent** due to a large payment from an aviation company as well as increased revenues from the statewide pool made up of sales tax revenue submitted to the Department of Revenue but not appropriately coded.
- The **communications sector** was **up 14.7 percent**, due to broad growth across telecoms companies in the City.

City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January-June		Dollar Change	Percent Change	Percent of Total		Percent of Change
	2013	2014			2013	2014	
Services	1,019,964	1,109,164	89,200	8.7%	12.7%	12.6%	11.7%
Contracting	1,288,133	1,373,719	85,586	6.6%	16.1%	15.7%	11.2%
Communications	221,862	254,404	32,542	14.7%	2.8%	2.9%	4.3%
Auto/Gas Retail	2,005,571	2,130,288	124,717	6.2%	25.0%	24.3%	16.4%
Gen Merch/Misc Retail	993,127	1,020,516	27,389	2.8%	12.4%	11.6%	3.6%
Retail Eating/Drinking	641,636	687,474	45,838	7.1%	8.0%	7.8%	6.0%
Other Retail	1,033,615	1,200,257	166,642	16.1%	12.9%	13.7%	21.9%
Wholesale	386,316	405,362	19,046	4.9%	4.8%	4.6%	2.5%
Miscellaneous	420,771	590,877	170,106	40.4%	5.3%	6.7%	22.4%
Total	8,010,995	8,772,061	761,066	9.5%	100.0%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to

City of Kirkland Actual Monthly Sales Tax Receipts

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2013	2014		
January	1,333,113	1,390,304	57,191	4.3%
February	1,618,028	1,800,690	182,662	11.3%
March	1,225,511	1,291,149	65,638	5.4%
April	1,181,984	1,285,803	103,819	8.8%
May	1,387,795	1,601,648	213,853	15.4%
June	1,264,563	1,402,468	137,905	10.9%
Total	8,010,994	8,772,062	761,068	9.5%

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City.

- Growth in monthly sales tax revenues was higher in the second quarter than during the first quarter, with gains in the second quarter averaging over 10 percent.
- In **April** sales were higher than 2013 in every category. About 70 percent of the increase was split among wholesale, contracting and the miscellaneous sector.
- **May** sales tax revenues saw the highest single month percentage increase when comparing 2013 and 2014. The growth was largely concentrated in other retail, contracting, services and a strong performance in the auto/gas retail sector.
- In **June** growth continued in almost every category, most of the growth was concentrated in the same sectors as May 2014, but was slightly offset by a decline in miscellaneous sector.
- During the first quarter of 2014 the boom in sales tax revenues from contracting, auto retail and services appeared to have slowed and been replaced by growth in single digits across a number of sectors, particularly retail. This suggested that pent up demand for housing and cars following the recession was beginning to be replaced by broader spending. Second quarter results indicate that broad base growth is continuing and there was renewed strong growth in some major categories, such as contracting and auto/gas retail.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Comparing to the same period last year:

Totem Lake, which accounted for 28.0 percent of the total sales tax receipts through the second quarter of 2014, was **up**

1.1 percent compared to 2013, or \$27,300. Growth in Totem Lake would be stronger, but for a large refund paid to a manufacturing business in 2014. Continued growth in the auto/gas retail section, which is up \$56,100, led this growth.

NE 85th Street, which made up 13.5 percent of the total sales tax receipts in the first two quarters of 2014, was **up 7.0 percent** compared to the same period last year. This area's sales grew due to improving retail performance, particularly auto retail and general retail sales, which accounted for 96.6 percent of the revenue in this neighborhood.

Downtown, which accounted for 6.6 percent of combined first and second quarter sales tax receipts in 2014, was **up 8.8 percent** largely due to the continued growth of information services revenues. Outside of this category, total retail businesses contributed about 65.1 percent of revenues from downtown and saw moderate growth compared to 2013.

Carillon Point & Yarrow Bay, which accounted for 1.7 percent of the total sales tax receipts the first half of 2014, were

up 0.5 percent compared to 2013, or \$695. Taken together, retail categories make up 63.8 percent of sales in this neighborhood.

Houghton & Bridle Trails, which produced 2.5 percent of the total sales tax receipts through the second quarter, were **down 1.0 percent** due to a decline in sales at eating & drinking establishments.

