

CITY OF KIRKLAND
FINANCIAL MANAGEMENT REPORT

AS OF APRIL 30, 2006**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 30th, September 30th, and December 31st). 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,

Gwen Chapman
Interim Director of Finance & Administration

Sandi Miller
Financial Planning Manager

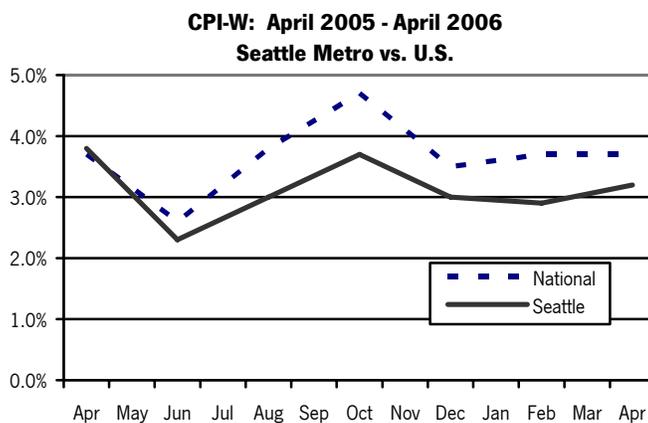
At a glance:

ECONOMIC ENVIRONMENT UPDATE

The Puget Sound region experienced strong economic growth in 2005, which has continued in 2006. The Seattle-Tacoma metropolitan area added almost 65,000 jobs since January 2005 and the unemployment rate in King County dropped to 3.8 percent as of April 2006, the lowest rate in six years. The revenue forecast report 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.¹ Two local economic confidence indexes reflect this solid economic performance. 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 the previous December.² Another local economic index conducted by the Western Washington chapter of the National Association of Purchasing Managers jumped 4.6 points in April to 70.4 from the previous month, faring much better than the national index, which was 57.3 in April.³ (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.) However, the positive news is tempered by concerns with consumers' response to rising oil prices, increasing inflation, and the uncertainties of the continued military involvement in Iraq.

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 April 2005 through April 2006 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 was considerably lower than the national average for much of 2005, but the gap is starting to narrow in 2006.



Month	U.S.	Seattle Metro
April 2005	3.7%	3.8%
Jun 2005	2.6%	2.3%
Aug 2005	3.8%	3.0%
Oct 2005	4.7%	3.7%
Dec 2005	3.5%	3.0%
Feb 2006	3.7%	2.9%
Apr 2006	3.7%	3.2%

Source: Bureau of Labor Statistics

¹ Washington Economic and Revenue Forecast Council, February 2006

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

³ *Purchasing index keeps rising*, Puget Sound Business Journal, May 4, 2006

All of the City's labor contracts are tied to the CPI-W for the Seattle metropolitan area. As of April 2006, two contracts are in negotiation. For the closed contracts, "cost of living allowances" (or COLAs) were 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 CPI-W (Seattle) of 2.3 percent and a first half 2005 CPI-W (Seattle) of 2.9 percent, the 2006 COLA for closed contracts ranges from 2.08 percent to 2.58 percent depending on the bargaining unit.

Unemployment rates for King County, Washington State, and the U.S. from April 2005 through April 2006 are noted in the table below:

Month	King County	Washington	U.S.
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%
2005 Average	4.7%	5.5%	5.1%
January 2006	4.2%	5.3%	5.1%
February 2006	4.5%	5.6%	5.1%
March 2006	4.2%	5.0%	4.8%
April 2006	3.8%	4.7%	4.5%

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. The rate has declined significantly both locally and nationally and the gap has also narrowed over the last three years, with the Washington State rate of 4.7 percent as of April 2006 compared to the national rate of 4.5 percent. Employment levels in King County have also improved considerably; the rate in April 2006 is the lowest since April 2000. The Puget Sound region has added approximately 65,000 jobs since January 2005.¹

Eastside **office vacancy rates** remain low at 9.75 percent as of the end of the first quarter of 2006 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. More than 1.8 million square feet of office space is presently under construction, primarily in downtown Bellevue and downtown Seattle. The Kirkland market has improved significantly, with vacancy rates down to 5.96 percent as of the first quarter of 2006 compared to 10.33 percent for the same period last year. According to local analysts Conway & Pedersen, the local economy is expected to outpace national growth for at least the next two years and the office market is responding accordingly.²

¹ Washington State Department of Employment Security Labor Market Information

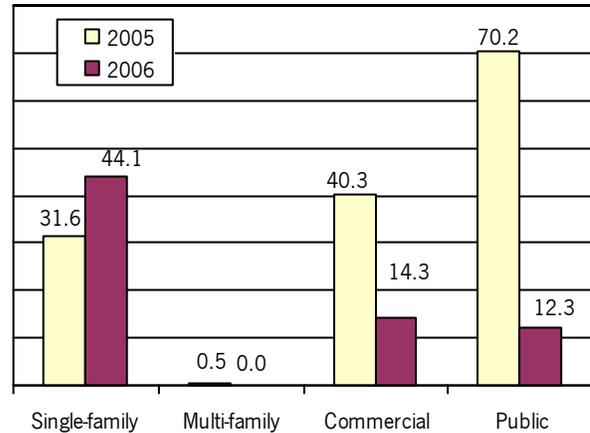
² CB Richard Ellis Real Estate Services, Market View Puget Sound Office, First Quarter 2006

According to the Northwest Multiple Listing Services, the median **residential housing price** for closed sales of homes and condominiums on the Eastside rose to a record \$478,500 in April, up more than 20 percent compared to April 2005. The number of closed sales for the Eastside as of April dipped 12 percent compared to the same period last year. However, inventory available has also declined while demand has not. As a result, local experts expect the strong housing market to continue through 2006.¹

Development activity through April 2005 and 2006, 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. While revenue through April 2006 is down compared to 2005, this reflects the record-breaking performance of development-related activity in 2005, rather than weakness in 2006.

Building permit-related revenue through April 2006 is down 26.6 percent and **other development-related fees** are down 4.2 percent compared to the same period in 2005. Even still, 2006 revenue is almost 20 percent higher than collected in 2004 (171 percent higher than collected in 2002). Single-family activity has remained especially strong. Public activity is down dramatically in 2006 reflecting the major construction projects at Evergreen Hospital that were permitted in 2005. Commercial activity has also slowed compared to 2005, but remains relatively strong. There has been no significant multi-family activity so far in 2006.

**Valuation of Building Permits
YTD Through April 2005 and 2006
(\$ Million)**



The upward trend in **sales tax** revenue that started in 2003 continues in 2006, which is up 17.1 percent compared to the same period in 2005. Most of this gain relates to strong performance in construction-related areas. A more detailed analysis of sales tax revenue is included later in this report.

Lodging tax revenue through April 2006 is down 8.9 percent compared to the same period in 2005, partially due to major renovations at one of the major hotels. Two new hotels are under construction, which should improve lodging tax revenue significantly in the future. The 150-room Marriott in Totem Lake is set to open in August of this year and the 91-room Heathman Kirkland in downtown is expected to open in the spring of 2007.

¹ Clayton Park, *Local home prices again set record*, King County Journal, May 6, 2006

BUDGET TO ACTUAL COMPARISON

As of April 30, 2006

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

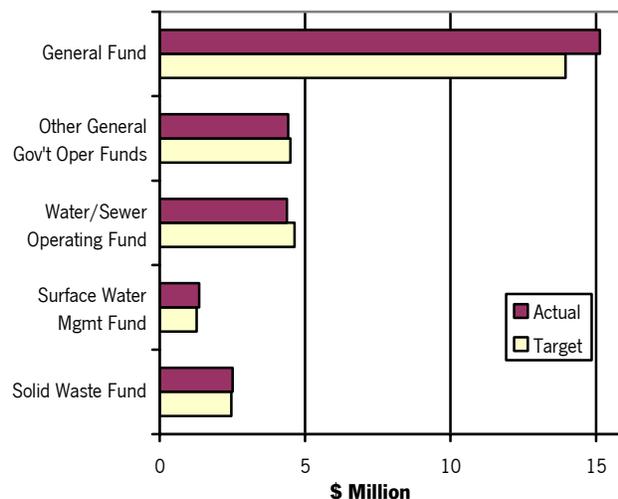
Resource Category	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
General Gov't Operating:					
General Fund	46,510,396	15,139,374	(31,371,022)	32.6%	30.0%
Other General Gov't Operating Funds	14,991,363	4,412,862	(10,578,501)	29.4%	30.0%
Total General Gov't Operating	61,501,759	19,552,236	(41,949,523)	31.8%	30.0%
Utilities:					
Water/Sewer Operating Fund	15,473,000	4,373,223	(11,099,777)	28.3%	30.0%
Surface Water Management Fund	5,086,035	1,356,951	(3,729,084)	26.7%	25.0%
Solid Waste Fund	7,449,930	2,500,553	(4,949,377)	33.6%	33.0%
Total Utilities	28,008,965	8,230,727	(19,778,238)	29.4%	30.0%
Total All Operating Funds	89,510,724	27,782,963	(61,727,761)	31.0%	30.0%

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

Comparing actual to budgeted revenues, each operating fund or fund type is slightly ahead of its respective revenue target, except for the Other General Government Operating Funds and Water/Sewer Operating Fund (see chart on the right):

- The **General Fund** is 2.6 percent ahead of target, primarily due to strong sales tax and development-related fee growth.
- The **Other General Government Operating Funds** are 29.4 percent of budget, which is barely behind their collective target of 30 percent.

