



**CITY OF KIRKLAND**  
**City Manager's Office**  
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## **MEMORANDUM**

**To:** Dave Ramsay, City Manager

**From:** Marilynne Beard, Assistant City Manager  
Sandi Miller, Financial Planning Manager

**Date:** March 12, 2006

**Subject:** FINANCIAL UPDATE

The purpose of this memo is to provide a report on the 2005 year-end financial results, an update of the financial forecast and a discussion of issues impacting the City's financial condition in the near term. This information is provided as one consideration for Council to use in establishing goals and work programs for the coming year.

### **2005 Year-End Results**

The 2005-2006 Budget was the first biennial budget prepared by the City. This report will focus on the annual results for 2005. The Financial Management Report (FMR) for 2005 is included as Attachment A. The 2005 year end results were important in that the 2006 portion of the biennium was balanced assuming that we could achieve a certain amount of expenditure savings in 2005. In fact, about \$1.3 million was needed in one-time funding to balance the second half of the biennium. Most of the \$1.3 million was estimated to come from revenue in excess of what was budgeted (primarily in sales tax reflecting the one-year lag) and the balance was to come from expenditure savings generally realized from position vacancies that occur throughout the year.

### **Revenue Performance**

By the end of 2005, General Fund actual revenue was \$2.86 million over the amount budgeted, with sales tax making up \$1.75 million of the total. Development services revenue was the second largest source over budget at about \$920,000. The booming construction trade in Kirkland is clearly driving revenue collections but the increased revenue should be viewed as a cyclical phenomenon with the expectation that when the current contracting cycle slows down, development-related revenue will decrease.

#### Sales Tax

At the end of 2005, total sales tax revenue had increased by \$1.6 million or 12.6% above 2004 receipts. Although contracting and related wholesale receipts are a significant part of that increase, the overall sales tax base consistently outperformed 2004. Sales tax from contracting averaged 13.66% from the period 2000 to 2004 compared to the 2005 year-end revenue which constituted 16.2% of total sales tax revenue. The difference between the average and 2005 represents about \$364,000 of the total sales tax increase. Two other areas also include construction-related sales tax – wholesale and services. Although we have no way to be certain, we estimate that as much as \$400,000 in wholesale and services sales tax were related to large installations occurring with new

construction (based on the abnormal spikes in two or three vendors' returns). Between the three areas, as much as \$764,000 of the \$1.6 million sales tax increase might be considered cyclical. Factoring out the amount, total sales tax for 2005 still increased by 6.6% over 2004.

#### Development Fees and Permits

Last year, staff reported that development fees continued to perform well, reflecting the busy construction cycle. Earlier in 2005, it appeared as though Planning Fees and Plan Check Fees would come in lower than expected. It was believed that this potentially signaled a slight slowing of the development cycle and Evergreen Hospital Planning and Plan Check fees were received in 2004, while the building permit was issued in 2005. By the end of 2005, both Plan Check and Planning Fees were over the budgeted amount. The continuing construction boom not only signals revenue but also indicates workload levels of the development departments. Council approved the conversion of six temporary development staff to regular status as part of the mid-biennial budget review and set aside \$920,000 in a new Development Services Reserve to assure staffing continuity when revenues begin to decline but the inspection workload remains.

#### Business License Fees

Business license fees outperformed the budgeted amount by \$47,000 primarily due to the licensing of new businesses based outside the City of Kirkland but doing business in Kirkland. The Revenue Generating Regulatory License (RGRL), which is the surcharge portion of the business license fee, generated \$929,000 in revenue in 2005 (\$29,500 over budget). Revenue fluctuations in this category occur largely as a result of licensing new businesses because the business license surcharge rate does not change from year to year for a business unless the business grows and it moves to the next category of surcharge.

The net number of businesses within the City of Kirkland (total businesses plus new businesses less closed businesses) does not change much from year to year. In 2005, there was a net increase of 40 businesses registered in Kirkland which would indicate a fairly stable business base. A summary of 2005 business licensing activity is shown below:

New Businesses (in Kirkland)	496
Closed Businesses (in Kirkland)	<u>456</u>
Net New Businesses	40
New Businesses (Outside Kirkland)	440
Closed Businesses (Outside Kirkland)	<u>160</u>
Net New Businesses (Outside Kirkland)	280
Total Businesses in Kirkland	3,415
Total Businesses Outside Kirkland	<u>1,214</u>
Total Licensed Businesses	4,629

By way of comparison, when the new business license fee was first implemented, the City had 3,263 licensed businesses within the City of Kirkland.

When the City Council implemented the new business license fee structure in 2003, they agreed to review the surcharge portion of the fee from time to time to determine if it could be reduced based on growth in other revenue sources (i.e. sales tax resulting from increased economic development efforts). A portion of the new business license revenue (\$170,000) was dedicated on an ongoing basis to economic development. Staff will present an analysis of the City's financial condition relative to our ability to reduce the surcharge as part of the 2007-2008

Biennial Budget process and, at the same time, provide a recommendation as to the sufficiency of the current allocation of \$170,000 for the economic development program. That review will include an analysis of revenue and expenditure trends since 2003 and looking forward as well as a discussion of the relative tax burden. In the interim, we have looked at two pieces of data relative to this issue.

First, we looked at sales tax revenue growth occurring since the recession began in 2002. Sales tax did not surpass actual 2000 sales tax revenue until 2005. Sales tax is still below what it would have been had it continued to grow at an annual rate of 5% per year. The table below shows actual sales tax receipts since 2000 compared to a scenario where sales tax continued to grow:

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Actual	12,745,495	11,837,426	11,220,760	12,672,451	12,703,975	14,309,798
5% Growth	12,745,495	13,382,770	14,051,908	14,754,504	15,492,229	16,266,840
Difference		(1,545,344)	(2,831,148)	(2,082,053)	(2,788,254)	(1,957,042)

At this time we are still nearly \$2 million below where we would have been assuming normal growth. This is just looking at sales tax alone. To do a complete analysis, it will be important to consider the mix of all revenues and expenditures impacting financial condition.

The second factor we looked at was the shift in tax burden. At the request of the Chamber of Commerce, we completed an update of the tax burden study first released in 2001. At that time, the study indicated that the residential tax burden in Kirkland was relatively higher than in other surrounding communities and the commercial tax burden was lower. Over time, taxation policies and disproportionate increases in residential assessed valuations had shifted the tax burden towards residences. This was one of the underlying rationales behind implementing the RGRL.

Not surprisingly, total taxes paid increased in the past five years for both the commercial and residential sectors. However, the overall tax burden has shifted away from commercial and toward residential and external taxpayers. The table below compares the tax burden study results from 2000 to 2005.

	<b>Kirkland 2005</b>	<b>Kirkland 2000</b>
<b>Residential Taxes</b>	<b>\$24,948,211</b>	<b>\$18,592,292</b>
<b>Commercial Taxes</b>	<b>\$13,296,812</b>	<b>\$10,923,777</b>
<b>External Taxes</b>	<b>\$468,096</b>	<b>\$175,683</b>
<b>Residential Share</b>	64.44%	62.62%
<b>Commercial Share</b>	34.35%	36.79%
<b>External Share</b>	1.21%	0.59%
<b>Population</b>	45,740	45,090
<b>Employees</b>	30,245	30,245
<b>Population Plus Employees</b>	75,985	75,335
<b>Population Share</b>	60.20%	59.85%
<b>Employee Share</b>	39.80%	40.15%
<b>Employees per Resident</b>	0.66	0.67

The external increase is primarily related to the implementation of the lodging tax which is assumed to be entirely paid from external sources. The most likely reason that the tax burden shifted toward residential (again) is due to the relative impact of home valuations rising faster than commercial properties and the fact that utility rate increases fell more heavily on the residential sector than on the commercial sector. Assessed valuation shifted from a ratio of 74.43% residential and 25.57% commercial to 81.26% residential and 18.74% commercial. Utility tax rates increased from 5% on all residential utilities up to the commercial rate of 6% or higher (7.5% on City utilities). The combined impact of these two items more than offset the increase in business taxes that resulted from the new business license fee program.

#### Other Revenue

Property tax is a very stable source of revenue and not subject to great fluctuations between the budgeted amount (the levy) and the actual (collections). The amount of collections varies each year depending on the delinquency rate but ranges between 98% and 99%. In 2005, the City had a 98.8% collection rate.

Interest income has improved, finishing 2005 \$488,000 over 2004. With interest rates back in a more normal range, we should be able to continue to meet our CIP and debt obligations funded with interest income without having to backfill from General Fund year-end resources.

#### **Expenditures**

General Fund expenditures were \$2.14 million under budget at the end of 2005. After taking into consideration unfinished projects that will carry over into 2006, the unspent balance decreases to \$1.1 million or 2.3% below budget. Year-end expenditure savings typically result from position vacancies and show up in the wage and benefit line-items. Of the \$1.1 million in expenditure savings, \$838,000 was attributable to wages and benefits.

#### **Looking Ahead – Updated Financial Forecast**

Staff presented Council with an updated financial forecast at the mid-biennial budget review that indicated a slight improvement in the projected financial position. The improvement was based on increased sales tax revenue and savings in wages (lower than anticipated CPI-W) and benefits (lower than anticipated increases in retirement rates). Nevertheless, the projected deficit going into the 2007-2008 biennium was still in excess of \$1.2 million for 2007, growing to \$2.1 million in 2008. The fundamental problem continues to be the rate at which expenditures grow relative to revenue growth.

Expenditures will continue to increase overall 6.5% per year considering that inflation is projected to increase slightly and stabilize at about 3%, the City's policy of paying at the mid-point of the market for wages, and benefit increases of 12% to 14%. On the revenue side, sales tax is projected to grow by 6%, but property tax only increases by 3% per year (1% optional increase plus 2% new construction) and utility tax increases by 4%. Together, these sources of revenue comprise about 60% of the General Fund ongoing resources while wages and benefits comprise about 76.5% of the General Fund.

Staff has prepared an updated forecast based on 2005 actual year-end results, which is shown following a brief discussion of the assumptions used in the updated forecast. Once again, we are projecting a slight improvement based on 2005 revenue performance. At this time, we project a deficit of \$584,000 for 2007 and a \$1.7 million deficit for 2008. If revenue continues to outperform the forecasted increases and we can contain the increase in expenditures, we may be able to balance the upcoming biennial budget. It may be necessary to once again use reserves to balance the budget with the hope that we won't have to actually tap reserves by the end of the biennium.

The updated forecast on the next page incorporates the following additions to ongoing service levels:

**Sales tax revenue**, beginning in 2007, was updated to reflect the 2005 actual receipts. Based on the City's one-year lag policy, 2007 sales tax revenue would be equal to the 2006 estimate. This was achieved by increasing the 2005 actual receipts by 6% to create the base 2007 sales tax projection. Sales tax is then assumed to increase at a rate of 6% per year.

**Property tax revenue** was updated to reflect the Council's use of 8.86% of the banked capacity for the public safety staffing additions in Police and Fire. Likewise, the Police and Fire department expenditure estimates were increased by the cost of the additional staffing. Although the additional positions were approved during the 2005-2006 Biennium, the cost is reflected in the forecast beginning in 2007 in order to maintain a balanced picture for 2005-2006.

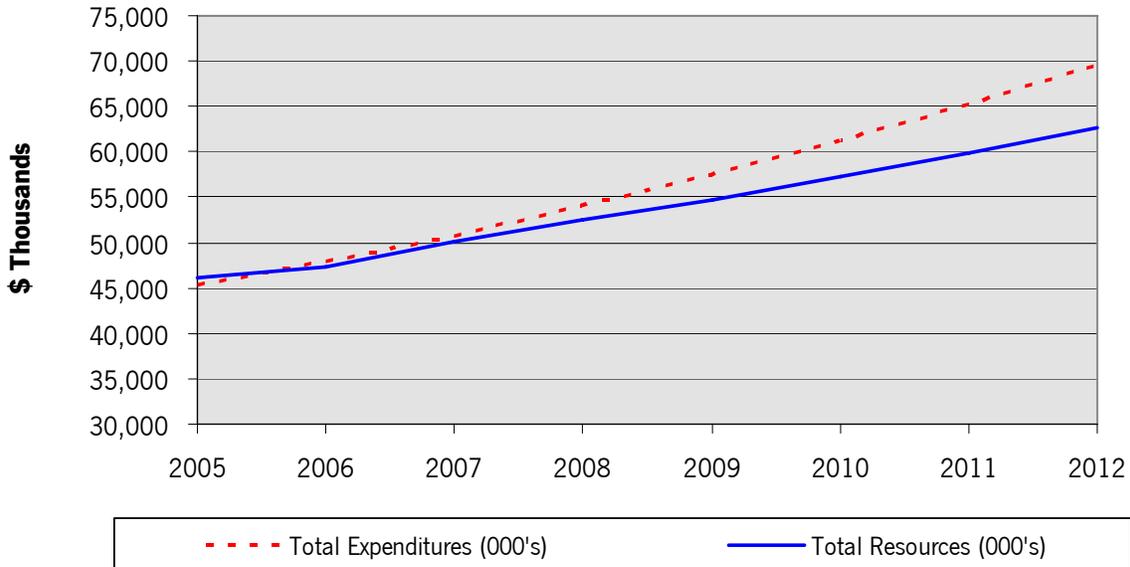
Also related to public safety staffing, **utility tax revenue** was adjusted to reflect the rate increase on City utilities from 6% to 7.5% (i.e. water, sewer, surface water and garbage). The additional revenue funds a portion of the public safety staffing additions.

**Development Services revenue and expenditures were updated** to reflect the conversion of 6 temporary development positions to FTE's, as approved by the Council during the Mid-Biennial review. These positions were funded through 2006 with one-time funding and remain as part of the base budget beginning in 2007 being funded by additional development-related revenue.

The **Municipal Court Judge was converted from a contract to a .85 FTE position**, funded by the additional sales tax. This position is maintained in the base budget beginning in 2007.

The **Receptionist position** at the front desk was approved at the Mid-Biennial review to become 1.0 FTE with the continuation of the passport acceptance program. The additional .5 FTE secured is entirely funded by passport revenue.