Juanita, which generated 1.4 percent of the total sales tax receipts during the first half of 2014, was **up 0.9 percent** compared to the same period in 2013. Continued positive growth in eating & drinking revenues along with growth in miscellaneous retail stores combined with small increases in some other categories for a total increase of \$6,500.

North Juanita, Kingsgate, & Finn Hill accounted for 3 percent of the total sales tax receipts in the first six months of 2014 and were collectively **up 2.4 percent** over the first quarter of 2013. Overall growth in the Kingsgate and Finn Hill neighborhoods was offset by a decline in revenues from stores in the North Juanita neighborhood.

Other revenue not assigned to a single district grew by 26.0 percent over 2013 due to a large payment from an aviation company, which was not assigned to one of the above business districts.

Second quarter tax receipts by business district for 2013 and 2014 are compared in the table on the next page.

Financial Management Report as of June 30, 2014

When reviewing sales tax receipts by business district, it's important to be aware that 47.7 percent of the revenue received in the first quarter of 2014 was in the "unassigned or no district" category largely due to contracting and other revenue, which includes revenue from internet, catalog sales and other businesses located outside of the City. This percentage has grown in recent years as internet sales have grown in volume.

Business District	Jan - Jun Receipts		Dollar Change	Percent Change	Percent of Total	
	2013	2014			2013	2014
Totem Lake	2,428,125	2,455,407	27,282	1.1%	30.3%	28.0%
NE 85th St	1,108,153	1,185,590	77,437	7.0%	13.8%	13.5%
Downtown	534,181	581,395	47,214	8.8%	6.7%	6.6%
Carillon Pt/Yarrow Bay	152,007	152,702	695	0.5%	1.9%	1.7%
Houghton & Bridle Trails	219,780	217,527	(2,253)	-1.0%	2.7%	2.5%
Juanita	124,291	125,413	1,122	0.9%	1.5%	1.4%
Kingsgate	88,195	94,560	6,365	7.2%	1.1%	1.1%
North Juanita	116,685	118,690	2,005	1.7%	1.5%	1.4%
Finn Hill	49,117	52,643	3,526	7.2%	0.6%	0.6%
Unassigned or No District:						
Contracting	1,286,797	1,372,280	85,483	6.6%	16.1%	15.6%
Other	1,903,664	2,415,854	512,190	26.9%	28.5%	32.1%
Total	8,010,995	8,772,061	761,066	9.5%	100.0%	100.0%

- Sales Tax Revenue Outlook** Sales tax revenue in the first half of 2014 has continued to grow compared to 2013, although year-on-year gains are much smaller between 2013 and 2014 than they were between 2012 and 2013. Additionally, the sectors driving the growth in 2013, while still growing, have slowed in 2014 which has led to the overall slow down in the rate of growth. This suggests that the pent up demand in the construction and auto industry seen in 2013 may have levelled off. Despite this, growth has remained consistent across most sectors and major business districts, and growth in the second quarter was actually stronger than in the first quarter.

OFFICE VACANCIES:

According to the latest report from CB Richard Ellis Real Estate Services, Kirkland's office vacancy rate in the first quarter of 2014 was 4.5 percent, less than half the Puget Sound average of 14.2 percent, and the lowest in the Puget Sound region. Overall the Eastside has the third lowest vacancy rate in the Puget Sound region, behind Downtown Seattle and Tacoma/Fife with an office vacancy rate of 13.2 percent in the second quarter of 2014.

Overall vacancy rates in the Puget Sound region have fallen for the fourth straight quarter with net absorption totaling over 500,000 square feet.

The region currently has 3,109,094 SF of office space under construction, including 180,000 SF in Kirkland and the continued expansion of Amazon near their current South Lake Union headquarters.

LODGING TAX REVENUE:

Lodging tax revenue grew slightly compared to 2013, finishing the second quarter up 7.5 percent, an increase of \$7,000, which put revenues at 42.4 percent of budget.

Economic Environment Update The June update from the Washington State Economic and Revenue Forecast Council (ERFC) found the Washington economy added 22,000 net new jobs from December 2013 through June 2014, 2,100 fewer than forecast. Private, service-providing industries accounted for most of the job growth adding a net 13,800 jobs, although this was fewer than expected. The construction sector added 5,200 jobs but manufacturing added only 400. Public sector payrolls added 2,500 jobs, which was more than forecast in February. Hiring by state and local government agencies continued to offset losses at the federal level.