TOTAL REVENUES BY OPERATING FUND TYPE OR FUND
Actual to Target as of 4/30/2006
Summary of All Operating Funds



- The **Water/Sewer Operating Fund** is 28.3 percent of budget, which is behind its target of 30 percent, due to lower than normal water sales.
- The **Surface Water Management Fund** is 26.7 percent of budget, which is ahead of its target of 25 percent primarily due to timing of property tax collections.
- The **Solid Waste Fund** is 33.6 percent of budget, which is slightly ahead of its target of 33 percent due to collection revenue.

Expenditures & Other Uses : Summary

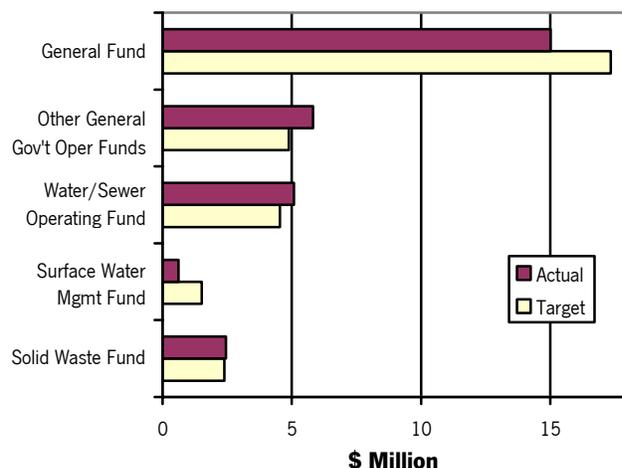
Expenditure Category	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
General Gov't Operating:					
General Fund	52,534,301	15,010,616	37,523,685	28.6%	33.0%
Other General Gov't Operating Funds	14,998,031	5,819,816	9,178,215	38.8%	33.0%
Total General Gov't Operating	67,532,332	20,830,432	46,701,900	30.8%	32.0%
Utilities:					
Water/Sewer Operating Fund	15,234,369	5,085,584	10,148,785	33.4%	33.0%
Surface Water Management Fund	5,116,738	611,333	4,505,405	11.9%	12.0%
Solid Waste Fund	7,251,514	2,451,469	4,800,045	33.8%	33.0%
Total Utilities	27,602,621	8,148,386	19,454,235	29.5%	30.0%
Total All Operating Funds	95,134,953	28,978,818	66,156,135	30.5%	32.0%

* 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 is slightly below its respective expenditure target except for the Other General Government Operating Funds, Water/Sewer Operating Fund, and Solid Waste Fund (see chart on the right):

- The **General Fund** is 28.6 percent of budget, which is under its target of 33 percent, primarily due to the timing of budgeted transfers to replenish capital reserves and establishing the development services reserve, as well as position vacancies.
- The **Other General Government Operating Funds** are 38.8 percent of budget, which is significantly over their collective target of 33 percent, primarily due to the timing of major vehicle purchases in the Equipment Rental Fund and computer purchases in the Information

TOTAL EXPENDITURES BY OPERATING FUND TYPE OR FUND
Actual to Target as of 4/30/2006
Summary of All Operating Funds



Technology Fund.

- The **Water/Sewer Operating Fund** is 33.4 percent of budget, which is right at its target of 33 percent.
- The **Surface Water Fund** is 11.9 percent of budget, which is right at its target of 12 percent.
- The **Solid Waste Fund** is 33.8 percent of budget, which is right at its target of 33 percent.

GENERAL FUND

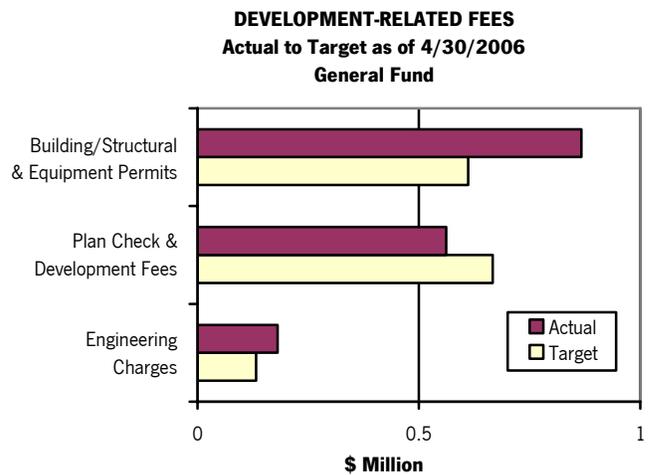
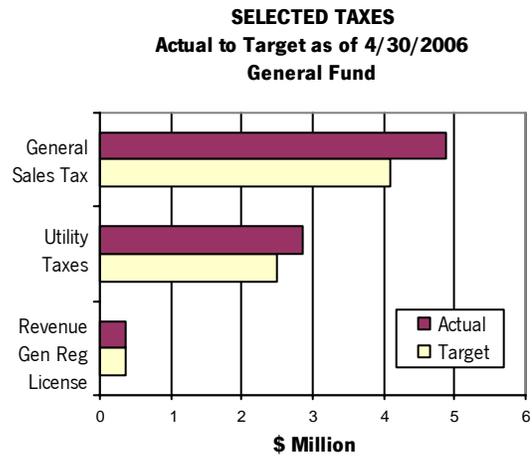
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development. About 355 of the City's 447 employees are budgeted within this fund.

Resources: General Fund

Resource Category	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
Taxes:					
Retail Sales Tax: General	12,392,069	4,868,387	(7,523,682)	39.3%	33.0%
Retail Sales Tax: Criminal Justice	890,000	330,515	(559,485)	37.1%	33.0%
Property Tax	8,117,113	2,127,444	(5,989,669)	26.2%	25.0%
Utility Taxes	7,171,200	2,868,004	(4,303,196)	40.0%	35.0%
Rev Generating Regulatory License	900,000	357,466	(542,534)	39.7%	40.0%
Other Taxes	464,800	172,294	(292,506)	37.1%	33.0%
Total Taxes	29,935,182	10,724,110	(19,211,072)	35.8%	33.0%
Licenses & Permits:					
Building, Structural & Equipment Permits	1,850,742	867,076	(983,666)	46.9%	33.0%
Business Licenses/Franchise Fees	1,184,775	570,054	(614,721)	48.1%	40.0%
Other Licenses & Permits	128,020	44,803	(83,217)	35.0%	33.0%
Total Licenses & Permits	3,163,537	1,481,933	(1,681,604)	46.8%	33.0%
Intergovernmental:					
Grants	88,693	41,868	(46,825)	47.2%	N/A
State Shared Revenues & Entitlements	581,780	194,239	(387,541)	33.4%	40.0%
Fire District #41	3,141,052	0	(3,141,052)	0.0%	0.0%
EMS	489,685	0	(489,685)	0.0%	0.0%
Other Intergovernmental Services	438,539	331,987	(106,552)	75.7%	N/A
Total Intergovernmental	4,739,749	568,094	(4,171,655)	12.0%	15.0%
Charges for Services:					
Internal Charges	3,531,586	1,098,759	(2,432,827)	31.1%	30.0%
Engineering Services	400,000	180,871	(219,129)	45.2%	33.0%
Plan Check & Development Fees	2,021,836	562,316	(1,459,520)	27.8%	33.0%
Recreation	74,000	12,150	(61,850)	16.4%	20.0%
Other Charges for Services	599,898	145,200	(454,698)	24.2%	25.0%
Total Charges for Services	6,627,320	1,999,296	(4,628,024)	30.2%	30.0%
Fines & Forfeits	1,157,550	267,908	(889,642)	23.1%	25.0%
Miscellaneous	585,814	98,033	(487,781)	16.7%	N/A
Total Revenues	46,209,152	15,139,374	(31,069,778)	32.8%	30.0%
Other Financing Sources:					
Interfund Transfers	301,244	0	(301,244)	0.0%	N/A
Total Other Financing Sources	301,244	0	(301,244)	0.0%	N/A
Total Resources	46,510,396	15,139,374	(31,371,022)	32.6%	N/A