**2005-2012 GENERAL FUND FORECAST**  
**March 2006 Council Retreat: Base Scenario**



	2005	2006	2007	2008	2009	2010	2011	2012
Total Expenditures (000's)	45,410	47,952	50,737	54,113	57,565	61,305	65,335	69,706
Total Resources (000's)	46,064	47,298	50,153	52,402	54,763	57,243	59,846	62,581
<b>Net Resources (000's)</b>	<b>654</b>	<b>(654)</b>	<b>(584)</b>	<b>(1,711)</b>	<b>(2,802)</b>	<b>(4,062)</b>	<b>(5,489)</b>	<b>(7,125)</b>

**Key Revenue Assumptions:**

- No additional diversion of current revenue sources to CIP
- No use of reserves in 2007-2012
- 1% optional property tax in 2005-2012
- 2% annual growth in new construction
- 1 year sales tax lag in 2005-2012
- 6% annual growth in sales tax in 2005-2011 reflected in 2007-2012 projections
- 4% annual growth in utility tax in 2007-2012
- 2% annual growth in other taxes (RGRL fee, gambling & leasehold excise) in 2007-2012
- EMS levy maintained
- 5% annual growth in other revenue in 2007-2012
- Excludes one-time outside agency funding beginning in 2006 and one-time service package funding beginning in 2007 (i.e. no one-time Forbes Creek F.S. funding in 2007)

**Key Expenditure Assumptions:**

- Based on 2005-2006 Final Budget
- New, ongoing service levels for:
  - Police strategic plan (Admin Lt. and ProAct Unit)
  - Fire & Building strategic plan (St. 27 Medical Aid Unit)
  - Development Services - convert temp positions to FTE's
  - Judge - convert from contract to FTE
  - Full time Reception Desk Staffing
- 6% annual growth in wages in 2007-2012:
  - 3.5% COLA + 1.1% steps + 1.4% market adj/reclass
- 14% annual increase in total benefits in 2007-2008 and 12% annual increase in 2009-2012
- 2% annual growth in supplies, services & capital in 2007-2012

## Downside Risks

As always, we are aware of a number of contingencies that potentially impact the financial forecast as presented.

- Uncertainty with regard to future **jail costs** continues to be an issue. Long term, local misdemeanor jail solutions are needed to provide a predictable and controllable supply of jail beds. Jail costs in 2005 continued to increase, with a growing number of detainees and increasing daily rates driving costs. Police staff are in the process of analyzing data and preparing recommendations for how the City can mitigate the increasing costs.
- **Inflation** is expected to moderate at about 3% to 3.5%, but we don't have control over inflation which drives the majority of our expenditures for wages. Each .5% of CPI-W translates to about \$300,000 in wage costs, so the difference between 3% and 3.5% is significant.
- The City Council is being asked to consider **funding for outside agencies** that will potentially add another \$140,000 of ongoing expenses to the base budget.
- The City Council made significant progress in funding the **Police Strategic Plan and the Fire and Emergency Services Strategic Plan** with the addition of fourteen new positions this past year. However, additional positions are still needed to meet the long term needs of the public safety departments.
- The Public Safety Committee received a briefing from our new Municipal Court Judge, Michael Lambo, regarding **Kirkland Municipal Court caseload trends and judicial time**. The daily calendars have become so full that the morning court calendars run through lunch and right up to the start of the afternoon calendar. Judge Lambo is requesting that the Council consider increasing his .85 FTE to 1.00 FTE and adding one additional court commissioner calendar to relieve his caseload. Staff is preparing a background memo for Council on costs and possible funding sources.
- Other program needs that were previously identified but not yet funded include a **Communications Specialist, Emergency Management Coordinator** and the potential for additional funding for **Economic Development**.
- **Streamlined sales tax** did not receive approval from the state legislature. Although streamlined sales tax was estimated to be mostly a "break even" proposition for Kirkland, the failure of legislation means that voluntary compliance that would have resulted in increased sales tax from internet sales won't be realized soon.
- **Annexation** may become a reality with the new legislation that provides State funding for up to ten years. The level of State funding closes much of the \$4.8 million gap identified last year. Our most current estimates show a remaining deficit position of about \$634,000 which we will most likely have to address through expenditure reductions in the proposed annexation budget. Aside from the ongoing financial challenges, there will be significant planning and start up costs that will need to be borne by the City. We will work with King County to obtain as much one-time funding as possible; however, the annexation will still be a financial strain on the City.

## Upside Opportunities

Continued economic growth seems to be the most likely scenario for 2006 and 2007, with a slow and steady pace of growth more likely than any great surges as those seen in the 1990's. This is positive for the City's finances, providing likely stability in retail sales tax, continuation of new development and moderate inflation. Clearly, the upside opportunities lie in new retail growth primarily in Totem Lake, although that growth will not be fully realized until 2010. Continued focus on economic development efforts will be important to sustaining our revenue base (retaining businesses) and increasing our revenue base beyond normal growth (attraction of new significant retail). In the meantime, maintenance of services should continue to be the first priority, with the understanding that new service levels will most likely require additional revenue.

## Status of Reserves

As part of the 2005-2006 mid-biennial review, staff provided a report on the status of reserves and recommended that Council make a deliberate effort to replenish reserves that are currently below target. Based on the positive 2005 year-end results, staff has recommended to the Finance Committee that a total of \$1,865,837 be transferred to the General Capital Contingency (the reserve farthest from the adopted target). The 2005 year-end transfer will also establish a Development Services Reserve of \$920,000 and replenish the Council Special Projects Reserve back to the target amount of \$250,000. The table below shows the status of reserves compared to target after the 2005 year-end transfer is taken into account.

Reserves	2005-06 Estimated End Balance	2005 Authorized Uses	2005 Authorized Additions	Revised 2005-06 End Balance*	2005-06 Target	Over (Under) Target
<b>GENERAL PURPOSE RESERVES</b>						
Contingency	2,115,677	66,293		2,049,384	2,952,182	(902,798)
General Capital Contingency	2,979,056	1,110,000	1,868,281	3,737,337	5,900,568	(2,163,231)
Park & Municipal Reserve:						
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836	2,676,890	35,946
Revenue Stabilization Reserve	1,493,480			1,493,480	2,082,380	(588,900)
Building & Property Reserve	1,817,461			1,817,461	N/A	N/A
Council Special Projects Reserve	254,760	96,200	91,440	250,000	250,000	0
Development Services Reserve	0	0	920,000	920,000	N/A	N/A
<b>Total General Purpose Reserves</b>	<b>11,373,270</b>	<b>1,272,493</b>	<b>2,879,721</b>	<b>12,980,498</b>	<b>13,862,020</b>	<b>(3,618,983)</b>

We should continue to focus on replenishing Council policy reserves in addition to trying to set aside capital funds for large projects.

- We will soon be faced with identifying \$3 million for the City's cash contribution to the Totem Lake Mall infrastructure improvements.
- The balloon payment on the 505 Market Building (\$1.7 million) comes due in 2007. We will either need to refinance the building or pay off the debt.
- Utility undergrounding on NE 85<sup>th</sup> Street is still under consideration and may require as much as \$3 million of additional funding.
- Regardless of annexation, the City will need to expand its space for City Hall and/or a Public Safety Building which will be a considerable investment.

# *CITY OF KIRKLAND*

## *FINANCIAL MANAGEMENT REPORT*

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AS OF DECEMBER 31, 2005

### **FOREWORD**

The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced three times a year (as of April 30<sup>th</sup>, September 30<sup>th</sup>, and December 31<sup>st</sup>). It is comprised of five sections:

- Economic Environment Update
- Budget to Actual Comparison
- Sales Tax Revenue Analysis
- Investment Summary
- Reserve Summary

The **Economic Environment Update** provides a brief look at the key economic indicators for the Eastside and Kirkland such as inflation, unemployment, office vacancies, residential housing prices, sales tax revenue, development activity, and lodging tax receipts.

The **Budget to Actual Comparison** report provides a summary look at year-to-date revenues and expenditures for all operating funds. Also included are more detailed reviews of the City's General Fund, Other General Government Operating funds, Water/Sewer Operating Fund, Surface Water Management Fund, and Solid Waste Fund.

The **Sales Tax Revenue Analysis** report takes a close look at the City's largest and most economically sensitive revenue source. Comparisons are made with the prior year's sales tax receipts on a year-to-date, monthly, business sector, and business district basis.

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.

Tables and graphs are provided with brief narratives to explain or highlight significant trends, issues, and anomalies. Our objective in preparing this report is to provide a brief overview of the City's financial condition and to highlight those areas of greatest significance to Kirkland's citizens, elected officials, and City staff.

Respectfully submitted,

Michael Olson  
Interim Director of Finance & Administration

Sandi Miller  
Financial Planning Manager

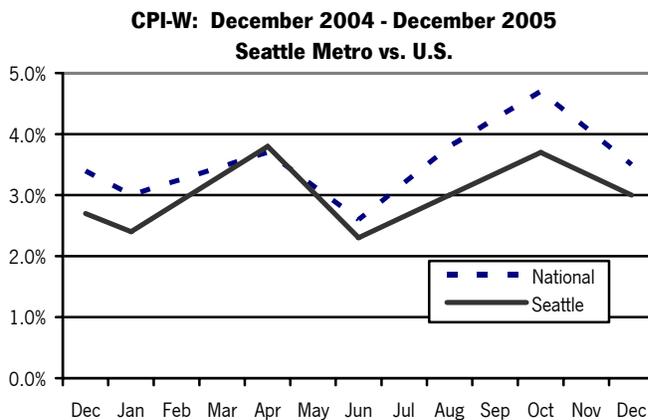
**At a glance:**

**ECONOMIC ENVIRONMENT UPDATE**

The Puget Sound region experienced strong economic growth in 2005. The Seattle-Tacoma metropolitan area added more than 45,000 jobs over the year and the unemployment rate in King County dropped to 4.4 percent as of December 2005. The revenue forecast from the Washington State Economic and Revenue Forecast Council predicts continued employment growth due to improvements in the aerospace and software industries. Additionally, Washington’s construction employment, bolstered by a hot housing market, has now erased the losses experienced during the recession.<sup>1</sup> Two local economic confidence indexes reflect this solid economic performance. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.) The Hebert Research-Business Journal Business Confidence Index rose to 62.4 for the fourth quarter of 2005, after three quarters of decline. However, the index fell short of the six-year high of 63.3 achieved last December.<sup>2</sup> Another local index conducted by the Western Washington chapter of the National Association of Purchasing Managers jumped 8.1 points in December to 75.9, which follows the 5.2 point gain in November. The strong local picture contrasts to the national index, which dropped over the past two months to 54.2 points in December.<sup>3</sup>

Selected economic indicators are reviewed below. They include inflation, unemployment, office vacancies, residential housing prices, development activity, sales tax revenue, and lodging tax revenue.

As measured by the **Consumer Price Index** for Wage Earners and Clerical Workers (CPI-W), the following chart and table track inflation for the U.S. and the Seattle metropolitan area from December 2004 through December 2005 on a bi-monthly basis. For each month, the annual change in inflation with respect to the same month of the prior year is noted. What stands out is that inflation in the Seattle metropolitan area has been generally lower than the national average. The table also includes the cumulative change in the Seattle metropolitan area’s inflation rate since December 2004.



Month	U.S.	Seattle Metro	Compared to Dec 2004*
Dec 2004	3.4%	2.7%	N/A
Feb 2005	3.0%	2.4%	1.1%
Apr 2005	3.7%	3.8%	3.1%
Jun 2005	2.6%	2.3%	2.4%
Aug 2005	3.8%	3.0%	2.6%
Oct 2005	4.7%	3.7%	4.4%
Dec 2005	3.5%	3.0%	3.0%

Source: Bureau of Labor Statistics

\* Bi-monthly growth in Seattle Metro CPI-W only.

All of the City’s labor contracts are tied to the CPI-W for the Seattle metropolitan area. More specifically, “cost of living allowances” (or COLAs) in these contracts are set at 90 percent of either the prior year’s June CPI-W or the prior year’s average for the first six months, with varying “floors” (i.e. minimums) established. Given a June 2005

<sup>1</sup> Washington Economic and Revenue Forecast Council, February 2006

<sup>2</sup> Eric Engleman, *Confidence hits high for '05*, Puget Sound Business Journal, February 3, 2006

<sup>3</sup> *Purchasing index for last month jumps*, Puget Sound Business Journal, January 4, 2006

CPI-W (Seattle) of 2.3 percent and a First Half 2004 CPI-W (Seattle) of 2.9 percent, the 2006 COLA will be 2.08 percent and 2.58 percent respectively depending on the bargaining unit. Seattle area inflation is expected to remain below the U.S. city average this year at 2.6 percent compared to 3.4 percent for the U.S. The stronger local economy should eventually cause Seattle inflation to rise above the U.S. rate by 2007.<sup>4</sup>

**Unemployment rates** for King County, Washington State, and the U.S. from December 2004 through December 2005 are noted in the table below:

<b>Month</b>	<b>King County</b>	<b>Washington</b>	<b>U.S.</b>
December 2004	4.6%	5.9%	5.1%
January 2005	4.9%	6.4%	5.7%
February 2005	5.1%	6.4%	5.8%
March 2005	4.6%	5.6%	5.4%
April 2005	4.2%	5.4%	4.9%
May 2005	4.8%	5.4%	4.9%
June 2005	4.7%	5.4%	5.2%
July 2005	4.6%	5.3%	5.2%
August 2005	4.5%	5.5%	4.9%
September 2005	4.9%	5.2%	4.8%
October 2005	4.7%	5.1%	4.6%
November 2005	4.8%	5.5%	4.8%
December 2005	4.4%	5.2%	4.6%
<b>2005 Average</b>	<b>4.7%</b>	<b>5.5%</b>	<b>5.1%</b>
<b>2004 Average</b>	<b>5.1%</b>	<b>6.2%</b>	<b>5.5%</b>

*Source: Washington Department of Employment Security*

In 2003, the average statewide unemployment rate of 7.6 percent was significantly higher than the average U.S. unemployment rate of 6.0 percent. This gap has significantly narrowed over the last two years, with the Washington State 2005 average rate at 5.5 percent compared to the national rate of 5.1 percent. Employment levels in King County have also improved considerably, ending 2005 with a lower average unemployment rate than the national average. As mentioned earlier, the Puget Sound region has added more than 45,000 jobs in 2005.