Consumer confidence showed moderate growth in the second quarter of 2014. The **Consumer Confidence Index** began the second quarter at 82.3, remained the same in April and May before rising slightly to 85.2 in June. This is 5 points higher than at the start of the year when consumer confidence stood at 80.7. According to the Conference Board, "Consumer confidence continues to advance and the index is now at its highest level since January 2008 (87.3). June's increase was driven primarily by improving current conditions, particularly consumers' assessment of business conditions. Expectations regarding the short-term outlook for the economy and jobs were moderately more favorable, while income expectations were a bit mixed. Still, the momentum going forward remains quite positive."

The U.S. **unemployment rate** for June 2014 was 6.1 percent, which was higher than the seasonally adjusted rate for Washington State, 5.8 percent. These rates are down from 7.5 percent nationally and 7.0 percent in Washington in June 2013. The Seattle/Bellevue/Everett provisional unemployment rate for June 2014 was 5.3 percent, up from 5.2 percent in June 2013. The unemployment rate in Kirkland was 4.7 percent in June 2014, down from 5.3 percent in June 2013, and down from 5.3 percent in March 2014. Note that the Bureau of Labor Statistics (BLS) data for the City of Kirkland does not yet include the 2011 annexation areas, and these areas will not be included until early 2015 when the database will be updated based on Census data according to the BLS. Unemployment data is reported on a one month lag at the national and state levels and on a two month lag at the county and city levels.

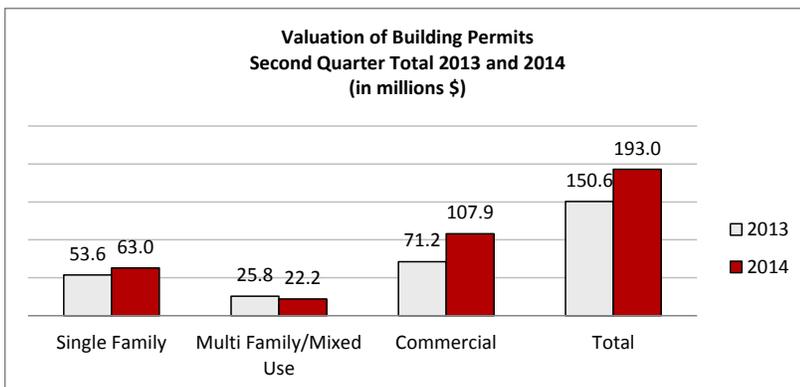
The Institute of Supply Management Western Washington Index slowed in the second quarter of 2014. After soaring to 68.7 in February, the highest reading in two years, the index declined to

(Continued on page 8)

Economic Environment Update *continued*

53.7 in April, before rebounding to 59.6 in May. Despite the decline the index remains healthy, indicated by a score above 50, and has done so every month since July 2009.

Local **development activity**, in terms of the valuation of the City's building permits for the second quarter of 2014, has risen compared to 2013. This is illustrated in the chart to the right. Development activity has increased across the board, with an 18 percent increase in the value of single family permits, slightly offset by a 14 percent decrease in the value of multi family permits, although the overall dollar amount is relatively small. The largest percentage and overall dollar increase is in the commercial sector, as a number of large permits, including the Google expansion project, were paid in the first quarter of 2014.



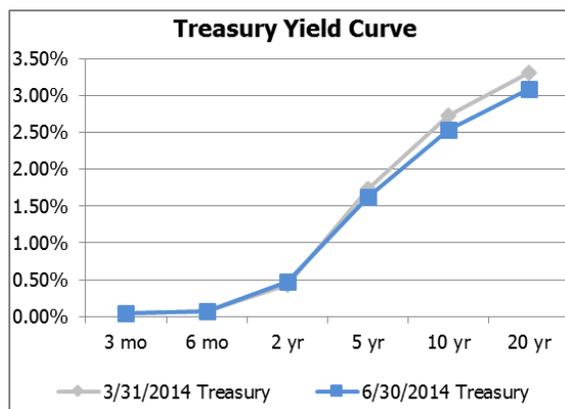
Regional **home prices** continue to rise. According to the S&P/Case-Shiller Home Price Indices, seasonally adjusted Seattle area home prices have risen in each of the last 29 months and, as of April 2014, are now 11.2 percent higher than in the previous April. Even with the recent gains, Seattle area home prices are still 12.2 percent lower than their 2007 peak.