Comparing actual to budgeted revenues, the General Fund is 32.8 percent of budget, which is ahead of its overall revenue target of 30 percent. Looking at specific revenues, the following are particularly noteworthy:

- **Sales tax** revenue is 39.3 percent of budget, which is leading its target of 33 percent, illustrating a strong performance in sales tax receipts so far this year, primarily in construction-related receipts (see “Selected Taxes” chart on the right). A more detailed analysis of general sales tax revenue follows in the Sales Tax Revenue Analysis report.
- **Utility Taxes** are 40.0 percent of budget, which is ahead of its target of 35 percent. This is primarily due to natural gas and electricity as result of higher rates and weather conditions.
- **Franchise fees** are 48.1 percent of budget, which is significantly ahead of their target of 40 percent, primarily due to higher than expected cable franchise revenues.
- **Development-related fees** performance remains strong early in the year (see “Development-Related Fees” chart on the right). **Building, structural and equipment permit fees** are 46.9 percent of budget and **engineering development fees** are 45.2 percent of budget compared to targets of 33 percent each due to the high level of building activity in single-family residential and commercial projects, as previously mentioned in the Economic Environment section. **Plan check and development fees** are 27.8 percent of budget, which is behind their target of 33 percent, mostly due to the timing of planning fees received. It is important to note that the increase in revenue over budget is already committed in future years to fund temporary development positions that were made permanent FTE’s in the mid-biennial budget process.



- **Other Intergovernmental Services** revenue is 75.7 percent of budget due to the timing of FEMA reimbursement for firefighters who worked during the Hurricane Katrina relief efforts in 2005.

Expenditures: General Fund

Department	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
Non-Departmental	2,001,306	262,492	1,738,814	13.1%	N/A
City Council	311,733	155,825	155,908	50.0%	55.0%
City Manager's Office	2,434,671	825,200	1,609,471	33.9%	33.0%
Human Resources	855,969	284,105	571,864	33.2%	33.0%
City Attorney's Office	903,406	278,382	625,024	30.8%	33.0%
Parks & Community Services	5,074,316	1,395,434	3,678,882	27.5%	30.0%
Public Works (Engineering)	2,943,151	949,813	1,993,338	32.3%	33.0%
Finance and Administration	2,960,324	927,787	2,032,537	31.3%	33.0%
Planning & Community Development	3,050,810	963,069	2,087,741	31.6%	33.0%
Police	13,000,127	4,031,011	8,969,116	31.0%	33.0%
Fire & Building	14,457,437	4,771,336	9,686,101	33.0%	33.0%
Total Expenditures	47,993,250	14,844,454	33,148,796	30.9%	33.0%
Other Financing Uses:					
Interfund Transfers	3,323,660	166,162	3,157,498	5.0%	N/A
Total Other Financing Uses	4,541,051	166,162	4,374,889	3.7%	N/A
Total Expenditures & Other Uses	52,534,301	15,010,616	37,523,685	28.6%	33.0%

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

Total actual expenditures for the General Fund are 30.9 percent of budget compared to a target of 33 percent. Most General Fund departments are relatively close to their respective targets. Of note are the following departments:

- The **Non-Departmental Division** is 13.1 percent of budget. Although this division does not have a target to measure against, it is noteworthy to explain the seemingly large variance between budget and year-to-date actuals. The Non-Departmental Division includes Cost of Living Adjustment (COLA) reserves for unsettled bargaining unit contracts. As of April 2006, the AFSCME and Teamsters contracts were unsettled. Once the contracts are settled, the COLA reserve will be distributed to the appropriate departmental budgets.
- The **City Attorney's Office** is 30.8 percent of budget, which is under its target of 33 percent, due to the timing of outside legal counsel expenses.
- The **Parks & Community Services Department** is 27.5 percent of budget, which is under its target of 30 percent, primarily due to the timing of human service contract payments.
- The **Finance & Administration Department** is 31.3 percent of budget, which is under its target of 33 percent, primarily due to a position vacancy.
- The **Planning & Community Development Department** is 31.6 percent of budget, which is under its target of 33 percent, primarily due to the timing of payments to the regional housing coalition (ARCH).
- The **Police Department** is 31.3 percent of budget, which is under its target of 33 percent, primarily due to the timing of hiring the new pro-active unit.

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 56 of the City's 447 employees are budgeted within this group of funds.

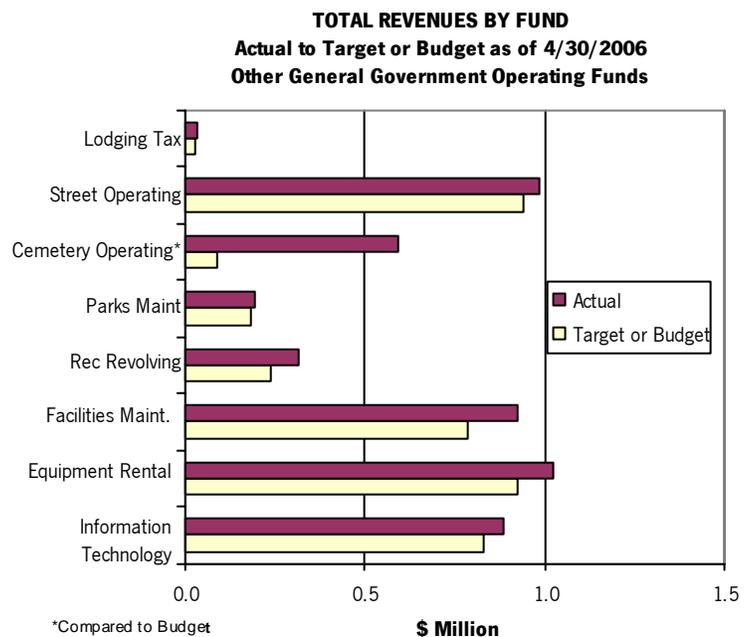
Resources: Other General Government Operating Funds

Fund	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
Lodging Tax	110,000	31,740	78,260	28.9%	25.0%
Street Operating	3,483,047	985,887	2,497,160	28.3%	27.0%
Cemetery Operating	90,000	30,663	59,337	34.1%	N/A
Parks Maintenance	737,667	195,852	541,815	26.6%	25.0%
Recreation Revolving	799,775	316,956	482,819	39.6%	30.0%
Facilities Maintenance	3,142,891	925,279	2,217,612	29.4%	25.0%
Equipment Rental	2,798,672	1,024,566	1,774,106	36.6%	33.0%
Information Technology	2,779,137	886,919	1,892,218	31.9%	30.0%
Total Revenues	13,941,189	4,397,862	9,543,327	31.5%	30.0%
Other Financing Sources:					
Interfund Transfers	1,050,174	15,000	(1,035,174)	1.4%	N/A
Total Other Financing Sources	1,050,174	15,000	12,723,057	1.4%	N/A
Total Resources	14,991,363	4,412,862	22,266,384	29.4%	N/A

* Budgeted and actual revenues exclude resources forward.

Across all Other General Government Operating Funds, total actual revenues are 31.5 percent of budget, which is just above its collective target of 30 percent. In reviewing revenue trends, the following items are worth noting (see chart on the right):

- The **Lodging Tax Fund** is 28.9 percent of budget, which is ahead of its target of 25 percent, due to conservative revenue budgeting.
- The **Recreation Revolving Fund** is 39.6 percent of budget, which is ahead of its target of 30 percent, due to higher than expected class registrations.



- The **Facilities Maintenance Fund** is 29.4 percent of budget, which is ahead of its target of 25 percent, due to higher than expected cable utility tax revenue.
- The **Equipment Rental Fund** is 36.6 percent of budget, which is ahead of its target of 33 percent, due to higher than expected sales of fixed assets and insurance recoveries.