As a sign of an improving economy, Eastside **office vacancy rates** have continued to drop significantly this year, down to 9.65 percent at the end of the fourth quarter compared to a high of 24 percent in the first quarter of 2003. The Eastside office market is the second largest in the region and “absorbed” over 250,000 square feet of vacant space in the fourth quarter of 2005 alone. The market is responding to the positive economic growth with office investments surpassing a record \$1.7 billion in the Puget Sound area in 2005. The Kirkland market has improved significantly, with vacancy rates down to 4.35 percent as of the fourth quarter of 2005 compared to 10.2 percent for the same period last year.<sup>5</sup> For comparison purposes, office vacancy rates for Kirkland and the Eastside were 3.7 percent and 4.3 percent respectively five years ago.

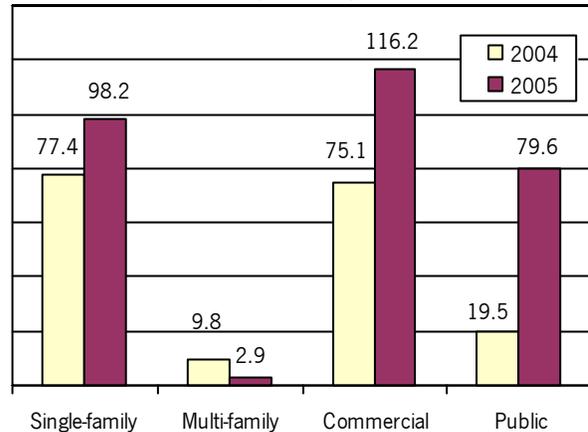
<sup>4</sup> Washington Economic and Revenue Forecast Council, February 2006

<sup>5</sup> CB Richard Ellis Real Estate Services, Market View Puget Sound Office, Fourth Quarter 2005

According to the Northwest Multiple Listing Services, the median **residential housing price** on the Eastside rose 17.1 percent from \$379,950 in December 2004 to \$444,975 in December 2005. Additionally, for the second year in a row, a record number of homes and condominiums were sold in King County in 2005 (41,923 versus 40,547 in 2004). Local and national housing experts expect home prices to rise in 2006, but not as fast as they did in the record-breaking year of 2005 and number of home sales to moderate as interest rates increase.<sup>6</sup>

**Development activity** through December 2004 and 2005, as measured by the valuation of new construction, alterations, and additions, is illustrated in the chart on the right. Development-related revenues have remained strong since the second half of 2002. Through December 2005, **building permit-related revenue** is up 45.0 percent and **other development-related fees** are up 12.8 percent compared to the same period in 2004. Public activity was up dramatically in 2005 reflecting the major construction projects at Evergreen Hospital and various school renovations and replacements. Commercial activity was up in 2005 due to the construction of the second phase of Juanita Village, several tenant improvements, as well as the mixed-used developments in the downtown area that are classified as commercial rather than multi-family. Single family activity was also strong in 2005. Multi-family activity decreased significantly, partly because a surge of permit activity happened at the end of 2004 in anticipation of building code changes that took effect in 2005 and partly because of the previously mentioned mixed-used complexes that are classified as commercial.

**Valuation of Building Permits  
YTD Through December 2004 and 2005  
(\$ Million)**



Single family activity was also strong in 2005. Multi-family activity decreased significantly, partly because a surge of permit activity happened at the end of 2004 in anticipation of building code changes that took effect in 2005 and partly because of the previously mentioned mixed-used complexes that are classified as commercial.

The upward trend in **sales tax** revenue that started in 2003 continued through 2005, increasing by 12.6 percent compared to the same period in 2004. Much of this gain relates to strong performance in the contracting and some retail sectors. A more detailed analysis of sales tax revenue is included later in this report.

Apparently the economic upswing has finally benefited the local lodging industry, which experienced virtually no growth between 2003 and 2004. **Lodging tax** revenue through December 2005 is up 8.2 percent compared to 2004.

<sup>6</sup> Clayton Park, *Eastside home prices set record...*, King County Journal, March 7, 2006

# BUDGET TO ACTUAL COMPARISON

*As of December 31, 2005*

## SUMMARY OF ALL OPERATING FUNDS

All of the City's operating funds are grouped into the following two categories:

1. **General Government Operating Funds**, which account for tax and fee supported services and include the General Fund.
2. **Utility Funds**, which account for water, sewer, surface water, and solid waste operations and maintenance services.

### Resources: Summary

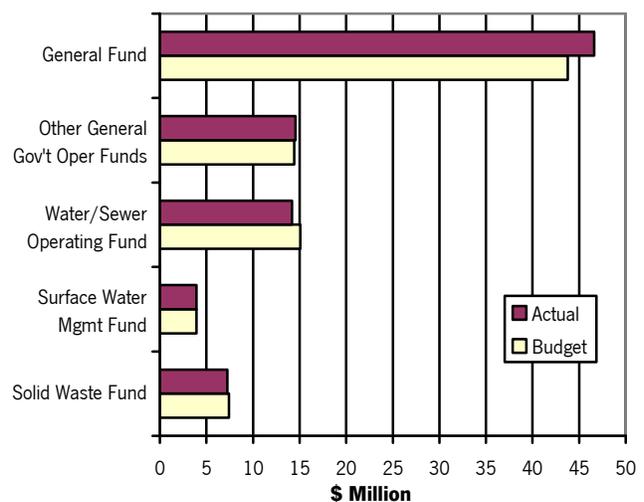
Resource Category	2005 Budgeted Revenues*	2005 Actual Revenues*	Amount Over/(Under) Budget	% of Budget
<b>General Gov't Operating:</b>				
General Fund	43,790,211	46,628,550	2,838,339	106.5%
Other General Gov't Operating Funds	14,409,400	14,568,735	159,335	101.1%
<b>Total General Gov't Operating</b>	<b>58,199,611</b>	<b>61,197,285</b>	<b>2,997,674</b>	<b>105.2%</b>
<b>Utilities:</b>				
Water/Sewer Operating Fund	15,076,094	14,184,002	(892,092)	94.1%
Surface Water Management Fund	3,916,785	3,913,748	(3,037)	99.9%
Solid Waste Fund	7,423,598	7,257,413	(166,185)	97.8%
<b>Total Utilities</b>	<b>26,416,477</b>	<b>25,355,163</b>	<b>(1,061,314)</b>	<b>96.0%</b>
<b>Total All Operating Funds</b>	<b>84,616,088</b>	<b>86,552,448</b>	<b>1,936,360</b>	<b>102.3%</b>

\* Budgeted and actual revenues exclude resources forward and include interfund transfers.

Comparing actual to budgeted revenues, each operating fund or fund type ended 2005 as follows (see chart on the right):

- The **General Fund** was 6.5 percent ahead of budget, primarily due to strong sales tax and development-related fee growth.
- The **Other General Government Operating Funds** were 1.1 percent ahead of budget primarily due to strong cable tax growth and higher than expected recreation class fees.
- The **Water/Sewer Operating Fund** was 5.9 percent behind budget due to lower than normal water sales because of voluntary water restrictions as a result of an unusually dry winter and a cool summer.

**TOTAL REVENUES BY OPERATING FUND TYPE OR FUND**  
Actual to Budget as of 12/31/2005  
Summary of All Operating Funds



- The **Surface Water Management Fund** was right on budget (only .1 percent behind budget). Surface Water fees are collected with the payment of property taxes.
- The **Solid Waste Fund** was 2.2 percent behind budget primarily due to lower than expected commercial collection revenue.

**Expenditures: Summary**

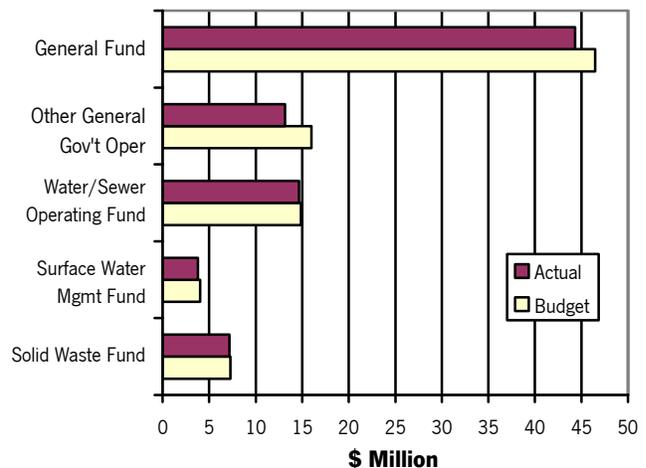
Expenditure Category	2005 Budgeted Expenditures*	2005 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget
<b>General Gov't Operating:</b>				
General Fund	46,466,578	44,325,497	2,141,081	95.4%
Other General Gov't Operating Funds	15,993,211	13,146,746	2,846,465	82.2%
<b>Total General Gov't Operating</b>	<b>62,459,789</b>	<b>57,472,243</b>	<b>4,987,546</b>	<b>92.0%</b>
<b>Utilities:</b>				
Water/Sewer Operating Fund	14,852,575	14,660,055	192,520	98.7%
Surface Water Management Fund	4,019,429	3,787,355	232,074	94.2%
Solid Waste Fund	7,285,527	7,181,827	103,700	98.6%
<b>Total Utilities</b>	<b>26,157,531</b>	<b>25,629,237</b>	<b>528,294</b>	<b>98.0%</b>
<b>Total All Operating Funds</b>	<b>88,617,320</b>	<b>83,101,480</b>	<b>5,515,840</b>	<b>93.8%</b>

\* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

Comparing actual to budgeted expenditures, each operating fund or fund type ended 2005 as follows (see chart on the right):

- The **General Fund** was 4.6 percent under budget primarily due to position vacancies, uncompleted projects (i.e. Economic Development and Downtown Strategic Plan), and the timing of service contract payments (e.g. human service contracts).
- The **Other General Government Operating Funds** were 17.8 percent under budget primarily due to uncompleted projects such as neighborhood traffic calming and parking facility improvements in the Street Operating Fund, GIS mapping and web interfaces in the Information Technology Fund, and the postponement of vehicle purchases in the Equipment Rental Fund where it was determined the vehicle life could be extended.

**TOTAL EXPENDITURES BY OPERATING FUND TYPE OR FUND**  
Actual to Budget as of 12/31/2005  
Summary of All Operating Funds



- The **Water/Sewer Operating Fund** was 1.3 percent under budget due to a position vacancy, uncompleted projects such as the Water Comp Plan, and lower than expected internal engineering charges.
- The **Surface Water Operating Fund** was 5.8 percent under budget primarily due to position vacancies and uncompleted projects relating to Shoreline Inventory and ESA regulations.
- The **Solid Waste Fund** was 1.4 percent under budget primarily due to lower than expected payments to Waste Management for commercial collection, lower taxes based on lower than expected revenue collection, and savings in recycling programs.

It should be noted that the end of 2005 is the halfway point of the 2005-2006 Biennial Budget. What appears as “expenditure savings” at the end of 2005 is largely related to uncompleted projects that will be completed during 2006. No carryover process is necessary to allow for this expenditure in 2006 because of the 2 year budget appropriation.

## GENERAL FUND

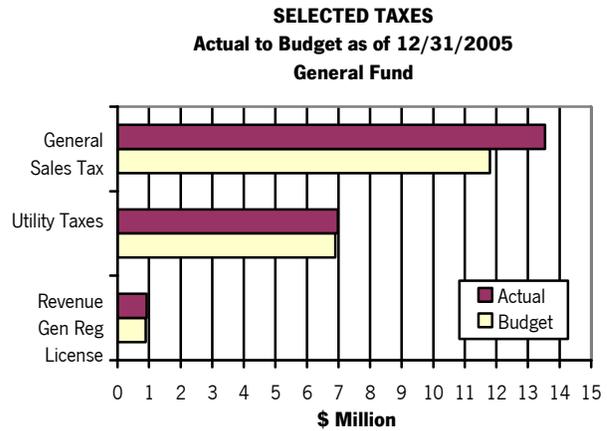
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development. About 341 of the City's 429 employees are budgeted within this fund.