Inflation in the Seattle area has risen and is now slightly higher than the national average. In April 2014, the Seattle all items CPI was 2.4 percent higher than the previous year compared to the 2.0 percent increase for the U.S. city average. Core inflation was 2.3 percent compared to 1.8 percent for the nation. The above average inflation rate in Seattle is entirely due to more rapidly rising shelter costs.

Investment Report

MARKET OVERVIEW

Economic activity picked up in the 2nd Quarter with Gross Domestic Product (GDP) increasing at an annual rate of 4 percent compared to the 2.1 percent decline for the first quarter. The Fed Funds rate remains at 0.25 percent, where it is expected to stay until mid-to-late 2015. The yield curve flattened slightly with rates falling on the short and long end and rising slightly in the 2 year range.

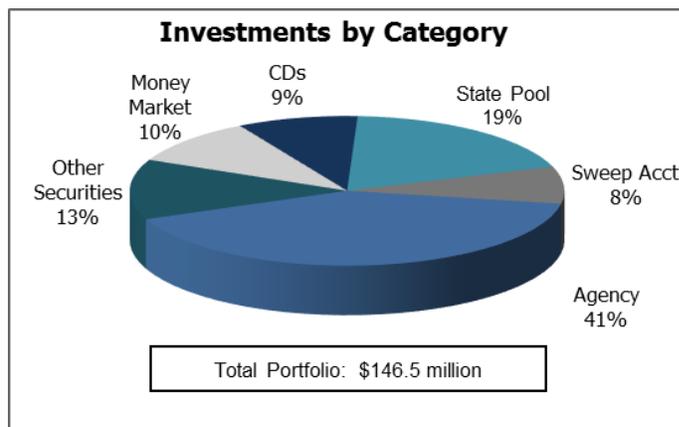


CITY PORTFOLIO

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not

place an undue financial burden on the City.

The City's portfolio increased in the 2nd quarter of 2014 to \$146.5 million compared to \$136.3 million on March 31, 2014. The increase in the portfolio is related to the normal cash flows of the 2nd quarter, as the first half of property taxes is received at the end of April and early May.



Diversification

The City's current investment portfolio is composed of Government Sponsored Enterprises (GSEs) bonds, US Government Obligations, State and Local Government bonds, Bank CDs, Money Market Accounts, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in U.S. Treasury or Federal Government obligations.

2014 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The outlook for growth in the U.S. economy looks mostly unchanged from that of three months ago, according to 43 forecasters surveyed by the Federal Reserve Bank of Philadelphia. The U.S. economy is expected to grow at an annual rate of 2.8 percent in 2014 and 3.1 percent in 2015. CPI inflation is expected to average 2.3 percent in 2014 and 2.2 percent in 2015. The unemployment rate is expected to average 6.3 percent in 2014 and 5.7 percent in 2015. The Fed Funds rate, currently at 0.25 percent, is expected to remain at this level throughout 2014 and into 2015.

The duration of the portfolio remains under 2 years as the purchase of longer term securities in the last quarter of 2012 continue to move toward maturity. Investment activity may increase in next 2 quarters as the City has entered into a contract for investment advisory services. Recommendations may be proposed by the investment advisor to rebalance the investment portfolio to take advantage of rising interest rates. Rebalancing could involve selling some of the low performing securities to be replaced with securities generating greater interest returns.

The opportunities for increasing portfolio returns are scarce as short term interest rates continue at historically low levels. During periods of low interest rates the portfolio duration should be kept shorter with greater liquidity so that the City is in a position to be able to purchase securities with higher returns when interest rates begin to rise. The State Pool is currently at 0.08 percent and will continue to remain low as the Fed Funds rate remains at 0.00 to 0.25 percent. Total estimated investment income for 2014 is \$690,000.