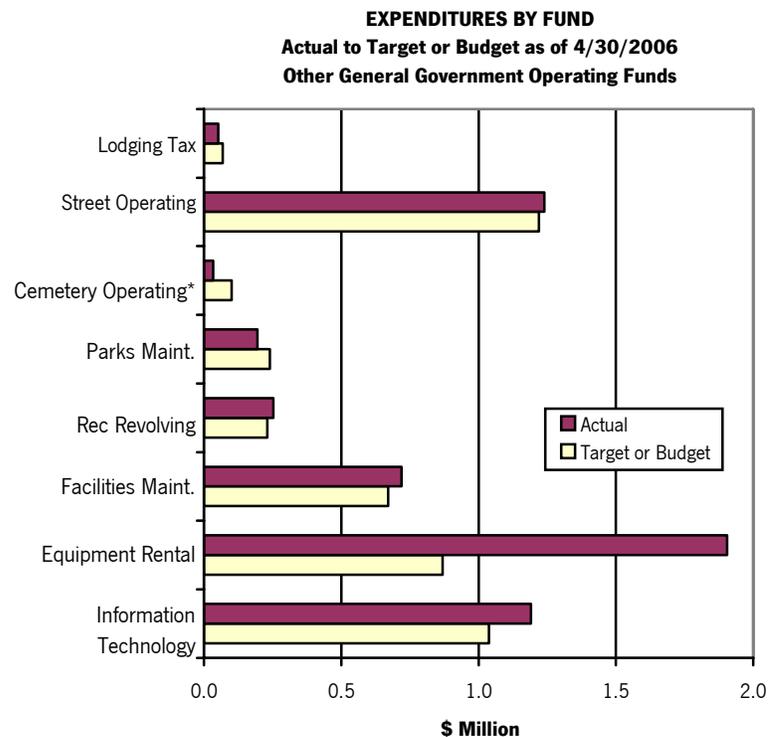
Expenditures: Other General Government Operating Funds

Fund	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
Lodging Tax	205,743	52,309	153,434	25.4%	33.0%
Street Operating	3,699,702	1,239,727	2,459,975	33.5%	33.0%
Cemetery Operating	101,072	34,006	67,066	33.6%	N/A
Parks Maintenance	802,009	194,396	607,613	24.2%	30.0%
Recreation Revolving	925,938	253,233	672,705	27.3%	25.0%
Facilities Maintenance	2,034,942	719,032	1,315,910	35.3%	33.0%
Equipment Rental	2,631,735	1,905,109	726,626	72.4%	33.0%
Information Technology	3,462,510	1,190,267	2,272,243	34.4%	30.0%
Total Expenditures	13,863,651	5,588,079	8,275,572	40.3%	33.0%
Other Financing Uses:					
Interfund Transfers	1,134,380	231,737	902,643	20.4%	N/A
Total Other Financing Uses	1,134,380	231,737	902,643	20.4%	N/A
Total Expenditures & Other Uses	14,998,031	5,819,816	9,178,215	38.8%	33.0%

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

Comparing actual to budgeted expenditures, the General Government Operating Funds as a whole are 40.3 percent of budget, which is noticeably above their overall expenditure target of 33 percent, primarily due to the timing of vehicle purchases in the Equipment Rental Fund and computers in the Information Technology Fund. Relative to their respective targets, the expenditure performance of the following funds stands out (see chart on the right):

- The **Lodging Tax Fund** is 25.4 percent of budget, which is significantly under its target of 33 percent, due to uncompleted tourism projects.



*Compared to budget

- The **Parks Maintenance Fund** is 24.2 percent of budget, which is significantly under its target of 30 percent, due to lower than expected costs in maintenance supplies, utility services and repairs and maintenance services.
- The **Facilities Maintenance Fund** is 35.3 percent of budget, ahead of its target of 33 percent, due to timing of projects and higher than expected utility costs.
- The **Equipment Rental Fund** is 72.4 percent of budget, which is significantly ahead of its target of 33 percent, due to the timing of vehicle purchases.
- The **Information Technology Fund** is 34.4 percent of budget, which is ahead of its target of 30 percent, primarily due to the timing of computer purchases.

WATER/SEWER OPERATING FUND

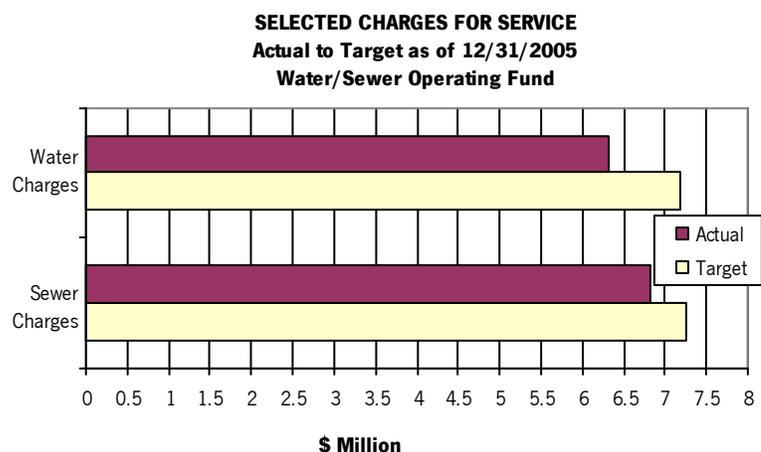
The Water/Sewer Operating Fund accounts for all administrative, operating, and maintenance costs of the City's Water/Sewer Utility. The infrastructure operated and maintained includes water and sewer mains, sewer lift stations, water reservoirs, pressure-reducing stations, and fire hydrants. Also included 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 447 employees are budgeted within this fund.

Resources: Water/Sewer Operating Fund

Resource Category	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
<i>Intergovernmental</i>	50,000	19,626	(30,374)	39.3%	N/A
<i>Charges for Services:</i>					
Water Charges	7,213,300	1,890,809	(5,322,491)	26.2%	30.0%
Sewer Charges	7,588,200	2,387,312	(5,200,888)	31.5%	33.0%
Other Charges for Services	55,000	32,847	(22,153)	59.7%	25.0%
Total Charges for Services	14,856,500	4,310,968	(10,545,532)	29.0%	30.0%
<i>Miscellaneous</i>	146,500	23,551	(122,949)	16.1%	10.0%
Total Revenues	15,053,000	4,354,145	(10,698,855)	28.9%	30.0%
<i>Other Financing Sources:</i>					
Interfund Transfers	420,000	19,078	(400,922)	4.5%	N/A
Total Other Financing Sources	420,000	19,078	(400,922)	4.5%	N/A
Total Resources	15,473,000	4,373,223	(11,099,777)	28.3%	N/A

* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Water/Sewer Operating Fund is 28.9 percent of budget, which is slightly below its target of 30 percent due to lower than expected water sales (see chart on the right).



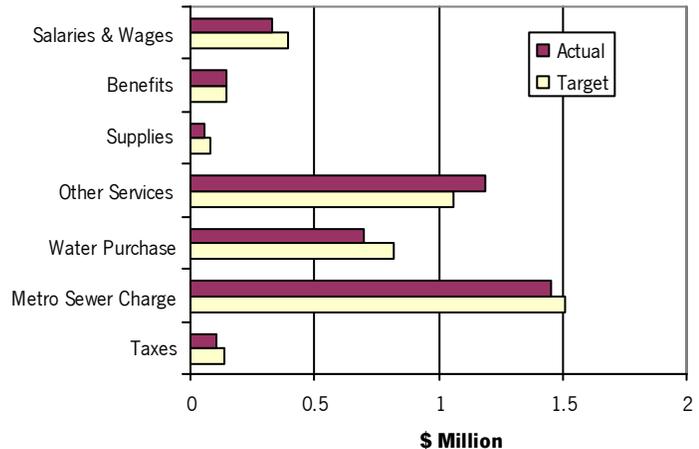
Expenditures: Water/Sewer Operating Fund

Expenditure Category	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
Salaries & Wages	1,190,355	331,287	859,068	27.8%	33.0%
Benefits	426,083	144,264	281,819	33.9%	33.0%
Supplies	235,030	52,816	182,214	22.5%	33.0%
Other Services	2,653,480	1,187,900	1,465,580	44.8%	40.0%
Water Purchase (CWA)	2,477,724	701,416	1,776,308	28.3%	33.0%
Metro Sewer Charge	4,570,959	1,450,447	3,120,512	31.7%	33.0%
Taxes	456,542	106,124	350,418	23.2%	30.0%
Capital Outlay	86,105	14,386	71,719	16.7%	N/A
Total Expenditures	12,096,278	3,988,640	8,107,638	33.0%	30.0%
Other Financing Uses:					
Interfund Transfers	3,138,091	1,096,944	2,041,147	35.0%	N/A
Total Other Financing Uses	3,138,091	1,096,944	2,041,147	35.0%	N/A
Total Expenditures & Other Uses	15,234,369	5,085,584	10,148,785	33.4%	N/A

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

Comparing actual to budgeted expenditures, the Water/Sewer Operating Fund is 33.0 percent of budget, which is over its target of 30 percent, primarily due to the timing of water purchase payments, connection charges paid to Cascade Water Alliance, and engineering charges (see chart on the right). The connection charge rate more than doubled as of January 2006, prompting many people to take advantage of the lower rate in 2005. The payment to Cascade Water Alliance in 2006 (included in “other services”) reflects the higher level of activity in the fourth quarter of 2005, resulting in higher than normal expense in 2006.