### **Resources: General Fund**

Resource Category	2005 Budgeted Resources	2005 Actual Resources	Amount Over/(Under) Budget	% of Budget
<b><i>Taxes:</i></b>				
Retail Sales Tax: General	11,791,604	13,539,797	1,748,193	114.8%
Retail Sales Tax: Criminal Justice	875,000	965,661	90,661	110.4%
Property Tax	6,988,283	6,906,932	(81,351)	98.8%
Utility Taxes	6,904,711	6,978,378	73,667	101.1%
Rev Generating Regulatory License	900,000	929,498	29,498	103.3%
Other Taxes	475,262	465,564	(9,698)	98.0%
<b>Total Taxes</b>	<b>27,934,860</b>	<b>29,785,830</b>	<b>1,850,970</b>	<b>106.6%</b>
<b><i>Licenses &amp; Permits:</i></b>				
Building, Structural & Equipment Permits	1,840,401	2,571,320	730,919	139.7%
Business Licenses/Franchise Fees	1,166,775	1,242,376	75,601	106.5%
Other Licenses & Permits	106,020	166,274	60,254	156.8%
<b>Total Licenses &amp; Permits</b>	<b>3,113,196</b>	<b>3,979,970</b>	<b>866,774</b>	<b>127.8%</b>
<b><i>Intergovernmental:</i></b>				
Grants	216,806	94,442	(122,364)	43.6%
State Shared Revenues & Entitlements	564,170	562,221	(1,949)	99.7%
Fire District #41	2,870,209	3,038,576	168,367	105.9%
EMS	475,422	475,422	-	100.0%
Other Intergovernmental Services	586,655	568,511	(18,144)	96.9%
<b>Total Intergovernmental</b>	<b>4,713,262</b>	<b>4,739,172</b>	<b>25,910</b>	<b>100.5%</b>
<b><i>Charges for Services:</i></b>				
Internal Charges	3,389,184	3,044,667	(344,517)	89.8%
Engineering Services	400,000	505,700	105,700	126.4%
Plan Check & Development Fees	1,895,761	1,980,163	84,402	104.5%
Recreation	74,000	78,577	4,577	106.2%
Other Charges for Services	595,341	666,334	70,993	111.9%
<b>Total Charges for Services</b>	<b>6,354,286</b>	<b>6,275,441</b>	<b>(78,845)</b>	<b>98.8%</b>
<b><i>Fines &amp; Forfeits</i></b>	<b>1,092,150</b>	<b>1,117,030</b>	<b>24,880</b>	<b>102.3%</b>
<b><i>Miscellaneous</i></b>	<b>392,214</b>	<b>540,864</b>	<b>148,650</b>	<b>137.9%</b>
<b>Total Revenues</b>	<b>43,599,968</b>	<b>46,438,307</b>	<b>2,838,339</b>	<b>106.5%</b>
<b><i>Other Financing Sources:</i></b>				
Interfund Transfers	190,243	190,243	-	100.0%
<b>Total Other Financing Sources</b>	<b>190,243</b>	<b>190,243</b>	<b>-</b>	<b>100.0%</b>
<b>Total Resources</b>	<b>43,790,211</b>	<b>46,628,550</b>	<b>2,838,339</b>	<b>106.5%</b>

Comparing actual to budgeted revenues, the General Fund ended 2005 6.5 percent ahead of budget, which represents about \$2.8 million. Looking at specific revenues, the following are particularly noteworthy:

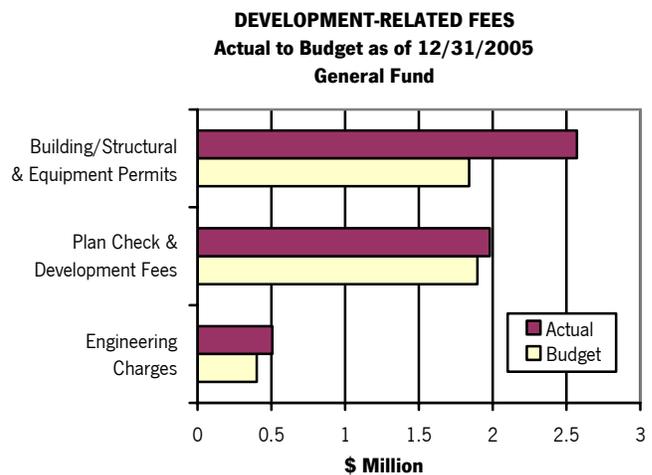
- **Sales tax** revenue was 14.8 percent ahead of budget due to continued improvement in the economy, particularly in the contracting and retail sectors (see “Selected Taxes” chart on the right). A more detailed analysis of general sales tax revenue follows in the Sales Tax Revenue Analysis report. As a note, the overall sales tax increase is 12.6 percent when taking into account the General Fund and the capital funds.



- **Revenue generating regulatory license** revenue was 3.3 percent ahead of budget primarily due to higher than expected licensing of businesses located outside the City’s limits.

- **Business licenses/franchise fees** were 6.5 percent ahead of budget due to higher than expected franchise fee revenues and strong performance in business licenses.

- **Development-related fees**, taken together, were 22.3 percent ahead of budget (see “Development-Related Fees” chart on the right). **Building, structural and equipment permit fees** were 39.7 percent ahead of budget and **engineering development fees** were 26.4 percent ahead of budget due to the high level of building activity in public sector, commercial and single-family residential projects. **Plan check and development fees** were also ahead of budget at 4.5 percent ahead of budget. Due to the timing of when plan check and development fees are received, they are not as significantly ahead of budget as the other development related fees at year end.



- **Internal Charges** were 10.2 percent behind budget due to lower than expected revenue from internal engineering services being charged to the other operating and capital funds. The budget was slightly overstated based on a historical charge model that will be addressed in the next budget process.

- **Grant** revenue was 56.4 percent behind budget due to the timing of FEMA reimbursement for our firefighters working during the Hurricane Katrina relief efforts. The grant reimbursement will be received in the first quarter of 2006.

- **Miscellaneous** revenue was 37.9 percent ahead of budget primarily due to higher than expected interest income.

**Expenditures: General Fund**

Department	2005 Budgeted Expenditures*	2005 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget
Non-Departmental	1,096,843	806,505	290,338	73.5%
City Council	327,091	312,886	14,205	95.7%
City Manager's Office	1,094,133	958,731	135,402	87.6%
Human Resources	945,254	826,950	118,304	87.5%
City Attorney's Office	916,310	870,749	45,561	95.0%
Parks & Community Services	5,097,229	4,796,470	300,759	94.1%
Public Works (Engineering)	2,886,290	2,690,376	195,914	93.2%
Finance and Administration	4,377,517	4,159,325	218,192	95.0%
Planning & Community Development	3,590,432	3,021,111	569,321	84.1%
Police	12,013,776	11,874,879	138,897	98.8%
Fire & Building	13,212,924	13,046,112	166,812	98.7%
<b>Total Expenditures</b>	<b>45,557,799</b>	<b>43,364,094</b>	<b>2,193,705</b>	<b>95.2%</b>
<b>Other Financing Uses:</b>				
Interfund Transfers	908,779	961,403	(52,624)	105.8%
<b>Total Other Financing Uses</b>	<b>908,779</b>	<b>961,403</b>	<b>(52,624)</b>	<b>105.8%</b>
<b>Total Expenditures &amp; Other Uses</b>	<b>46,466,578</b>	<b>44,325,497</b>	<b>2,141,081</b>	<b>95.4%</b>

\* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves and the year-end transfer.

Comparing actual to budgeted expenditures, the General Fund ended the year 4.6 percent under budget, which represents about \$2.1 million in expenditure savings. Of note are the following departments:

- The **Non-Departmental Division** was 26.5 percent under budget, primarily due to unspent COLA (Cost of Living Adjustment) reserves and savings in LEOFF 1 retiree medical costs.
- The **City Manager's Office** was 12.4 percent under budget primarily due to the timing of professional services reimbursements received for regional projects and savings in benefit expenses.
- The **Human Resources Department** was 12.5 percent under budget primarily due to position vacancies.
- The **Parks & Community Services Department** was 5.9 percent under budget primarily due to position vacancies and the timing of human service contract payments.
- The **Public Works Department** was 6.8 percent under budget primarily due to position vacancies and uncompleted projects such as traffic counts.
- The **Planning & Community Development Department** was 15.9 percent under budget due to uncompleted projects such as the Shoreline Master Plan, Downtown Strategic Plan and the tree planting program.

As noted previously, the end of 2005 is the halfway point of the 2005-2006 Biennial Budget. "Expenditure savings" in the General Fund of \$1.1 million at the end of 2005 related to uncompleted projects will be spent during 2006. No carryover process is necessary to allow for this expenditure in 2006 because of the 2 year budget appropriation.

## OTHER GENERAL GOVERNMENT OPERATING FUNDS

The Other General Government Operating Funds (which exclude the General Fund) account for two types of services: 1) those that have external revenue sources that are restricted for specific uses (i.e. tourism, street maintenance, cemetery operations, parks maintenance, and recreation programs); and 2) those that assess internal user charges to support other City departments (i.e. facilities maintenance, fleet services, and technology services). Approximately 53 of the City's 429 employees are budgeted within this group of funds.

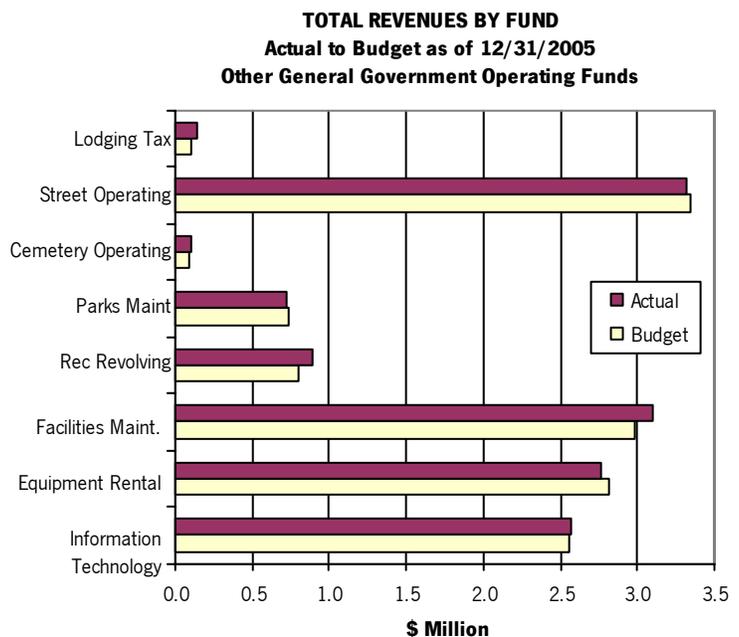
### **Resources: Other General Government Operating Funds**

Fund	2005 Budgeted Revenues*	2005 Actual Revenues*	Amount Over/(Under) Budget	% of Budget
Lodging Tax	105,000	135,592	30,592	129.1%
Street Operating	3,340,016	3,322,033	(17,983)	99.5%
Cemetery Operating	90,000	106,682	16,682	118.5%
Parks Maintenance	730,415	726,658	(3,757)	99.5%
Recreation Revolving	795,075	893,310	98,235	112.4%
Facilities Maintenance	2,979,972	3,103,206	123,234	104.1%
Equipment Rental	2,810,885	2,763,547	(47,338)	98.3%
Information Technology	2,555,675	2,566,298	10,623	100.4%
<b>Total Revenues</b>	<b>13,407,038</b>	<b>13,617,326</b>	<b>210,288</b>	<b>101.6%</b>
<b>Other Financing Sources:</b>				
Interfund Transfers	1,002,362	951,409	(50,953)	94.9%
<b>Total Other Financing Sources</b>	<b>1,002,362</b>	<b>951,409</b>	<b>(50,953)</b>	<b>94.9%</b>
<b>Total Resources</b>	<b>14,409,400</b>	<b>14,568,735</b>	<b>159,335</b>	<b>101.1%</b>

\* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Other General Government Funds collectively ended the year 1.1 percent ahead of budget, representing about \$160,000. Reviewing individual funds, the following are worth noting (see chart on the next page):

- The **Lodging Tax Fund** was 29.1 percent ahead of budget due to higher than expected lodging tax revenues.
- The **Recreation Revolving Fund** was 12.4 percent ahead of budget primarily due to higher than expected enrollment in recreation and aquatic classes and daycamps.



- The **Facilities Maintenance Fund** was 4.1 percent ahead of budget primarily due to higher than expected cable utility tax revenue.
- The **Equipment Rental Fund** was 1.7 percent behind budget due to lower than expected revenue from the sales of surplus vehicles and lower than budgeted replacement charges due to an operational delay in the purchase of several vehicles.

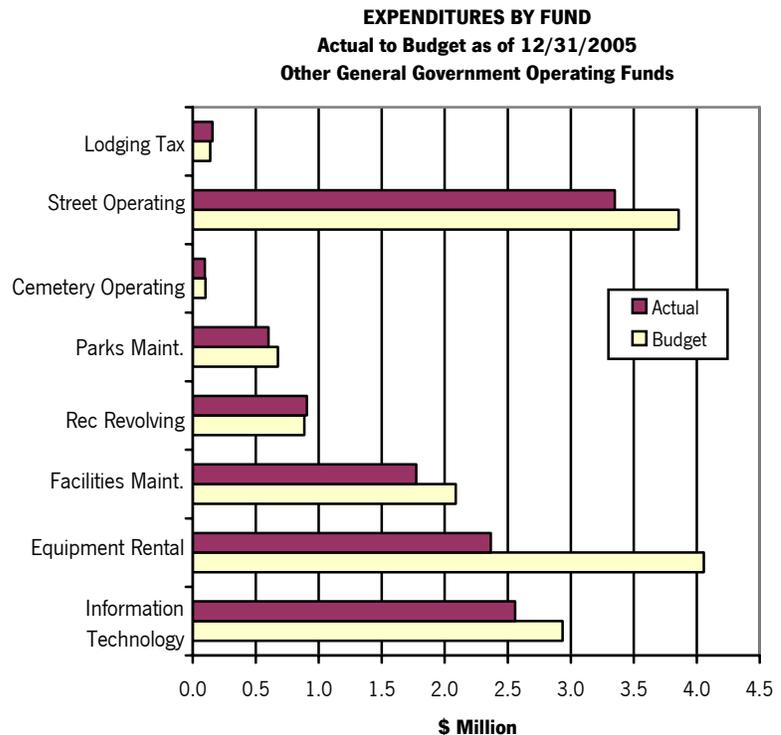
**Expenditures: Other General Government Operating Funds**

Fund	2005 Budgeted Expenditures*	2005 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget
Lodging Tax	140,220	157,441	(17,221)	112.3%
Street Operating	3,856,005	3,348,711	507,294	86.8%
Cemetery Operating	100,208	95,935	4,273	95.7%
Parks Maintenance	676,967	600,090	76,877	88.6%
Recreation Revolving	885,438	906,487	(21,049)	102.4%
Facilities Maintenance	2,087,313	1,773,558	313,755	85.0%
Equipment Rental	4,055,895	2,363,922	1,691,973	58.3%
Information Technology	2,935,721	2,559,948	375,773	87.2%
<b>Total Expenditures</b>	<b>14,737,767</b>	<b>11,806,092</b>	<b>2,931,675</b>	<b>80.1%</b>
<b>Other Financing Uses:</b>				
Interfund Transfers	1,255,444	1,340,654	(85,210)	106.8%
<b>Total Other Financing Uses</b>	<b>1,255,444</b>	<b>1,340,654</b>	<b>(85,210)</b>	<b>106.8%</b>
<b>Total Expenditures &amp; Other Uses</b>	<b>15,993,211</b>	<b>13,146,746</b>	<b>2,846,465</b>	<b>82.2%</b>

\* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

Comparing actual to budgeted expenditures, the Other General Government Operating Funds collectively ended the year 17.8 percent under budget. Looking at each individual fund, the following are noteworthy (see chart on the next page):

- The **Lodging Tax Fund** was 12.3 percent over budget primarily due to greater than expected tourism expenditures, which are offset by increased revenue.
- The **Street Operating Fund** was 13.2 percent under budget primarily due to uncompleted projects such as neighborhood traffic calming and parking facility improvements.
- The **Parks Maintenance Fund** was 11.4 percent under budget due to expenditure savings related to maintenance supplies, utility services and repairs and maintenance services.
- The **Facilities Maintenance Fund** was 15.0 percent under



budget primarily due to position vacancies, savings related to repairs and maintenance services, and lower than expected utility costs.