Investment Report *continued*

Liquidity

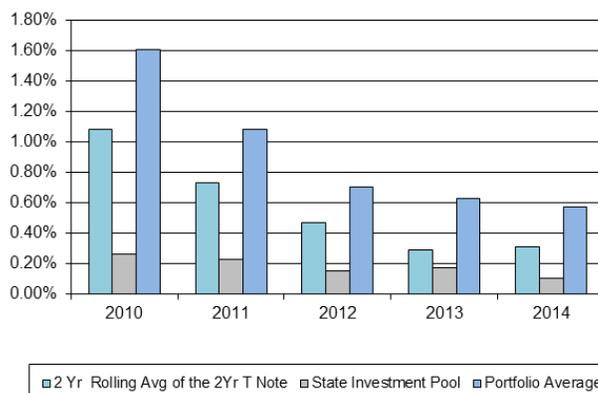
The target duration for the City's portfolio is based on the 0-5 year U.S. Treasury. The average maturity of the City's investment portfolio decreased from 1.81 years on March 31, 2014 to 1.56 years on June 30, 2014 as the securities in the portfolio move closer to maturity.

Yield

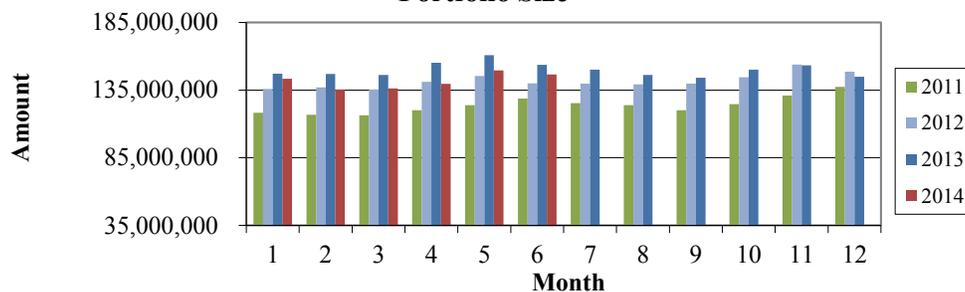
The City Portfolio yield to maturity declined slightly to 0.56 percent on June 30, 2014 from 0.59 percent on March 31, 2014. Through June 30, 2014, the City's annual average yield to maturity also declined slightly from 0.58 percent to 0.57 percent. The City's portfolio benchmark is the range between the 90 day Treasury Bill and the 2 year rolling average of the 2 year Treasury Note. This benchmark is used as it is reflective of the maturity guidelines required in the Investment Policy adopted by City Council. The City's portfolio outperformed both the 90 day T Bill and the 2 year rolling average of the 2 year Treasury Note, which was 0.31 percent on June 30, 2014.

The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.

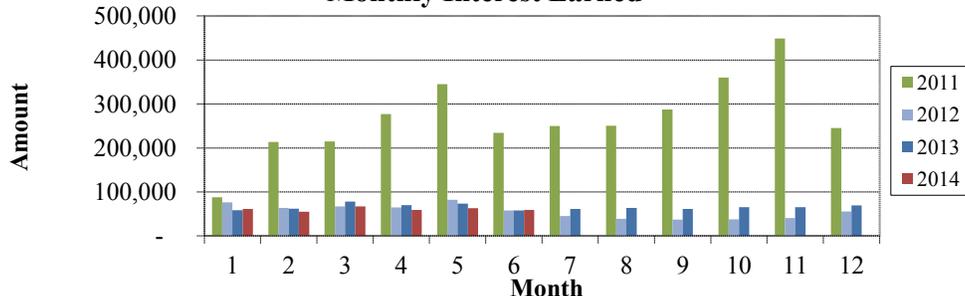
Investment Interest Rate Comparisons



Portfolio Size



Monthly Interest Earned



Reserves are an important indicator of the City's fiscal health and effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are dedicated to a specific purpose. The reserves display budgeted beginning 2013 and ending 2014 balances, with changes caused by subsequent authorized uses or additions.

Reserve Analysis

General Purpose Reserves

- The **Revenue Stabilization Reserve** was used almost in its entirety during the 2009-10 biennium as part of the budget balancing strategy to address the severe economic downturn, which allowed the City to mitigate some negative impacts to services. Contributions have been made to replenish the reserves since then and with planned contributions in 2014, the reserve is expected to be at target by the end of 2014.
- The **Building and Property Reserve** has been identified as an available funding source for facility expansion and renovation projects and a significant portion is planned to be used during the current biennium, which will bring the reserve just slightly below target. Planned transfers have been delayed until 2014 due to the timing of funding needs for the Kirkland Justice Center Building.
- The **General Capital Contingency Reserve** was used to fund project cost increases in the previous biennium, so replenishment from General Fund 2012 year-end cash was planned in 2013. The recent use of \$820,000 of this reserve to provide funding for property acquisition for Totem Lake Park expansion is planned to be replenished from King County Park Levy revenue over approximately 4 years.