SELECTED EXPENDITURES BY CATEGORY
Actual to Target as of 4/30/2006
Water/Sewer Operating Fund



SURFACE WATER MANAGEMENT FUND

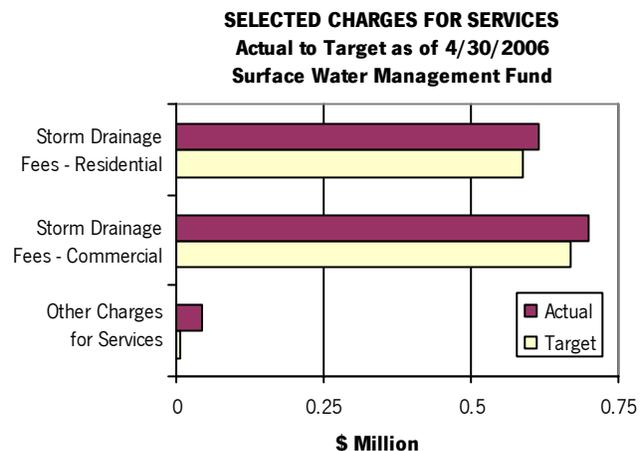
The Surface Water Management Fund accounts for all administrative, operating, and maintenance costs of the City's Surface Water Utility. The infrastructure operated and maintained includes storm drain mains, manholes, and catch basins. This utility serves all residential, multi-family, and commercial 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 15 of the City's 447 employees are budgeted within this fund.

Resources: Surface Water Management Fund

Resource Category	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
<i>Charges for Services:</i>					
Storm Drainage Fees - Residential	2,357,730	615,556	(1,742,174)	26.1%	25.0%
Storm Drainage Fees - Commercial	2,674,305	698,331	(1,975,974)	26.1%	25.0%
Other Charges for Services	21,000	42,311	21,311	201.5%	25.0%
Total Charges for Services	5,053,035	1,356,198	(3,696,837)	26.8%	25.0%
<i>Miscellaneous</i>	33,000	753	(32,247)	2.3%	N/A
Total Revenues	5,086,035	1,356,951	(3,729,084)	26.7%	25.0%
<i>Other Financing Sources:</i>					
Interfund Transfers	0	0	0	0.0%	N/A
Total Other Financing Sources	0	0	0	N/A	N/A
Total Resources	5,086,035	1,356,951	(3,729,084)	26.7%	N/A

* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Surface Water Management Fund is 26.7 percent of budget, which is ahead of its target of 25 percent, due to the timing of property tax collection and increased engineering charges for surface water capital improvement projects due to an understated budget (see chart on the right).



Expenditures: Surface Water Management Fund

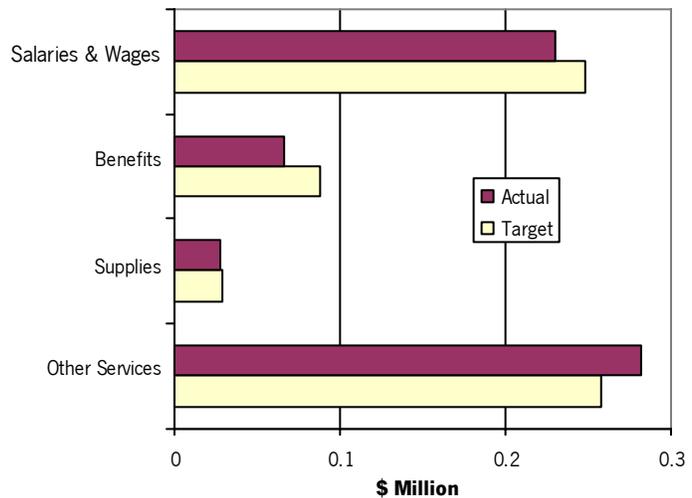
Expenditure Category	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
Salaries & Wages	829,224	230,053	599,171	27.7%	30.0%
Benefits	293,108	66,048	227,060	22.5%	30.0%
Supplies	95,025	27,618	67,407	29.1%	30.0%
Other Services	783,091	282,109	500,982	36.0%	33.0%
Intergovernmental Services & Taxes	109,000	2,512	106,488	2.3%	10.0%
Capital Outlays	23,310	2,993	20,317	12.8%	N/A
Total Expenditures	2,132,758	611,333	1,521,425	28.7%	30.0%
Other Financing Uses:					
Interfund Transfers	2,983,980	0	2,983,980	0.0%	0.0%
Total Other Financing Uses	2,983,980	0	2,983,980	0.0%	0.0%
Total Expenditures & Other Uses	5,116,738	611,333	4,505,405	11.9%	12.0%

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

Comparing actual to budgeted expenditures, the Surface Water Management Fund is 28.7 percent of budget, which is under its target of 30 percent, primarily due to position vacancies and benefit savings and despite the timing of engineering charges (see chart on 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 is lower than the city-wide average demographic.

The interfund transfers are used to fund capital improvement projects budgeted in the Surface Water CIP fund and are typically done in June and December.

SELECTED EXPENDITURES BY CATEGORY
Actual to Target as of 4/30/2006
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 447 employees, 1 employee is budgeted in this fund.

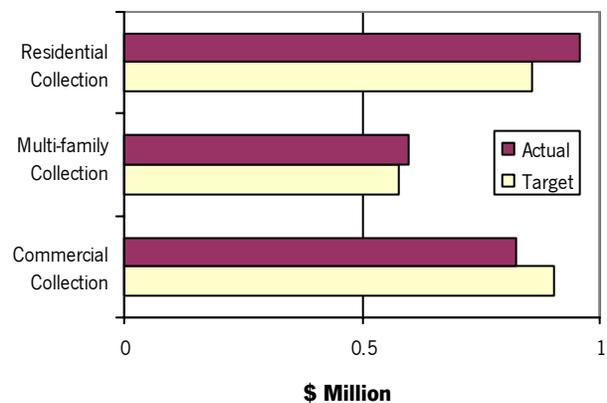
Resources: Solid Waste Fund

Resource Category	2006 Budgeted Revenues*	2006 Actual Revenues*	Amount Over/(Under) Budget	% of Budget	Target
<i>Intergovernmental</i>	112,000	36,380	(75,620)	32.5%	N/A
<i>Charges for Services:</i>					
Residential Collection	2,598,930	957,696	(1,641,234)	36.8%	33.0%
Multi-family Collection	1,744,500	597,488	(1,147,012)	34.2%	33.0%
Commercial Collection	2,735,500	825,336	(1,910,164)	30.2%	33.0%
Other Charges for Services	227,000	83,653	(143,347)	36.9%	35.0%
Total Charges for Services	7,305,930	2,464,173	(4,841,757)	33.7%	33.0%
<i>Miscellaneous</i>	32,000	0	(32,000)	N/A	N/A
Total Revenues	7,449,930	2,500,553	(4,949,377)	33.6%	33.0%
<i>Other Financing Sources:</i>					
Interfund Transfers	0	0	0	0.0%	N/A
Total Other Financing Sources	0	0	0	N/A	N/A
Total Resources	7,449,930	2,500,553	(4,949,377)	33.6%	N/A

* Budgeted and actual revenues exclude resources forward.

Comparing actual to budgeted revenues, the Solid Waste Fund is 33.6 percent of budget, which is right at its target of 33 percent (see chart to the right).