- The **Equipment Rental Fund** was 41.7 percent under budget primarily due to repairs and maintenance cost savings and the postponement of scheduled vehicle replacements where it was determined the vehicle life could be extended.
- The **Information Technology Fund** was 12.8 percent under budget due to savings in maintenance support contracts, uncompleted projects such as GIS web mapping, and lower than expected costs for computer replacement purchases.

## WATER/SEWER OPERATING FUND

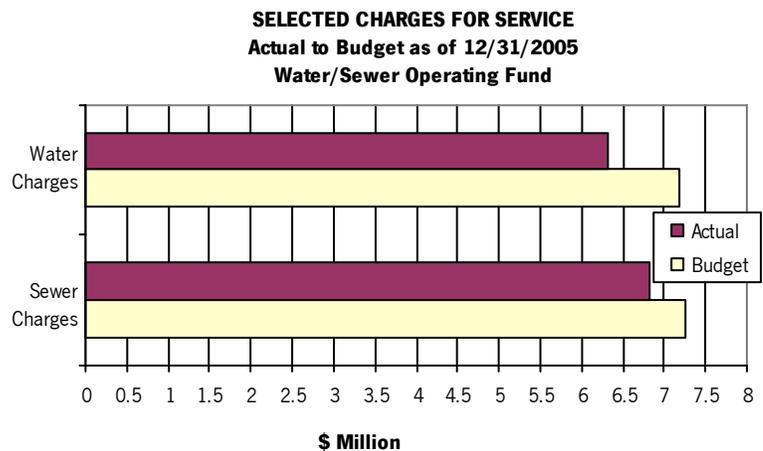
The Water/Sewer Operating Fund accounts for all administrative, operating, and maintenance costs of the City's Water/Sewer Utility. The infrastructure operated and maintained includes water and sewer mains, sewer lift stations, water reservoirs, pressure-reducing stations, and fire hydrants. Also included are the purchase of water from Cascade Water Alliance (CWA) and the contracting of sewage treatment services with METRO. The water and sewer systems serve approximately 11,000 and 9,000 customers respectively. This fund is managed like a business with customer charges fully supporting all costs. About 20 of the City's 429 employees are budgeted within this fund.

### Resources: Water/Sewer Operating Fund

Resource Category	2005 Budgeted Revenues*	2005 Actual Revenues*	Amount Over/(Under) Budget	% of Budget
<b><i>Intergovernmental</i></b>	50,000	67,353	17,353	134.7%
<b><i>Charges for Services:</i></b>				
Water Charges	7,178,559	6,328,072	(850,487)	88.2%
Sewer Charges	7,261,941	6,825,021	(436,920)	94.0%
Other Charges for Services	55,000	69,109	14,109	125.7%
<b>Total Charges for Services</b>	<b>14,495,500</b>	<b>13,222,202</b>	<b>(1,273,298)</b>	<b>91.2%</b>
<b><i>Miscellaneous</i></b>	130,700	219,966	89,266	168.3%
<b>Total Revenues</b>	<b>14,676,200</b>	<b>13,509,521</b>	<b>(1,166,679)</b>	<b>92.1%</b>
<b><i>Other Financing Sources:</i></b>				
Interfund Transfers	399,894	674,481	274,587	168.7%
<b>Total Other Financing Sources</b>	<b>399,894</b>	<b>674,481</b>	<b>274,587</b>	<b>168.7%</b>
<b>Total Resources</b>	<b>15,076,094</b>	<b>14,184,002</b>	<b>(892,092)</b>	<b>94.1%</b>

\* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Water/Sewer Operating Fund ended the year 5.9 percent behind budget due to lower than normal water sales because of voluntary water restrictions as a result of an unusually dry winter and a cool summer (see chart to the right).

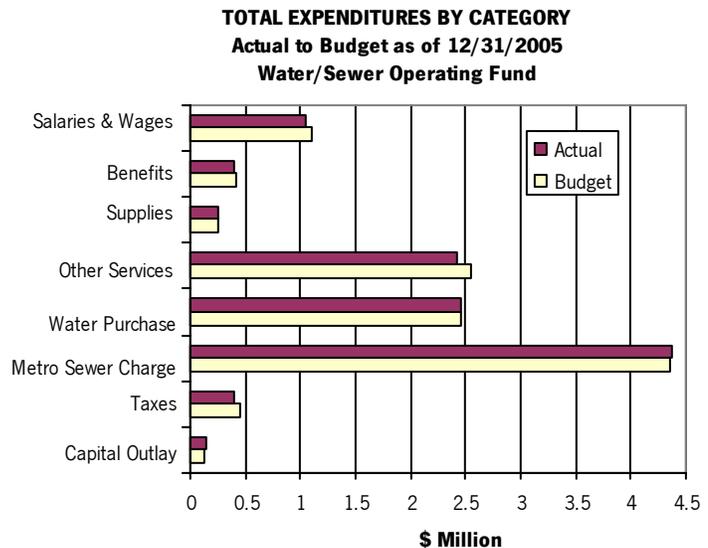


**Expenditures: Water/Sewer Operating Fund**

Expenditure Category	2005 Budgeted Expenditures*	2005 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget
Salaries & Wages	1,098,995	1,056,187	42,808	96.1%
Benefits	408,199	394,785	13,414	96.7%
Supplies	249,150	251,140	(1,990)	100.8%
Other Services	2,551,085	2,425,762	125,323	95.1%
Water Purchase (CWA)	2,453,192	2,455,454	(2,262)	100.1%
Metro Sewer Charge	4,352,916	4,373,175	(20,259)	100.5%
Taxes	445,996	392,246	53,750	87.9%
Capital Outlay	127,594	138,631	(11,037)	108.7%
<b>Total Expenditures</b>	<b>11,687,127</b>	<b>11,487,380</b>	<b>199,747</b>	<b>98.3%</b>
<b>Other Financing Uses:</b>				
Interfund Transfers	3,165,448	3,172,675	(7,227)	100.2%
<b>Total Other Financing Uses</b>	<b>3,165,448</b>	<b>3,172,675</b>	<b>(7,227)</b>	<b>100.2%</b>
<b>Total Expenditures &amp; Other Uses</b>	<b>14,852,575</b>	<b>14,660,055</b>	<b>192,520</b>	<b>98.7%</b>

\* Budgeted expenditures exclude working capital and an operating reserve.

Comparing actual to budgeted expenditures, the Water/Sewer Operating Fund ended the year 1.3 percent under budget primarily due to a position vacancy, uncompleted projects such as the Water Comp Plan, and lower than expected internal engineering charges (see chart to the right). It should be noted that payments to CWA are at an average fixed level month to month while the revenues received from water sales continue to vary with consumption. This affects the comparison of water revenues to water expenditures at any one point in time. Over time, the effect will be normalized.



## SURFACE WATER MANAGEMENT FUND

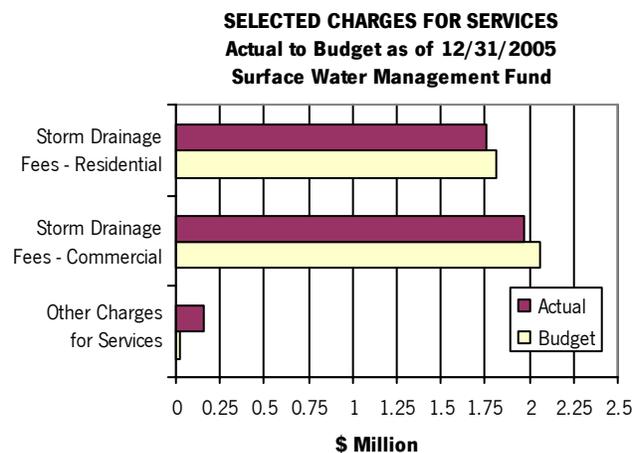
The Surface Water Management Fund accounts for all administrative, operating, and maintenance costs of the City's Surface Water Utility. The infrastructure operated and maintained includes storm drain mains, manholes, and catch basins. This utility serves all residential, multi-family, and commercial customers within the City. Like the Water/Sewer Operating Fund, this fund is managed like a business with customer charges fully supporting all costs. About 14 of the City's 429 employees are budgeted within this fund.

### **Resources: Surface Water Management Fund**

Resource Category	2005 Budgeted Revenues*	2005 Actual Revenues*	Amount Over/(Under) Budget	% of Budget
<b><i>Charges for Services:</i></b>				
Storm Drainage Fees - Residential	1,816,035	1,756,144	(59,891)	96.7%
Storm Drainage Fees - Commercial	2,060,250	1,968,306	(91,944)	95.5%
Other Charges for Services	21,000	156,936	135,936	747.3%
<b>Total Charges for Services</b>	<b>3,897,285</b>	<b>3,881,386</b>	<b>(15,899)</b>	<b>99.6%</b>
<b><i>Miscellaneous</i></b>	19,500	24,390	4,890	125.1%
<b>Total Revenues</b>	<b>3,916,785</b>	<b>3,905,776</b>	<b>(11,009)</b>	<b>99.7%</b>
<b><i>Other Financing Sources:</i></b>				
Interfund Transfers	0	7,972	7,972	N/A
<b>Total Other Financing Sources</b>	<b>0</b>	<b>7,972</b>	<b>7,972</b>	<b>N/A</b>
<b>Total Resources</b>	<b>3,916,785</b>	<b>3,913,748</b>	<b>(3,037)</b>	<b>99.9%</b>

\* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Surface Water Management Fund ended the year almost equal to budget at 0.1 percent behind budget (see chart to the right). Surface Water fees are collected with property taxes.



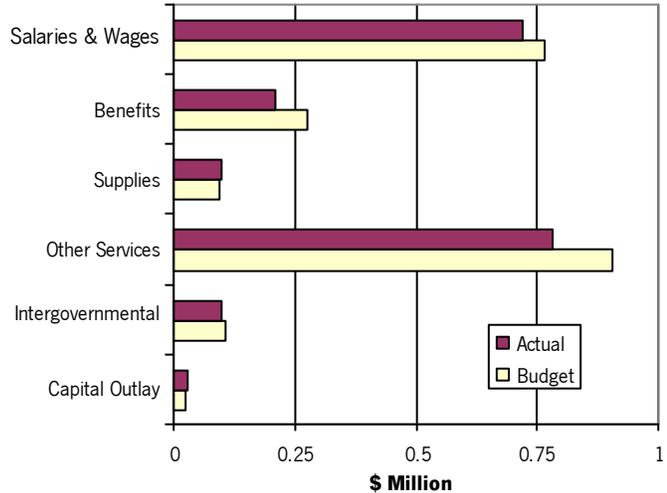
**Expenditures: Surface Water Management Fund**

Expenditure Category	2005 Budgeted Expenditures*	2005 Actual Expenditures	Amount (Over)/Under Budget	% of Budget
Salaries & Wages	766,336	720,204	46,132	94.0%
Benefits	273,906	210,104	63,802	76.7%
Supplies	96,350	99,740	(3,390)	103.5%
Other Services	905,047	782,220	122,827	86.4%
Intergovernmental Services & Taxes	108,000	100,327	7,673	92.9%
Capital Outlays	23,310	28,280	(4,970)	121.3%
<b>Total Expenditures</b>	<b>2,172,949</b>	<b>1,940,875</b>	<b>232,074</b>	<b>89.3%</b>
<b>Other Financing Uses:</b>				
Interfund Transfers	1,846,480	1,846,480	0	100.0%
<b>Total Other Financing Uses</b>	<b>1,846,480</b>	<b>1,846,480</b>	<b>0</b>	<b>100.0%</b>
<b>Total Expenditures &amp; Other Uses</b>	<b>4,019,429</b>	<b>3,787,355</b>	<b>232,074</b>	<b>94.2%</b>

\* Budgeted expenditures exclude working capital and an operating reserve.

Comparing actual to budgeted expenditures, the Surface Water Management Fund ended the year 5.8 percent under budget primarily due to benefits savings and uncompleted projects relating to Shoreline Inventory and ESA regulations (see chart to the right). Benefits are budgeted using a city-wide average demographic for all employees, but the average demographic for the employees in the Surface Water Management Fund have typically been lower than the city-wide average demographic.

**TOTAL EXPENDITURES BY CATEGORY**  
**Actual to Budget as of 12/31/2005**  
**Surface Water Management Fund**



## SOLID WASTE FUND

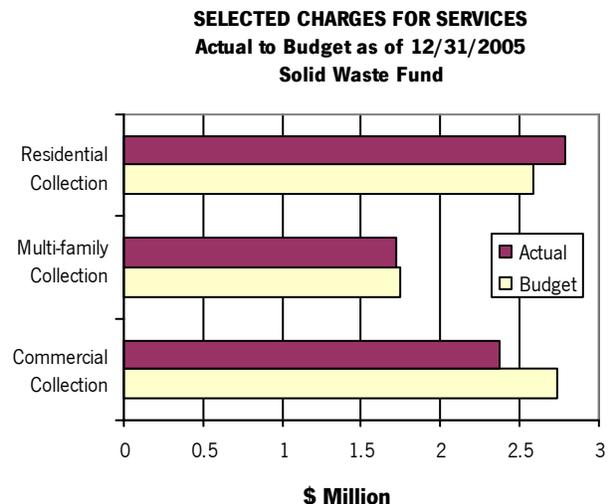
The Solid Waste Fund accounts for all administrative and operating costs of the City's Solid Waste Utility. The collection and recycling service is currently provided through a contract with Waste Management and serves approximately 11,600 customers. Of the City's 429 employees, 1 employee is budgeted in this fund.