General Capital Reserves

- Real estate activity remains relatively strong in 2014, although below the same period in 2013. **Real Estate Excise Tax (REET)** collections are **13.2 percent behind 2013**, six months through the year. Revenue is still on trending above budget expectations at **76 percent of budget** after the second quarter.
- **Impact fees** are 153 and 202 percent of budget for Park and Transportation respectively. Despite this strong performance this is **39.3 percent below the same period last year for Parks**, while Transportation Impact fees are **about 44.4 percent ahead**. There is minimal planned use of transportation impact fees for capital projects and no planned use of park impact fees for park capital projects in the current budget cycle except for debt related to parks. As with REET, the budgeted ending balance for Impact Fees will be reviewed at the end of 2014.

The City is in the process of completing several master plans this year, which likely will identify significant capital needs. The positive revenue performance above budget could be a source to help fund

Reserves	Est. 2013 Beginning Balance	Adopted 2014 Ending Balance	Revised 2014 Ending Balance	2013-14 Target	Revised Over (Under) Target
GENERAL PURPOSE RESERVES WITH TARGETS					
General Fund Reserves:					
General Fund Contingency	50,000	50,000	3,382	50,000	(46,618)
General Oper. Reserve (Rainy Day)	2,806,513	2,806,513	2,806,513	4,219,482	(1,412,969)
Revenue Stabilization Reserve	1,231,431	2,468,068	2,468,068	2,468,068	0
Building & Property Reserve	2,137,598	571,579	571,579	600,000	(28,421)
Council Special Projects Reserve	250,000	178,372	33,072	250,000	(216,928)
Contingency	2,201,870	2,426,425	2,426,425	4,275,442	(1,849,017)
General Capital Contingency*	2,686,587	4,810,795	3,990,795	5,735,330	(1,744,535)
General Purpose Reserves with Targets	11,363,999	13,311,752	12,299,834	17,598,322	(5,298,488)
ALL OTHER RESERVES WITH TARGETS					
General Fund Reserves:					
Litigation Reserve	350,000	350,000	350,000	50,000	300,000
Firefighter's Pension Reserve*	1,746,298	1,484,958	1,484,958	1,568,207	(83,249)
Health Benefits Fund:					
Claims Reserve*	1,187,813	2,615,856	2,615,856	1,424,472	1,191,384
Rate Stabilization Reserve	1,000,000	1,000,000	1,000,000	500,000	500,000
Excise Tax Capital Improvement:					
REET 1**	3,477,948	4,507,512	2,933,824	1,071,000	1,862,824
REET 2**	2,284,826	2,319,112	2,073,800	2,225,500	(151,700)
Water/Sewer Operating Reserve:					
Water/Sewer Debt Service Reserve:	488,200	498,591	498,591	508,717	(10,126)
Water/Sewer Capital Contingency:	1,107,600	1,107,600	1,107,600	250,000	857,600
Surface Water Operating Reserve:	706,364	706,364	706,364	412,875	293,489
Surface Water Capital Contingency:	816,480	816,480	816,480	758,400	58,080
Other Reserves with Targets	15,580,000	17,820,944	16,001,944	10,748,551	5,253,393
Reserves without Targets	35,751,424	35,847,270	35,845,216	n/a	n/a
Total Reserves	62,695,423	66,979,966	64,146,994	n/a	n/a

The target comparison reflects revised ending balances to the targets established in the budget process for those reserves with targets.

General Purpose reserves are funded from general revenue and may be used for any general government function.

All Other Reserves with Targets have restrictions for use either from the funding source or by Council-directed policy (such as the Litigation Reserve).

*Includes replenishments adopted in early April 2013 and adjustments to actual cash balances adopted in June.
 **Includes replenishments adopted in early April 2013 and adjustments to actual cash balances adopted in June; does not reflect increased collections in 2013.