SELECTED CHARGES FOR SERVICES
Actual to Target as of 4/30/2006
Solid Waste Fund



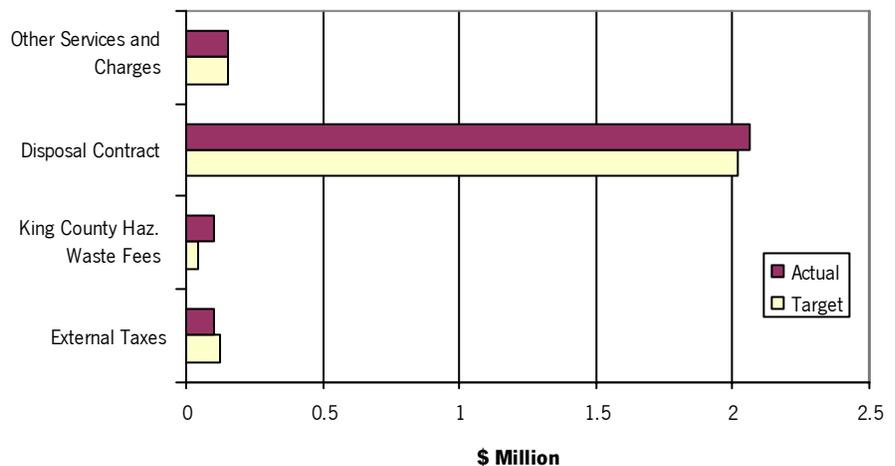
Expenditures: Solid Waste Fund

Expenditure Category	2006 Budgeted Expenditures*	2006 Actual Expenditures*	Amount (Over)/Under Budget	% of Budget	Target
Salaries & Wages	66,473	20,828	45,645	31.3%	33.0%
Benefits	20,090	6,890	13,200	34.3%	33.0%
Supplies	3,000	6,004	(3,004)	200.1%	N/A
Other Services and Charges	504,172	153,642	350,530	30.5%	30.0%
Disposal Contract	6,117,779	2,064,935	4,052,844	33.8%	33.0%
King County Hazardous Waste Fee	170,000	100,284	69,716	59.0%	25.0%
External Taxes	370,000	98,886	271,114	26.7%	33.0%
Total Expenditures	7,251,514	2,451,469	4,800,045	33.8%	33.0%
Other Financing Uses:					
Interfund Transfers	0	0	0	0.0%	N/A
Total Other Financing Uses	0	0	0	0.0%	N/A
Total Expenditures & Other Uses	7,251,514	2,451,469	4,800,045	33.8%	N/A

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

Comparing actual to budgeted expenditures, the Solid Waste Fund is 33.8 percent of budget, which is slightly ahead of its target of 33 percent, partially due to the timing of a rate increase for the King County Hazardous Waste Fee (see chart to the right).

SELECTED EXPENDITURES BY CATEGORY
Actual to Target as of 4/30/2006
Solid Waste Fund



SALES TAX REVENUE ANALYSIS

Through April 30, 2005 and 2006

BACKGROUND

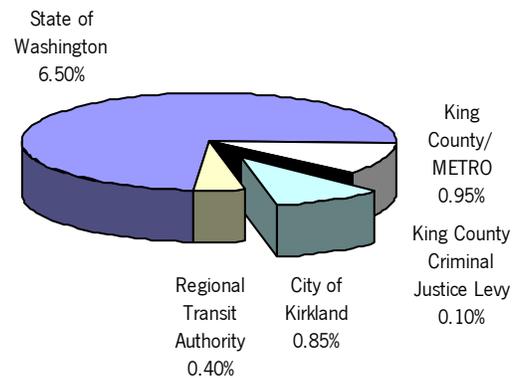
Sales tax is the single largest revenue source in the General Fund as well as the City's primary funding source for general government services. In addition, sales tax is a dedicated funding source for transportation capital projects (\$270,000), neighborhood capital projects (\$100,000), and technology 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 for collection administration costs). 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 April 30, 2006 and compares them to the same period in 2005. Year-to-date, monthly, business sector (according to categories established by NAICS or "North American Industry Classification System"), and business district (according to geographic area) comparisons follow.

Sales Tax Distribution (8.8%)

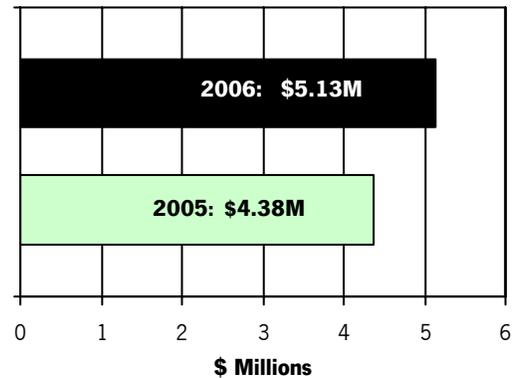


SUMMARY COMPARISON

The improving local economy and the opening significant new businesses over the last few years (e.g., two automobile dealerships and Costco Home) contributed to the positive sales tax performance that the City has enjoyed since 2003. However, construction-related revenue is almost completely responsible for the growth in 2005 and 2006. 2006 sales tax receipts are up 17.1 percent compared to 2005 as illustrated in the chart to the right. Assuming a more typical 5 percent growth in construction-related receipts would reduce the year-to-date increase over last year to 3.1 percent.

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

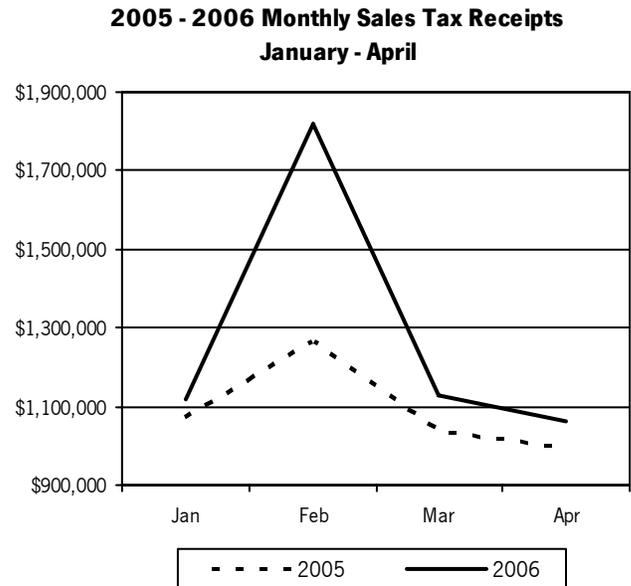
Sales Tax Receipts through April 2005 & 2006



example, sales tax received by the City in April 2006 is for sales actually made in February 2006. Monthly sales tax receipts through April 2005 and 2006 are compared in the following table and chart.

Month	Sales Tax Receipts		Percent Change
	2005	2006	
January	1,074,628	1,116,572	3.9%
February	1,265,274	1,821,021	43.9%
March	1,036,353	1,126,328	8.7%
April	998,836	1,061,134	6.2%
Total	4,375,091	5,125,055	17.1%

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 2006 mostly follows 2005 but at a higher level. The unusually large spike in February 2006 is due to construction-related receipts, including installation of technology equipment.

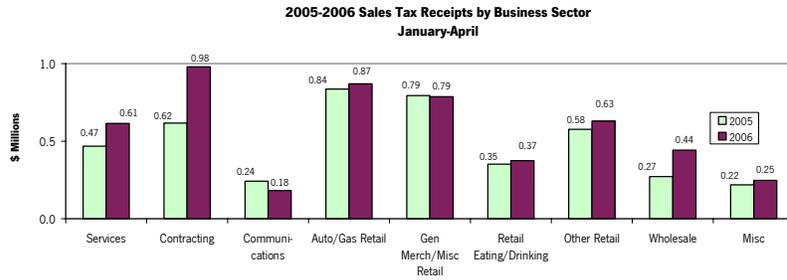


BUSINESS SECTOR COMPARISON

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). The following nine business sector groupings were used to compare 2005 and 2006 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-Apr		Dollar Change	Percent Change	Percent of Total	
	2005	2006			2005	2006
Services	467,908	614,242	146,334	31.3%	10.7%	12.0%
Contracting	616,945	980,162	363,217	58.9%	14.1%	19.1%
Communications	242,103	180,685	(61,418)	(25.4%)	5.5%	3.5%
Auto/Gas Retail	835,736	870,201	34,465	4.1%	19.1%	17.0%
Gen Merch/Misc Retail	793,224	786,380	(6,844)	(0.9%)	18.1%	15.3%
Retail Eating/Drinking	351,868	374,582	22,714	6.5%	8.0%	7.3%
Other Retail	576,645	629,063	52,418	9.1%	13.2%	12.3%
Wholesale	271,463	442,061	170,598	62.8%	6.2%	8.6%
Miscellaneous	219,199	247,679	28,480	13.0%	5.1%	4.9%
Total	4,375,091	5,125,055	749,964	17.1%	100.0%	100.0%