### Resources: Solid Waste Fund

Resource Category	2005 Budgeted Revenues*	2005 Actual Revenues*	Amount Over/(Under) Budget	% of Budget
<i>Intergovernmental</i>	112,098	128,345	16,247	114.5%
<b><i>Charges for Services:</i></b>				
Residential Collection	2,586,000	2,789,218	203,218	107.9%
Multi-family Collection	1,744,500	1,714,552	(29,948)	98.3%
Commercial Collection	2,735,500	2,377,361	(358,139)	86.9%
Other Charges for Services	227,000	218,216	(8,784)	96.1%
<b>Total Charges for Services</b>	<b>7,293,000</b>	<b>7,099,347</b>	<b>(193,653)</b>	<b>97.3%</b>
<i>Miscellaneous</i>	18,500	29,721	11,221	N/A
<b>Total Revenues</b>	<b>7,423,598</b>	<b>7,257,413</b>	<b>(166,185)</b>	<b>97.8%</b>
<b><i>Other Financing Sources:</i></b>				
Interfund Transfers	0	0	0	0.0%
<b>Total Other Financing Sources</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>N/A</b>
<b>Total Resources</b>	<b>7,423,598</b>	<b>7,257,413</b>	<b>(166,185)</b>	<b>97.8%</b>

\* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Solid Waste Fund ended the year 2.2 percent behind budget due to lower than expected commercial collection revenue (see chart to the right).

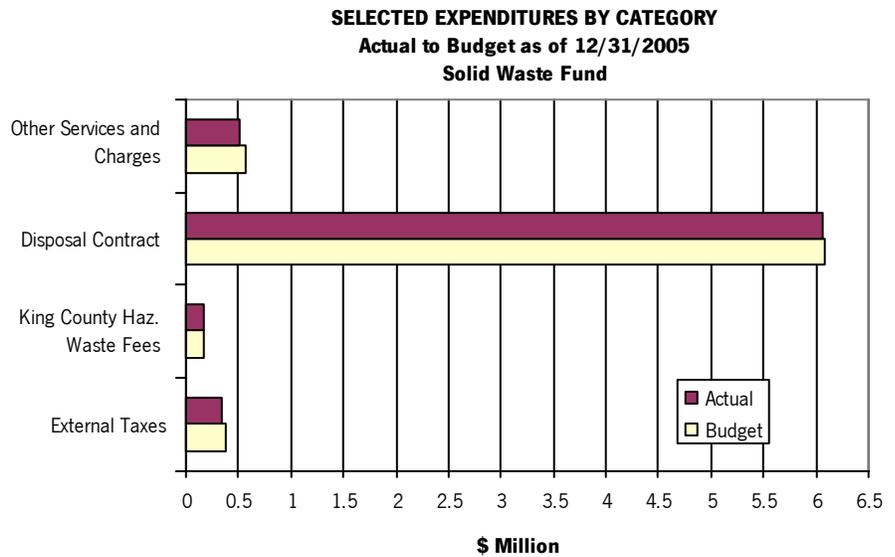


**Expenditures: Solid Waste Fund**

Expenditure Category	2005 Budgeted Expenditures*	2005 Actual Expenditures	Amount (Over)/Under Budget	% of Budget
Salaries & Wages	59,432	60,930	(1,498)	102.5%
Benefits	18,430	19,899	(1,469)	108.0%
Supplies	3,000	13,812	(10,812)	460.4%
Other Services and Charges	577,172	502,705	74,467	87.1%
Disposal Contract	6,087,493	6,066,844	20,649	99.7%
King County Hazardous Waste Fee	170,000	171,968	(1,968)	101.2%
External Taxes	370,000	345,669	24,331	93.4%
<b>Total Expenditures</b>	<b>7,285,527</b>	<b>7,181,827</b>	<b>103,700</b>	<b>98.6%</b>
<b>Other Financing Uses:</b>				
Interfund Transfers	0	0	0	N/A
<b>Total Other Financing Uses</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0.0%</b>
<b>Total Expenditures &amp; Other Uses</b>	<b>7,285,527</b>	<b>7,181,827</b>	<b>103,700</b>	<b>98.6%</b>

\* Budgeted expenditures exclude working capital and an operating reserve.

Comparing actual to budgeted expenditures, the Solid Waste Fund ended the year 1.4 percent under budget primarily due to lower than expected payments to Waste Management for commercial collection, lower taxes based on lower than expected revenue collection, and savings in recycling programs (see chart to the right).



# SALES TAX REVENUE ANALYSIS

*Through December 31, 2004 and 2005*

## BACKGROUND

Sales tax is the single largest revenue source in the General Fund as well as the City's primary funding source for general government services. In addition, sales tax is a dedicated funding source for transportation capital projects (\$270,000), neighborhood capital projects (\$100,000), and technology capital projects (\$400,000).

State law defines those transactions that are subject to retail sales tax. Most notably, the sale of most consumer goods (except most food products) is taxable. Also, certain types of services, such as recreational activities and the improvement of real or personal property, are taxable. Due to changes in the economy, buying habits of consumers, and construction activity within Kirkland, sales tax revenue received by the City fluctuates from year to year.

Kirkland's sales tax rate is 8.8 percent, with an additional 0.5 percent imposed by King County for food and beverages sold by restaurants, taverns, and bars and an additional 0.3 percent imposed on vehicle purchases or leases. Of the 8.8 percent collected from regular sales tax, the City receives 1 percent (less 0.15 percent remitted to King County). The remaining 7.8 percent is distributed to the State and other public agencies as depicted in the chart on the right.

This report analyzes sales tax revenues through December 31, 2005 and compares them to the same period in 2004. Year-to-date, monthly, business sector (according to standard industrial classification code), and business district (according to geographic area) comparisons follow.

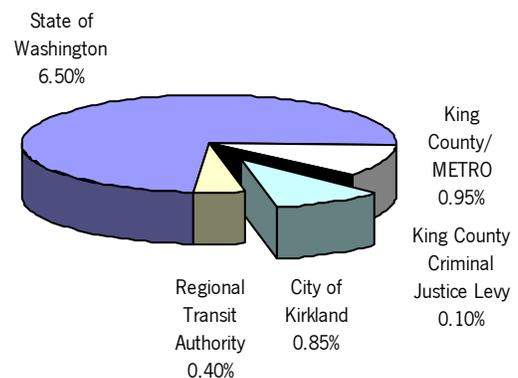
## SUMMARY COMPARISON

Kirkland experienced an economic recession that lasted from October 2000 through early 2003. A moderate recovery began in February 2003, partially due to the opening or re-opening of two automobile dealerships and the Costco Home Store. Additionally, contracting activity and a general economic improvement contributed to positive performance in 2004 and greatly improved performance in 2005.

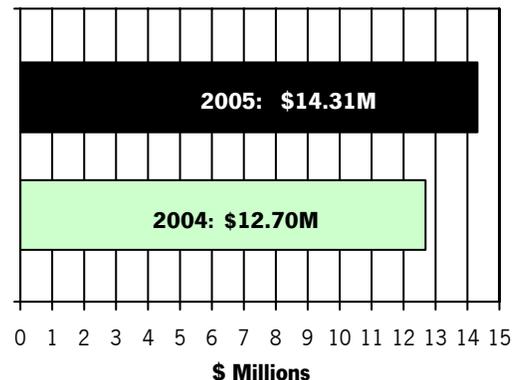
2005 sales tax receipts are up 12.6 percent compared to 2004 as illustrated in the chart to the right. The improvement in sales tax revenue in 2005 is due to significant contracting activity, an upswing in communications receipts, strong performance by electronics and internet retailers, and technology and software companies.

When analyzing monthly sales tax receipts, it is important to note two things. 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

**Sales Tax Distribution (8.8%)**

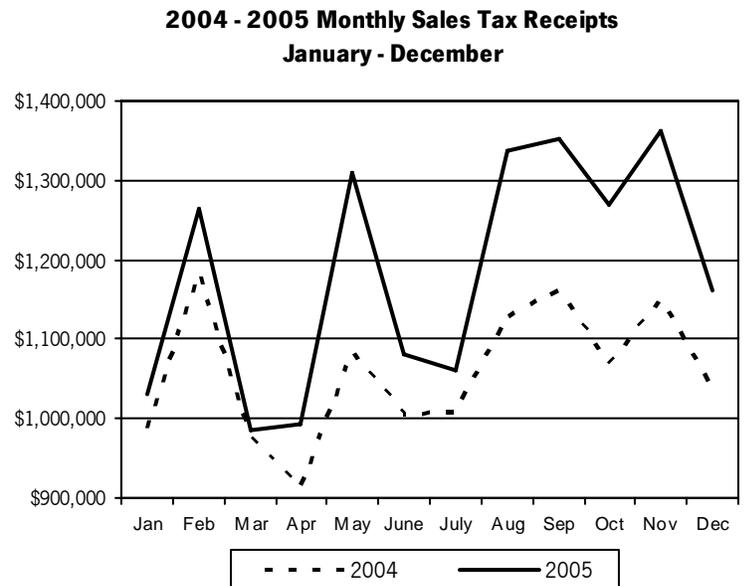


**2004 - 2005 YTD Sales Tax Receipts**



lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in December 2005 is for sales actually made in October 2005. Monthly sales tax receipts through December 2004 and 2005 are compared in the following table and chart.

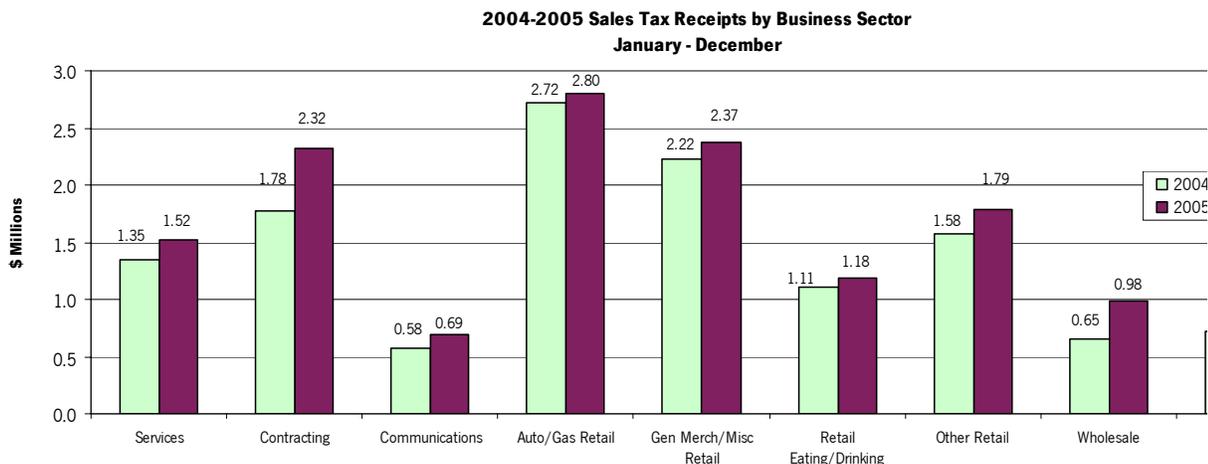
Month	Sales Tax Receipts		Percent Change
	2004	2005	
January	989,173	1,074,628	8.6%
February	1,183,162	1,265,274	6.9%
March	975,804	1,036,353	6.2%
April	913,060	998,836	9.4%
May	1,082,572	1,309,116	20.9%
June	1,004,369	1,081,910	7.7%
July	1,008,151	1,059,853	5.1%
August	1,129,833	1,337,976	18.4%
September	1,160,908	1,351,158	16.4%
October	1,068,443	1,270,456	18.9%
November	1,149,143	1,362,604	18.6%
December	1,039,356	1,161,634	11.8%
<b>Total</b>	<b>12,703,974</b>	<b>14,309,798</b>	<b>12.6%</b>



Looking at both years, the seasonal pattern is the same, with a sales tax spike in February (for sales in December) followed by a decline in March and April. The monthly trend for 2005 follows 2004 but at a higher level. Note that the monthly percentage increase ranges from a low of 5.1 percent in July to a high of 20.9 percent in May and the last five months of 2005 posted consecutive increases greater than 11 percent.

## BUSINESS SECTOR COMPARISON

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to SIC, or standard industrial classification, code). The following nine business sector groupings were used to compare 2004 and 2005 year-to-date sales tax receipts in the following table and chart: 1) Services, 2) Contracting, 3) Communications, 4) Automotive/Gas Retail, 5) General Merchandise/Miscellaneous Retail, 6) Retail Eating/Drinking, 7) Other Retail, 8) Wholesale, and 9) Miscellaneous.