The summary to the right details all Council authorized uses and additions through June 2014

USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION
2013-14 Council Authorized Uses		
2013 First Quarter Uses	\$302,000	
2013 Second Quarter Uses	\$626,319	
2013 Third Quarter Uses	\$489,981	
2013 Fourth Quarter Uses	\$1,103,451	
2014 First Quarter Uses	\$1,369,000	
Council Special Projects Reserve	\$25,000	Nourishing Networks Operating Support
Council Special Projects Reserve	\$75,300	Totem Lake Economic Impact Study
Council Special Projects Reserve	\$16,000	Kirkland Performance Center Operating Support
Council Special Projects Reserve	\$7,000	Imagine Housing
General Fund Contingency	\$37,500	Salary Survey & Climate Change Population Measures
2013-14 Council Authorized Additions		
Real Estate Excise Tax 2 - Transp.	\$77,303	Return from NE 120th Street Extension (East)
Surface Water Transportation	\$49,000	Return from NE 112th Street Sidewalk

General Fund and Contingency reserves are funded from general purpose revenue and are governed by Council-adopted policies.

Special Purpose reserves reflect both restricted and dedicated revenue for specific purpose, as well as general revenue set aside for specific purposes.

General Capital Reserves provide the City the ability to respond to unexpected changes in costs and accumulate funds for future projects. It is funded from both general revenue and restricted revenue.

Utility reserves are funded from utility rates and provide the utilities with the ability to respond to unexpected costs and accumulate funds for future replacement projects.

Internal service funds are funded by charges to operating departments. They provide for the accumulation of funds for the replacement of equipment, as well as the ability to respond to unexpected costs.

Reserves	Description	Est. 2013 Beginning Balance	Adopted 2014 Ending Balance	Additional Authorized Uses/Additions	Revised 2014 Ending Balance
GENERAL FUND/CONTINGENCY					
General Fund Reserves:					
General Fund Contingency	Unexpected General Fund expenditures	50,000	50,000	(46,618)	3,382
General Oper. Reserve (Rainy Day)	Unforeseen revenues/temporary events	2,806,513	2,806,513	0	2,806,513
Revenue Stabilization Reserve	Temporary revenue shortfalls	1,231,431	2,468,068	0	2,468,068
Building & Property Reserve	Property-related transactions	2,137,598	571,579	0	571,579
Council Special Projects Reserve	One-time special projects	250,000	178,372	(145,300)	33,072
Contingency	Unforeseen expenditures	2,201,870	2,426,425	0	2,426,425
Total General Fund/Contingency		8,677,412	8,500,957	(191,918)	8,309,039
SPECIAL PURPOSE RESERVES					
General Fund Reserves:					
Litigation Reserve	Outside counsel costs contingency	350,000	350,000	0	350,000
Labor Relations Reserve*	Labor negotiation costs contingency	65,348	65,348	0	65,348
Police Equipment Reserve*	Equipment funded from seized property	48,685	58,685	0	58,685
LEOFF 1 Police Reserve	Police long-term care benefits	618,079	618,079	0	618,079
Facilities Expansion Reserve	Special facilities expansions reserve	800,000	-	0	0
Development Services Reserve*	Revenue and staffing stabilization	1,004,194	1,187,020	0	1,187,020
Development Svcs. Technology Reserv	Permit system replacement	264,810	159,792	0	159,792
Tour Dock*	Dock repairs	138,892	171,392	0	171,392
Tree Ordinance*	Replacement trees program	29,717	29,717	0	29,717
Revolving/Donation Accounts*	Fees/Donations for specific purposes	451,090	537,890	0	537,890
Lodging Tax Fund*	Tourism program and facilities	240,991	221,951	0	221,951
Cemetery Improvement*	Cemetery improvements/debt service	662,614	712,174	0	712,174
Off-Street Parking	Downtown parking improvements	147,016	212,836	0	212,836
Firefighter's Pension*	Long-term care/pension benefits	1,746,298	1,484,958	0	1,484,958
Total Special Purpose Reserves		6,567,734	5,809,842	0	5,809,842
GENERAL CAPITAL RESERVES					
Excise Tax Capital Improvement:					
REET 1**	Parks/transportation/facilities projects, parks debt service	3,477,948	4,507,512	(1,573,688)	2,933,824
REET 2**	Transportation and other capital projects	2,284,826	2,319,112	(245,312)	2,073,800
Impact Fees					
Roads**	Transportation capacity projects	2,060,540	2,066,737	0	2,066,737
Parks**	Parks capacity projects	685,727	598,023	0	598,023
Street Improvement	Street improvements	995,958	995,958	0	995,958
General Capital Contingency*	Changes to General capital projects	2,686,587	4,810,795	(820,000)	3,990,795
Total General Capital Reserves		12,191,586	15,298,137	(2,639,000)	12,659,137
UTILITY RESERVES					
Water/Sewer Utility:					
Water/Sewer Operating Reserve	Operating contingency	2,414,471	2,414,471	0	2,414,471
Water/Sewer Debt Service Reserve*	Debt service reserve	488,200	498,591	0	498,591
Water/Sewer Capital Contingency	Changes to Water/Sewer capital	1,107,600	1,107,600	0	1,107,600
Water/Sewer Construction Reserve	Replacement/re-prioritized/new projects	9,093,871	8,228,606	0	8,228,606
Surface Water Utility:					
Surface Water Operating Reserve	Operating contingency	706,364	706,364	0	706,364
Surface Water Capital Contingency	Changes to Surface Water capital	816,480	816,480	0	816,480
Surface Water-Transp. Related Rsv	Replacement/re-prioritized/new projects	3,794,629	4,580,229	(153,619)	4,426,610
Surface Water Construction Reserve	Trans. related surface water projects	1,990,126	1,485,091	(465,000)	1,020,091
Total Utility Reserves		20,411,741	19,837,432	(618,619)	19,218,813
INTERNAL SERVICE FUND RESERVES					
Health Benefits:					
Claims Reserve*	Health benefits self insurance claims	1,187,813	2,615,856	0	2,615,856
Rate Stabilization Reserve	Rate stabilization	1,000,000	1,000,000	0	1,000,000
Equipment Rental:					
Vehicle Reserve*	Vehicle replacements	9,154,784	9,260,709	0	9,260,709
Radio Reserve	Radio replacements	7,686	7,686	0	7,686
Information Technology:					
PC Replacement Reserve*	PC equipment replacements	308,256	482,150	0	482,150
Technology Initiative Reserve	Technology projects	690,207	523,835	0	523,835
Major Systems Replacement Reserve	Major technology systems replacement	245,500	656,200	0	656,200
Facilities Maintenance:					
Operating Reserve	Unforeseen operating costs	550,000	550,000	0	550,000
Facilities Sinking Fund*	20-year facility life cycle costs	1,702,704	2,437,162	(475,711)	1,961,451
Total Internal Service Fund Reserves		14,846,950	17,533,598	(475,711)	17,057,887
Grand Total		62,695,423	66,979,966	(3,925,248)	63,054,718