Most of the 17.1 percent increase in 2006 sales tax receipts can be traced to the following five business sectors comprising 69 percent of the City's total sales tax receipts:

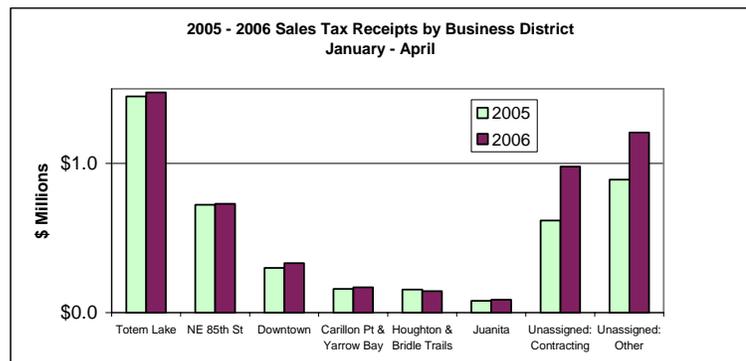


1. **Contracting**, which accounts for over 19 percent of the total sales tax receipts, **is up 58.9 percent** due to the continuing high level of construction activity in Kirkland. Contributing to this phenomenal growth are large commercial and public projects, such as Evergreen Hospital, two large condominium projects on Kirkland Avenue, two hotels, the new Lee Johnson Chevrolet/Mazda showroom, the Ben Franklin Elementary School replacement, and the Sound Transit 405 Transit Center/Access project.
2. **Wholesale**, which accounts for over 8 percent of the total sales tax receipts, **is up 62.8 percent** primarily due to construction-related equipment installation and technology hardware/software companies.
3. **Services**, which accounts for 12 percent of the total sales tax receipts, **is up 31.3 percent** primarily due to growth in construction-related services.
4. **Other Retail**, which accounts for over 12 percent of the total sales receipts, **is up 9.1 percent** primarily due to catalog and Internet retailers.
5. **Auto/gas retail**, which accounts for 17 percent of the total sales tax receipts, **is up 4.1 percent** due to the strong performance of key retailers.

In looking at the proportion of total sales tax receipts generated by each business sector group, two changes are worth noting. First, “contracting” increased from 9.9 percent in 1999 to 19.1 percent in 2006 (this sector averaged 4.7 percent over the 5-year period of 2000 to 2004.) This shift is troubling since this sector is by nature economically-sensitive and therefore can't be fully relied on to support on-going services. Second, the share of sales tax receipts from all “retail” categories declined from 60.1 percent in 2000 to 51.9 percent in 2006 illustrating the generally flat performance in the retail sector and the more importantly, the impact of construction-related receipts. The high level of construction activity is not only impacting the “contracting” sector this year, but also in the “wholesale” and “services” sectors. As mentioned previously, removing the exceptional construction-related growth in these three sectors and assuming a more typical 5 percent growth rate would reduce the overall 2006 year-to-date increase over 2005 to 3.1 percent instead of 17.1 percent. The business sectors' shares of total sales in 2006 would also be more similar to 2005.

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 85th 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 April 2005 and 2006 are compared in the chart to the right and the table below.



Business District	Jan - Apr Receipts		Dollar Change	Percent Change	Percent of Total	
	2005	2006			2005	2006
Totem Lake	1,449,367	1,476,088	26,721	1.8%	33.1%	28.8%
NE 85th St	722,714	728,477	5,763	0.8%	16.5%	14.2%
Downtown	299,140	332,220	33,080	11.1%	6.8%	6.5%
Carillon Pt & Yarrow Bay	159,506	169,693	10,187	6.4%	3.6%	3.3%
Houghton & Bridle Trails	155,639	144,104	-11,535	-7.4%	3.6%	2.8%
Juanita	79,477	86,871	7,394	9.3%	1.8%	1.7%
Unassigned or No District:						
Contracting	616,945	980,161	363,216	58.9%	14.1%	19.1%
Other	892,303	1,207,441	315,138	35.3%	22.3%	25.3%
Total	4,375,091	5,125,055	749,964	17.1%	100.0%	100.0%

When reviewing sales tax receipts by business district, it's important to point out that over 90 percent of the revenue gain achieved in 2006 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 related to construction in the "wholesale" and "business services" sector, and "other retail" (mostly on-line and catalog retailers).

Reviewing the performance of the City's business districts:

1. **Totem Lake**, which accounts for almost 29 percent of the total sales tax receipts, **is up 1.8 percent**, primarily due to strong performance in "auto/gas retail" and "retail eating/drinking." There was a fairly large one-time recovery in 2005 that skews the comparison to 2006. Factoring out this one-time impact improves this business sector's performance to about 4 percent comparing to 2006 to 2005.
2. **NE 85th Street**, which accounts for over 14 percent of the total sales tax receipts, **is up 0.8 percent** primarily due to the "retail automotive/gas" sector and despite weak performance in the "general merchandise/miscellaneous retail" sector.
3. **Downtown**, which accounts for over 6 percent of the total sales receipts, **is up 11.1 percent** due to strong performance (in contrast with the city-wide trend) in the "general merchandise/miscellaneous retail" and "retail eating/drinking" sectors.
4. **Carillon Point & Yarrow Bay**, which accounts for over 3 percent of the total sales tax receipts, **is up 6.4 percent** primarily due to the performance of three software/technology companies.
5. **Houghton & Bridle Trails**, which accounts for almost 3 percent of the total sales receipts, **is down 7.4 percent** almost entirely due to "general merchandise/miscellaneous retail" and "other retail."
6. **Juanita**, which accounts for almost 2 percent of the total sales receipts, **is up 9.3 percent** largely due to the "retail eating/drinking" sector.

2006 OUTLOOK

2006 sales tax receipts continue on the positive trend the City has experienced since 2003. However, the current growth is almost entirely due to the high level of construction activity in the city. The retail sectors are up collectively only 3.9 percent over the same period in 2005, partially due to the impact of the Woodinville Costco store. Contracting and construction-related receipts in other sectors are contributing an estimated 90 percent of the sales tax growth in 2006.

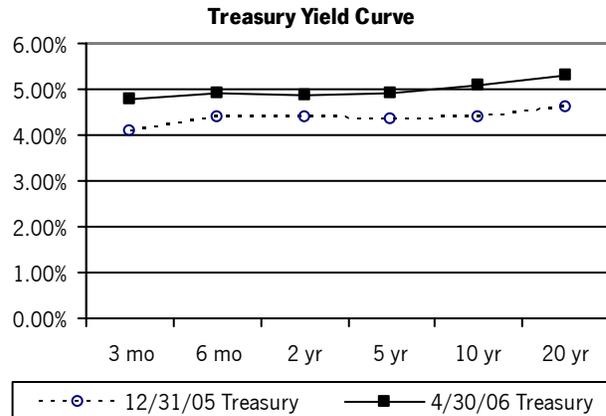
Opportunities for growth exist from the redevelopment of Totem Lake Mall, the current major expansion at a key automobile dealership, and the new hotels currently under construction. However, the economic recession a few years ago and the current reliance on construction-related sales tax growth serve 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.

2006 INVESTMENT REPORT

As of April 30, 2006

MARKET OVERVIEW

The first quarter of economic activity was strong with a Gross Domestic Product (GDP) nearing 4 percent. Inflation and unemployment remained low. The Fed Funds Rate increased from 4.25 percent at the beginning of the year to 4.75 percent as of the end of April. The yield curve rose slightly and continued to remain fairly flat. The short term treasury rates are expected to stay in the 5 percent range for the next year.

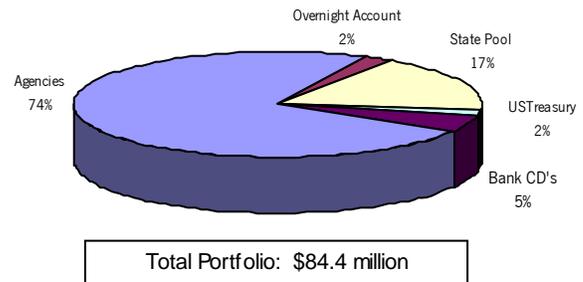


CITY PORTFOLIO

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 \$2.3 million in the first four months of 2006 finishing April at \$86.7 million compared to \$84.4 million on December 31, 2005.