Business Sector Group	Jan - Dec Receipts		Dollar Change	Percent Change	Percent of Total	
	2004	2005			2004	2005
Services	1,347,480	1,518,349	170,869	12.7%	10.6%	10.6%
Contracting	1,777,419	2,315,568	538,149	30.3%	14.0%	16.2%
Communications	576,840	689,090	112,250	19.5%	4.5%	4.8%
Auto/Gas Retail	2,721,983	2,797,473	75,490	2.8%	21.4%	19.5%
Gen Merch/Misc Retail	2,220,194	2,366,854	146,660	6.6%	17.5%	16.5%
Retail Eating/Drinking	1,109,576	1,181,884	72,308	6.5%	8.7%	8.3%
Other Retail	1,577,589	1,787,484	209,895	13.3%	12.4%	12.5%
Wholesale	652,515	984,837	332,322	50.9%	5.1%	6.9%
Miscellaneous	720,378	668,259	(52,119)	-7.2%	5.8%	4.7%
<b>Total</b>	<b>12,703,974</b>	<b>14,309,798</b>	<b>1,605,824</b>	<b>12.6%</b>	<b>100.0%</b>	<b>100.0%</b>

Most of the 12.6 percent increase in 2005 sales tax receipts can be traced to the following six business sectors comprising over 67 percent of the City's total sales tax receipts:

1. **Contracting**, which accounts for over 16 percent of the total sales tax receipts, **is up 30.3 percent** due to the continuing high level of construction activity in Kirkland. Activity at large commercial and public projects, such as Evergreen Hospital, Juanita Village (a mixed used retail/office/apartment complex), and Juanita Elementary, as well as the renovation or repair of several apartment and condominium complexes have contributed to the strong performance of this sector. Several new projects started in 2005, including two large condominium projects on Kirkland Avenue, the tower at Evergreen Hospital, a hotel in Totem Lake, and the Sound Transit 405 Transit Center/Access project.
2. **Wholesale**, which accounts for almost 7 percent of the total sales tax receipts, **is up 50.9 percent** primarily due to construction-related equipment installation, technology hardware/software companies and a fire apparatus and equipment company.
3. **Other Retail**, which accounts for over 12 percent of the total sales receipts, **is up 13.3 percent** due to an audio/visual equipment distributor, and catalog and Internet retailers.
4. **Services**, which accounts for over 10 percent of the total sales tax receipts, **is up 10.6 percent** primarily due to growth in business and health care services.
5. **General Merchandise/Miscellaneous Retail**, which accounts for over 16 percent of the total sales tax receipts, **is up 6.6 percent** due to the strong performance of key retailers.
6. **Communications**, which accounts for almost 5 percent of the total sales receipts, **is up 19.5 percent** due to a combination of one-time corrections and an overall improvement in this sector. Factoring out the one-time receipts of almost \$55,000, this sector is up about 11 percent.

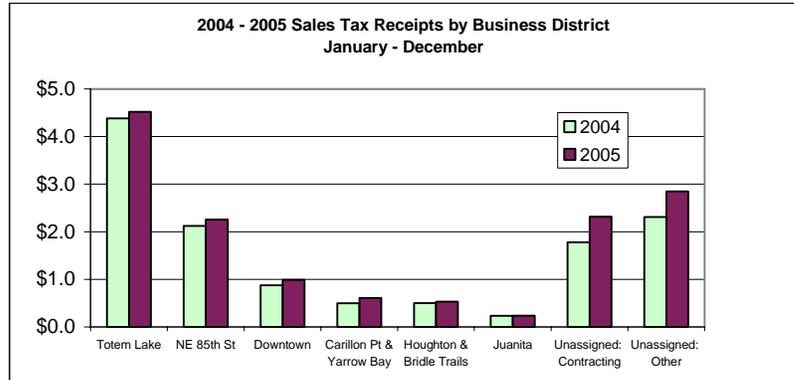
The important "automotive /gas retail" sector is noticeably absent from the list above. This sector performed poorly most of the year, recovering enough during the last quarter to post a 2.8 percent gain over 2004.

In looking at the proportion of total sales tax receipts generated by each business sector group, a few changes are worth noting. First, the long-term impact of the closure of Apple Computer and HomeBase is demonstrated by comparing the "wholesale" category share in 2005 to 2000. "Wholesale" declined from 11.3 percent in 2000 to only 6.9 percent in 2005. Second, the share of sales receipts from all "retail" categories increased from 53.0 percent in 2000 to 56.8 percent in 2005. Third, the "contracting" sector share has been particularly volatile over

the last few years, with a low of 12.3 percent in 2003 to a high of 16.2 percent in 2005, pointing out the vulnerability in depending on this sector to support ongoing services.

## BUSINESS DISTRICT COMPARISON

Kirkland's sales tax base is further broken down by business district (according to geographic area) as follows: 1) Totem Lake, 2) NE 85<sup>th</sup> Street, 3) Downtown, 4) Carillon Point & Yarrow Bay, 5) Houghton & Bridle Trails, 6) Juanita, and 7) Unassigned or No District (comprised of the contracting sector, businesses with no physical presence in Kirkland, and unassigned small businesses in Kirkland). Year-to-date sales tax receipts through December 2004 and 2005 are compared in the chart to the right and the table below.



Business District	Jan - Dec Receipts		Dollar Change	Percent Change	Percent of Total	
	2004	2005			2004	2005
Totem Lake	4,384,825	4,517,513	132,688	3.0%	34.5%	31.6%
NE 85th St	2,121,133	2,256,705	135,572	6.4%	16.7%	15.8%
Downtown	876,875	989,822	112,947	12.9%	6.9%	6.9%
Carillon Pt & Yarrow Bay	498,656	608,365	109,709	22.0%	3.9%	4.3%
Houghton & Bridle Trails	500,737	532,597	31,860	6.4%	3.9%	3.7%
Juanita	235,198	239,825	4,627	2.0%	1.9%	1.7%
Unassigned or No District:						
Contracting	1,777,419	2,315,567	538,148	30.3%	14.0%	16.2%
Other	2,309,131	2,849,404	540,273	23.4%	20.1%	21.5%
<b>Total</b>	<b>12,703,974</b>	<b>14,309,798</b>	<b>1,605,824</b>	<b>12.6%</b>	<b>100.0%</b>	<b>100.0%</b>

When reviewing sales tax receipts by business district, it's important to point out that over two-thirds of the revenue gain achieved in 2005 is in the "unassigned or no district" category. This is a result of the significant growth in the "contracting" sector, as well as strong performance in "other retail" (mostly on-line and catalog retailers), "communications," and "business services" sectors.

Reviewing the performance of the City's business districts:

1. **Totem Lake**, which accounts for almost 32 percent of the total sales tax receipts, **is up 3.0 percent**, primarily due to strong performance in "wholesale," "general merchandise/miscellaneous retail," "other retail" and health-related "services" and despite the loss of a pharmaceutical technology equipment company.

2. **NE 85<sup>th</sup> Street**, which accounts for almost 16 percent of the total sales tax receipts, **is up 6.4 percent** primarily due to growth in the “general merchandise/miscellaneous retail,” and “retail automotive/gas” sectors.
3. **Downtown**, which accounts for almost 7 percent of the total sales receipts, **is up 12.9 percent** due to the “miscellaneous retail,” “retail eating/drinking,” business-related “services” and finance/real estate in the “miscellaneous” sector.
4. **Carillon Point & Yarrow Bay**, which accounts for over 4 percent of the total sales tax receipts, **is up 22.0 percent** primarily due to the performance of three software/technology companies.
5. **Houghton & Bridle Trails**, which accounts for almost 4 percent of the total sales receipts, **is up 6.4 percent** almost entirely due to an audio visual distributor and despite the closure of a miscellaneous retailer.
6. **Juanita**, which accounts for almost 2 percent of the total sales receipts, **is up 2.0 percent** almost entirely due to the “miscellaneous retail” sector.

## **2005 OUTLOOK**

2005 sales tax receipts beat the “benchmark” year of 2000 by 12.3 percent. This is largely due to the high level of construction activity in the city, as well as an upswing in the communications sector. A few large technology companies, as well as some key retailers, also contributed to the positive growth for this year.

On the downside, the automotive/gas retail sector cooled considerably. Additionally, Costco opened their new Woodinville area store at the end of August 2005. The opening of the Issaquah Costco ten years ago significantly impacted the Kirkland store. Since Costco is such a significant contributor of sales tax revenue for the City, this was a major concern. Due to the nature of the lag in timing of receipts, this impacted the last two months of 2005. So far this impact is much less than expected and hopefully this trend will continue in 2006.

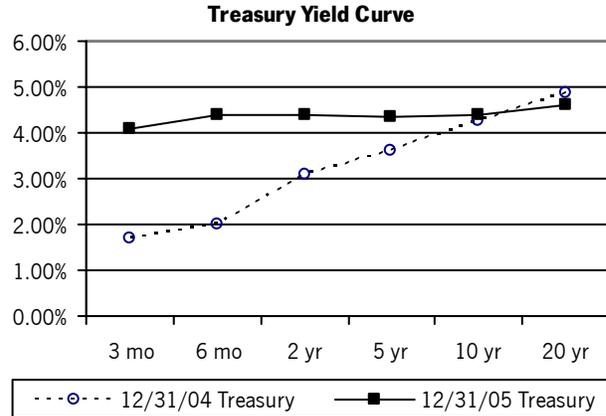
The economic recession a few years ago and the potential impact from the opening of the Woodinville Costco serve as reminders that sales tax is an economically sensitive revenue source. In good times, sales tax growth easily outpaces the rate of inflation and is an attractive funding source for service packages. However, when a downturn occurs, the City’s financial ability to maintain existing services can be quickly threatened. Additional volatility is created by gaining or losing significant businesses, shifts in construction activity due to economic conditions, and one-time field audit recoveries.

# 2005 INVESTMENT REPORT

As of December 31, 2005

## MARKET OVERVIEW

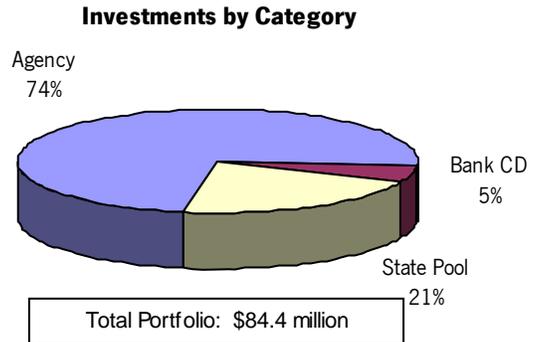
Gross domestic product GDP, the most widely used measure of economic activity, grew 3.5 percent in 2005. Growth in the 4<sup>th</sup> quarter of 2005 slowed to 1.6 percent after increasing 4.1 percent in the 3<sup>rd</sup> quarter. Inflation was approximately 3.3 percent and short term interest rates rose with the Fed Funds moving from 2.25 percent at the beginning of the year to 4.25 percent by year end. There was significant flattening of the yield curve in 2005 indicating expectations of low inflation in the future. Rates are expected to continue increasing slightly as the Fed Funds rate is forecast to reach 5 percent in 2006.



## CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities, in order of priority, 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 \$3.3 million in 2005 finishing the year at \$84.4 million compared to \$81.1 million on December 31, 2004.



## Diversification

The City's current investment portfolio is composed of Bank Certificates of Deposit, Federal Agencies, and the State Investment Pool. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Agency obligations. The purchase of callable Federal Agency obligations is limited to 50% of the portfolio and 20% per issuer.

Agency Diversification		
Agency	Target Max %	Actual
FFCB	20%	18%
FHLB	20%	19%
FHLMC	20%	18%
FNMA	20%	19%

## Liquidity

The target duration for the City's portfolios is based on the current 2 year treasury rate. As the 2 year treasury rate increased from 3.08 percent on December 31, 2004 to 4.41 percent on December 31, 2005, the average maturity of the City's investment portfolio increased from 1.05 years on December 31, 2004 to 1.24 years on December 31, 2005. The current maturity duration is within the acceptable target range when the 2 year Treasury note yield is between 4 and 5 percent.

Liquidity: Average Time to Maturity		
T Note Yield	Target	City
Under 3%	.75 – 1 yr	
3 – 4%	1.0 – 1.2 yrs	
4 – 5%	1.2 – 1.4 yrs	1.24
5 – 6%	1.4 – 1.7 yrs	
6 – 7%	1.7 – 1.9 yrs	
Over 7%	1.9 – 2.1 yrs	

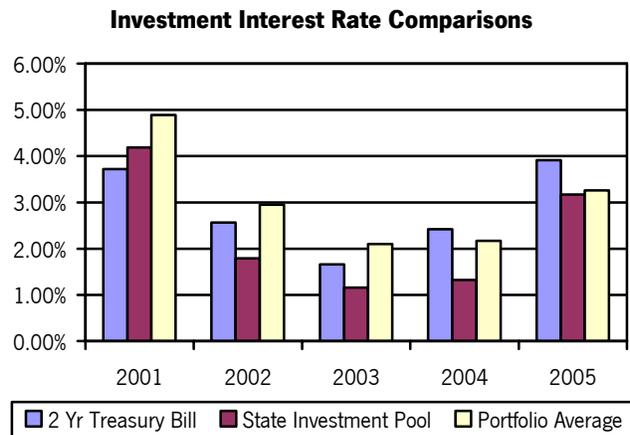
## Yield

Rising interest rates due to improved economic improvement and the increased Fed Funds rate has helped increase the City's Portfolio yield in 2005. The City Portfolio yield to maturity increased from 2.58 percent on December 31, 2004 to 3.88 percent on December 31, 2005.

Through December 31, 2005, the City's average yield to maturity was 3.26 percent, which outperformed the State Investment Pool average yield to maturity at 3.17 percent and was below the 2 Year Treasury note average for 2005 at 3.91 percent.

The City portfolio's cash yield for 2005 at 2.82 percent was an increase over the 2004 yield of 2.00 percent. Total interest earnings for 2005 were \$2.34 million, \$488 thousand over the \$1.85 million budgeted.

Benchmark Comparison	December 31, 2005	December 31, 2004
City Yield to Maturity (YTM)	3.88%	2.58%
City Average YTM	3.26%	2.17%
City Year to Date Yield	2.82%	2.00%
State Pool Average Yield	3.17%	1.32%
2 yr Treasury Note Avg YTM	3.91%	2.42%



## 2006 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

According to the recent Federal Reserve Survey of Professional Forecasters the U.S. economy will grow strongly in the first quarter, following unexpectedly slow growth in last year's fourth quarter. The forecasters project first-quarter growth at an annual rate of 4.4 percent and project steady year-over-year growth at 3.2 percent in each of the next two years.

The unemployment rate is forecast to be constant at 4.8 percent over the four quarters of this year and rising just a bit, to 4.9 percent, in 2007. Beyond the very short term, the forecasters see little threat of accelerating inflation. CPI inflation is forecast at 2.4 percent in 2006 and 2.3 percent in 2007. Over the longer run, the forecasters see inflation averaging 2.5 percent over the next 10 years, the same rate they have been expecting since the surveys conducted in the late 1990s. The Fed Funds rate, currently at 4.5 percent as of February is expected to reach 5 percent by the end of 2006.