*Includes replenishments adopted in early April 2013 and adjustments to actual cash balances adopted in June.

**Includes replenishments adopted in early April 2013 and adjustments to actual cash balances adopted in June; does not reflect increased collections in 2013, which will be considered for budget adjustments.



The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a **summary budget to actual and year over year comparisons** for year-to-date revenues and expenditures for all operating funds.
 - The **Sales Tax Revenue Analysis** report takes a closer look at one of the City's larger and most economically sensitive revenue sources.
 - **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
 - The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
 - The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.
- Tracey Dunlap, Director of Finance & Administration
 - Michael Olson, Deputy Director of Finance & Administration
 - Tom Mikesell, Financial Planning Manager
 - Neil Kruse, Senior Financial Analyst
 - Kyle Butler, Budget Analyst
 - George Dugdale, Budget Analyst



City of Kirkland
123 5th Avenue
Kirkland, WA 98033

Economic Environment Update References:

- The Conference Board Consumer Confidence Index Press Release June 25, 2014
- Carol A. Kujawa, MA, A.P.P., *ISM-Western Washington, Inc. Report On Business*, Institute for Supply Management-Western Washington, June, 2014
- Quarterly Economic and Revenue Publication, June 2014—Washington State Economic & Revenue Forecast Council
- CB Richard Ellis Real Estate Services, Market View Puget Sound, Second Quarter 2014
- CB Richard Ellis Real Estate Services, Market View Puget Sound, Second Quarter 2013
- Northwest Multiple Listing Service
- U.S. Bureau of Labor Statistics
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- City of Kirkland Building Division
- City of Kirkland Finance & Administration Department