The City will continue to follow policy guidelines for portfolio duration in 2006 focusing on shorter term securities in the beginning of the year and extending the duration in the 2<sup>nd</sup> half of the year as interest rates level off. Total budgeted investment income for 2006 is \$2.7 million. Investment revenue is estimated to be above budget at approximately \$2.9 million for 2006 based on the City's current portfolio and State Investment Pool rates.

## **2005 RESERVE SUMMARY**

### ***As of December 31, 2005***

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves).

Following this narrative is a summary schedule detailing all Council authorized uses and additions to each reserve through December 2005. Also provided is a separate schedule of all City reserves reflecting the 2005-06 ending balance and corresponding target for each reserve.

### **GENERAL PURPOSE RESERVES**

General purpose reserves are available to meet a wide variety of contingencies. They are funded by excess general purpose revenues, which have no restrictions on the public purpose for which they are spent.

#### **General Operating Reserve**

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

#### **Revenue Stabilization Reserve**

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

#### **Contingency Fund**

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

#### **General Capital Contingency**

This reserve is available to fund general capital projects when the scope or cost of the project exceeds the budgeted amount. The target established by fiscal policy is ten percent of the funded six-year Capital Improvement Program (CIP) less utility projects. Funding is received from the General Fund year-end transfer and interest income. Use of the General Capital Contingency is secured through a request to Council. Typically, this reserve has covered

changes in project scope, unanticipated costs that arose out of the bid process, or unavoidable change orders. Council granted limited administrative authority to the City Manager to fund small project overruns (e.g. up to \$100,000 per year each for the general and utility capital reserves and up to \$25,000 for any single project).

### **Building and Property Reserve**

This reserve is used for property purchases, building improvements and other property-related transactions. It has also been used as a general purpose reserve to fund Council-approved unanticipated expenditures.

### **Council Special Project Reserve**

This reserve is available to the City Council to fund special one-time projects that were unforeseen at the time the budget was prepared. When the reserve is used, it is replenished from the General Fund year-end transfer.

## **SPECIAL PURPOSE RESERVES**

Special purpose reserves are dedicated either by Council policy or by state or local laws that govern their use. Following are descriptions of a few of the larger and more important special purpose reserves.

### **Excise Tax Capital Improvement Reserve**

There are two reserves in the Real Estate Excise Tax Capital Improvement Fund – one for the first quarter percent real estate excise tax (REET 1) and one for the second quarter percent real estate excise tax (REET 2). These cash balances must be kept separate due to the dedication of REET 2 to transportation capital projects. The REET 1 reserve is used primarily as a general CIP grant match reserve and/or for significant project scope changes. The target should be reviewed periodically against potential grants.

### **Equipment Rental Fund**

The Equipment Rental Fund is one of two internal service funds. There are two capital reserves maintained in this fund. One relates to the replacement of vehicles and the other is for the replacement of 800 MHz radios. Vehicle replacement rates, based on the estimated useful life and replacement cost of each vehicle, are assessed monthly to each user department. The radio replacement reserve was funded previously via the year-end transfer from the General Fund; however, future funding will come from radio replacement rates which will be assessed in the year after a radio is replaced.

### **Information Technology Fund**

The Information Technology Fund is the second internal service fund. There are two reserves within this fund. The Personal Computer (PC) replacement reserve in this fund is for the replacement of personal computers. PC replacement rates, based on the estimated useful life and replacement cost of each type of PC, are assessed monthly to each user department. The Technology Major Systems Replacement Reserve was initiated by Council in July 2003 by reallocating a portion of the General Capital Contingency. The reserve will be used to fund projected major system replacements that cannot be covered through the current CIP funding allocations. An initial amount of \$1 million was reallocated from the General Capital Contingency to start the reserve which will be funded in future years by replacement charges to department users.

### **Facilities Maintenance Fund**

The Facilities Maintenance Fund accounts for the costs of maintaining and repairing City buildings. The fund operates much like an internal service fund whereby revenue to the fund is derived primarily from user charges to other funds. Two types of reserves are budgeted in this fund – an operating reserve and a sinking fund reserve. The operating reserve is set at \$550,000 (\$50,000 for each of the City's eleven facilities), and is used to pay for major, unanticipated repairs. It is replenished, if necessary, from the General Fund year-end transfer.

The sinking fund reserve is used to pay for each City facility's twenty-year life cycle costs related to the repair or replacement of major architectural, mechanical, and electrical components. A facilities sinking fund charge is assessed to each operating fund and is in addition to the annual facilities rental charge, which covers the basic annual maintenance costs for each facility. In 2001, a 20-year facilities life cycle analysis was completed to determine what the annual sinking fund charges should be for each facility. A significant gap was identified, which the Council decided to bridge over five years from 2002 through 2006 by implementing an "additional sinking fund charge" in 20% increments, supplemented by the General Fund year-end transfer. To facilitate the phased implementation of the sinking fund charges, the sinking fund reserve received a transfer from the General Operating Reserve in an amount equivalent to the amount that should have been transferred at the end of 2002 and 2003. The full implementation of the additional sinking fund charge will be completed in 2007.

### Street Improvement Fund

The Street Improvement Fund is dedicated to funding transportation CIP projects. Included in this fund is the restricted portion of the gas tax which is a legally dedicated revenue source for transportation capital projects. In addition, a portion of the sales tax received by the City is dedicated by Council policy to such projects. The reserve is built from revenue collected in excess of the annual amount dedicated to the CIP and from interest revenue.

### USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION
<b>2005 Council Authorized Uses</b>		
Contingency Fund	\$20,000	Funding for a sidewalk bond support survey.
	\$6,000	Additional funding for the sidewalk bond support survey.
	\$10,000	Funding for an architectural and structural assessment of the Kirkland Cannery Building.
	\$30,293	Funding for a pension payout related to the municipal court.
General Capital Contingency	\$60,000	Funding for undergrounding utilities on Central Way.
	\$350,000	Additional funding for the final settlement payment for the Slater Avenue Roadway Improvements project.
	\$640,000	Additional funding for Central Way Corridor improvements to cover higher than anticipated costs.
	\$60,000	Additional funding for Phase II of the Maintenance Center Space Improvements project.
Council Special Projects Reserve	\$17,000	Funding for equipment for the Park Smart program.
	\$22,000	Funding for the Family Net program.
	\$7,200	Funding for off-leash enforcement in City parks.
	\$50,000	Funding for an art planning consultant related to the Totem Lake Mall development.
Street Improvement Reserve	\$24,000	Additional funding for the Kirkland Avenue Sidewalk project due to unexpected utility conflicts and the addition of storm drain improvements.
	\$513,536	Additional funding for the Slater Avenue Roadway Improvements project.
Water/Sewer Operating Reserve	\$13,426	Additional funding for the purchase of a pipeline video truck.

<b>RESERVE</b>	<b>AMOUNT</b>	<b>DESCRIPTION</b>
<b>2005 Council Authorized Uses (continued)</b>		
Water/Sewer Capital Contingency	\$116,000	Additional funding for the 18 <sup>th</sup> Avenue Watermain Replacement project for additional engineering costs, higher railroad right-of-way expenses, and elevated construction costs.
	\$111,500	Additional funding for 2005 Water System Improvement projects due to increased construction materials costs.
	\$20,000	Additional funding for 2004 Surface Water Streambank Stabilization/Watermain Replacement project due to cost increases and overruns.
Water/Sewer Construction Reserve	\$350,000	Funding for the encasement of a sewer line along the I-405 corridor due to the State's highway widening improvements project.
	\$400,000	Additional funding for the 2005 Emergency Sewer Program to address additional septic system failures.
Surface Water Capital Contingency	\$44,000	Additional funding for the NE 47 <sup>th</sup> Street Surface Water Outfall project due to a change in the project scope.
Surface Water Construction Reserve	\$10,000	Additional funding for the Surface Water Sediment Pond Reclamation project due to unanticipated pipe replacement.
	\$50,000	Grant match funding for the Juanita Creek Channel Enhancements project at Juanita Beach Park.
<b>2005 Council Authorized Additions</b>		
General Capital Contingency	\$2,444	2002 and 2004 Accessibility Improvement projects completed and closed; lower than anticipated construction costs resulted in savings.
Street Improvement Reserve	\$16,836	Market/State Streets Bike Lanes project completed and closed; lower than anticipated construction costs resulted in savings.
	\$15,731	Norkirk Neighborhood Traffic Control project completed and closed; lower than anticipated construction costs resulted in savings.
	\$37,244	2003 Street Preservation Program project completed and closed; lower than anticipated construction costs resulted in savings.
	\$77,954	128 <sup>th</sup> Lane NE/BNSF Railroad Crossing project closed, but not completed. Project will be undertaken at a later date and funded through other means.
	\$5,297	2002 Street Preservation Program completed and closed; additional private funding received resulted in savings.

<b>RESERVE</b>	<b>AMOUNT</b>	<b>DESCRIPTION</b>
<b>2005 Council Authorized Additions (continued)</b>		
Street Improvement Reserve (continued)	\$110,496	School Walk Route Improvements (Phase I) completed and closed; lower than anticipated construction costs resulted in savings.
Excise Tax REET 2 Reserve	\$60,000	NE 132 <sup>nd</sup> Street/124 <sup>th</sup> Ave NE Intersection Improvements project completed and closed; coordination with private development allowed for lower than anticipated construction costs.
	\$251,528	NE 95 <sup>th</sup> Street Sidewalk project completed and closed; lower than anticipated construction costs resulted in savings.
	\$6,518	8 <sup>th</sup> Street S/9 <sup>th</sup> Ave S Sidewalk project completed and closed; lower than anticipated construction costs resulted in savings.
	\$2,687	NE 68 <sup>th</sup> Street/State Street Intersection Improvements project completed and closed; additional federal funding resulted in savings.
	\$4,046	NE 124 <sup>th</sup> St/100 <sup>th</sup> Ave NE Intersection Improvements project completed and closed; additional federal funding and lower than anticipated construction costs resulted in savings.
Water/Sewer Construction Reserve	\$4,128	7 <sup>th</sup> Avenue Watermain Replacement project completed and closed; lower than anticipated construction costs resulted in savings.
	\$9,036	2 <sup>nd</sup> Street Watermain Replacement project completed and closed; lower than anticipated construction costs resulted in savings.
	\$11,074	5 <sup>th</sup> Avenue West Watermain Replacement project completed and closed; lower than anticipated construction costs resulted in savings.
Surface Water Construction Reserve	\$9,345	Juanita Creek Culvert Replacement project completed and closed; additional government aid resulted in savings.

# General Government & Utility Reserves Summary

Reserves	2005-06 Est End Balance	2005 Auth. Uses	2005 Auth. Additions	Revised 2005-06 End Balance*	2005-06 Target	Over (Under) Target
<b>GENERAL PURPOSE RESERVES</b>						
Contingency	2,115,677	66,293		2,049,384	2,952,182	(902,798)
General Capital Contingency	2,979,056	1,110,000	2,444	1,871,500	5,900,568	(4,029,068)
Park & Municipal Reserve:						
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836	2,676,890	35,946
Revenue Stabilization Reserve	1,493,480			1,493,480	2,082,380	(588,900)
Building & Property Reserve	1,817,461			1,817,461	N/A	N/A
Council Special Projects Reserve	254,760	96,200		158,560	250,000	(91,440)
<b>Total General Purpose Reserves</b>	<b>11,373,270</b>	<b>1,272,493</b>	<b>2,444</b>	<b>10,103,221</b>	<b>13,862,020</b>	<b>(5,576,260)</b>
<b>SPECIAL PURPOSE RESERVES</b>						
Excise Tax Capital Improvement:						
REET 1	3,990,296			3,990,296	1,435,000	2,555,296
REET 2	2,033,112		324,779	2,357,891	6,033,700	(3,675,809)
Equipment Rental:						
Vehicle Reserve	6,187,826			6,187,826	6,187,826	0
Radio Reserve	36,000			36,000	N/A	N/A
Information Technology:						
PC Replacement Reserve	429,835			429,835	429,835	0
Major Systems Replacement Reserve	1,000,000			1,000,000	1,025,000	(25,000)
Facilities Maintenance:						
Operating Reserve	550,000			550,000	550,000	0
Facilities Sinking Fund	925,240			925,240	925,240	0
Impact Fees						
Roads					N/A	N/A
Parks					N/A	N/A
Park Bond Reserve					N/A	N/A
Cemetery Improvement	411,462			411,462	N/A	N/A
Off-Street Parking	69,564			69,564	N/A	N/A
Tour Dock	155,578			155,578	130,000	25,578
Street Improvement	1,901,759	537,536	263,558	1,627,781	N/A	N/A
Firefighter's Pension	1,117,566			1,117,566	1,052,000	65,566
Park & Municipal Reserve:						
Litigation Reserve	60,450			60,450	50,000	10,450
Police Equipment Reserve	43,883			43,883	N/A	N/A
LEOFF 1 Police Reserve	621,650			621,650	863,000	(241,350)
Public Safety Building Reserve	1,205,100			1,205,100	N/A	N/A
Fire Engine (Forbes Creek F.S.)	350,000			350,000	350,000	0
Labor Relations Reserve	199,700			199,700	N/A	N/A
Donation Accounts	113,207			113,207	N/A	N/A
Revolving Accounts	115,168			115,168	N/A	N/A
Water/Sewer Operating Reserve	1,436,674	13,426		1,423,248	1,436,674	(13,426)
Water/Sewer Debt Service Reserve	845,962			845,962	845,962	0
Water/Sewer Capital Contingency	1,766,520	247,500		1,519,020	1,766,520	(247,500)
Water/Sewer Construction Reserve	4,599,401	750,000	24,238	3,873,639	N/A	N/A
Surface Water Operating Reserve	252,187			252,187	252,187	0
Surface Water Capital Contingency	569,490	44,000		525,490	569,490	(44,000)
Surface Water Construction Reserve	1,008,603	60,000	9,345	957,948	N/A	N/A
<b>Total Special Purpose Reserves</b>	<b>31,996,233</b>	<b>1,652,462</b>	<b>621,920</b>	<b>30,965,691</b>	<b>23,902,434</b>	<b>(1,590,195)</b>