Investments by Category



Diversification

The City's current investment portfolio is composed of Bank Certificates of Deposit, Federal Agencies, the State Investment Pool, U.S. Treasury Notes and an overnight sweep account with Bank of America. 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%	19.5%
FHLB	20%	18.2%
FHLMC	20%	18.5%
FNMA	20%	18.5%

Liquidity

The target duration for the City's portfolio is based on the current 2 year treasury rate. The 2 year treasury rate increased from 4.41 percent on December 31, 2005 to 4.87 percent on April 30, 2006. The average maturity of the City's investment portfolio decreased from 1.24 years on December 31, 2005 to 1.13 years on April 30, 2006. This was due to maturing investments which had not yet been reinvested and increased cash in the State Investment Pool with the property tax receipts at the end of April. (Updated note: The investment portfolio's current maturity duration has increased to 1.31 years as of May 2006.)

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	1.13
5 – 6%	1.4 – 1.7 yrs	
6 – 7%	1.7 – 1.9 yrs	
Over 7%	1.9 – 2.1 yrs	

Yield

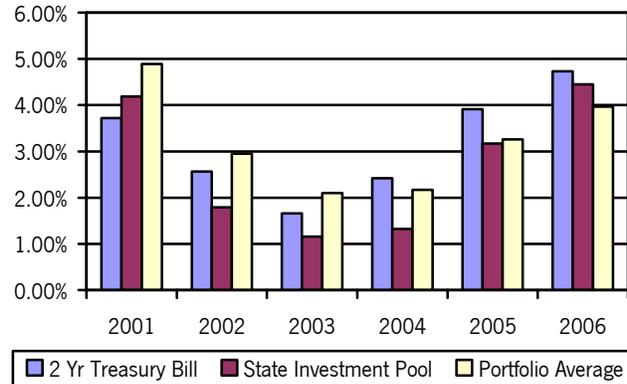
Rising interest rates due to improved economic improvement, increased Fed Funds Rate and lower yield maturing investments reinvested at current rates have helped increase the City's Portfolio yield in 2006. The City Portfolio yield to maturity increased from 3.88 percent on December 31, 2005 to 4.09 percent on April 30, 2006.

Through April 30, 2006, the City's average yield to maturity was 3.97 percent. The State Investment Pool average yield to maturity at 4.45 percent and the 2 Year Treasury note average for 2006 to date at 4.73 percent are greater than the City's return as those benchmarks respond more quickly to increases in the Fed Funds Rate.

The City portfolio's cash yield for 2006 to date is 3.33 percent which is an increase over the 2005 yield of 2.82 percent.

Benchmark Comparison	April 30, 2006	December 31, 2005
City Yield to Maturity (YTM)	4.09%	3.88%
City Average YTM	3.97%	3.26%
City Year to Date Yield	3.33%	2.82%
State Pool Average Yield	4.45%	3.17%
2 yr Treasury Note Avg YTM	4.73%	3.91%

Investment Interest Rate Comparisons



2006 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The Federal Reserve Survey of Professional Forecasters predicts that the Gross Domestic Product is expected to grow 3.4 percent in 2006. The continuing expectation is that inflation will remain low, about 2.6 percent for 2006 and approximately 2.3 percent for 2007 and 2008. Beyond the very short term, the forecasters see little threat of accelerating inflation. 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 unemployment rate is now forecast down .1 percent to be 4.7 percent over the four quarters of this year and rising just a bit, to 4.8 percent, in 2007. The Federal Open Market Committee (FOMC) raised the Fed Funds Rate to 4.75 percent on March 28. The direction that the housing market moves and the effect of increases in interest rates and energy prices will be a significant factor in determining if the Fed Funds Rate continues to increase in 2006 or level off around 5 percent.

As interest rates are leveling off around 5 percent the City will purchase investments with longer durations. This will capture current rates for a longer term. Total budgeted investment income for 2006 is \$2.7 million. Investment revenue is estimated to be above budget at approximately \$3 million for 2006 based on the City's current portfolio and State Investment Pool rates.

2006 RESERVE SUMMARY

As of April 30, 2006

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 April 2006. 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
2006 Council Authorized Uses		
Contingency Fund	\$52,000	Funding for the purchase of water rights from King County Water District # 1.
General Capital Contingency	\$150,000	Additional funding for Central Way corridor improvements due to design changes and subsurface conditions.
	\$69,200	Bridge funding for State Street undergrounding of utilities. Funds will be fully reimbursed when two concomitants are called upon completion of the project.
Building/Property Reserve	\$215,000	Funding for purchase and sale of Plaza on State Condominium to retain unit as part of affordable housing stock. Sale of the purchased unit will reimburse the reserve for an estimated \$191,150, resulting in an estimated net cost to the City of up to \$23,850.
Real Estate Excise Tax (REET) 2 Reserve	\$14,800	Additional funding to fully fund and close-out the Hazard Elimination Safety project.
Water/Sewer Construction Reserve	\$130,000	Funding for Kirkland Avenue sewer main replacement due to sewer line break and subsequent inspection that revealed multiple broken pipe joints and other pipe deficiencies.
Surface Water Capital Contingency	\$3,000	Additional funding for the NE 47 th Street Surface Water Outfall project due to an increase in the scope of the project with the discovery of a second outfall causing damage to the ravine.

2006 Council Authorized Additions

No Council Authorized Additions as of April 30, 2006.

General Government & Utility Reserves Summary

Reserves	2005-06 Est End Balance	12/31/05 End Balance	2006 Auth. Uses	2006 Auth. Additions	Revised 2005-06 End Balance	2005-06 Target	Over (Under) Target
GENERAL PURPOSE RESERVES							
Contingency	2,115,677	2,049,384	52,000		1,997,384	2,952,182	(902,798)
General Capital Contingency	2,979,056	3,737,337	219,200		3,518,137	5,900,568	(2,163,231)
Park & Municipal Reserve:							
General Oper. Reserve (Rainy Day)	2,712,836	2,712,836			2,712,836	2,676,890	35,946
Revenue Stabilization Reserve	1,493,480	1,493,480			1,493,480	2,082,380	(588,900)
Building & Property Reserve	1,817,461	1,817,461	215,000		1,602,461	N/A	N/A
Council Special Projects Reserve	254,760	250,000			250,000	250,000	0
Total General Purpose Reserves	11,373,270	12,060,498	486,200	0	11,574,298	13,862,020	(3,618,983)
SPECIAL PURPOSE RESERVES							
Excise Tax Capital Improvement:							
REET 1	3,990,296	3,990,296			3,990,296	1,435,000	2,555,296
REET 2	2,033,112	2,357,891	14,800		2,343,091	6,033,700	(3,675,809)
Equipment Rental:							
Vehicle Reserve	6,187,826	6,187,826			6,187,826	6,187,826	0
Radio Reserve	36,000	36,000			36,000	N/A	N/A
Information Technology:							
PC Replacement Reserve	429,835	429,835			429,835	429,835	0
Major Systems Replacement Reserve	1,000,000	1,000,000			1,000,000	1,025,000	(25,000)
Facilities Maintenance:							
Operating Reserve	550,000	550,000			550,000	550,000	0
Facilities Sinking Fund	925,240	925,240			925,240	925,240	0
Impact Fees							
Roads	1,045,991	1,045,991			1,045,991	N/A	N/A
Parks	490,464	490,464			490,464	N/A	N/A
Park Bond Reserve	18,150	18,150			18,150	N/A	N/A
Cemetery Improvement	411,462	411,462			411,462	N/A	N/A
Off-Street Parking	69,564	69,564			69,564	N/A	N/A
Tour Dock	155,578	155,578			155,578	130,000	25,578
Street Improvement	1,901,759	1,627,781			1,627,781	N/A	N/A
Firefighter's Pension	1,117,566	1,117,566			1,117,566	1,052,000	65,566
Park & Municipal Reserve:							
Litigation Reserve	60,450	60,450			60,450	50,000	10,450
Police Equipment Reserve	43,883	43,883			43,883	N/A	N/A
LEOFF 1 Police Reserve	621,650	621,650			621,650	863,000	(241,350)
Public Safety Building Reserve	1,205,100	1,205,100			1,205,100	N/A	N/A
Fire Engine (Forbes Creek F.S.)	350,000	350,000			350,000	350,000	0
Labor Relations Reserve	199,700	199,700			199,700	N/A	N/A
Donation Accounts	113,207	113,207			113,207	N/A	N/A
Revolving Accounts	115,168	115,168			115,168	N/A	N/A
Water/Sewer Operating Reserve	1,436,674	1,423,248			1,423,248	1,436,674	(13,426)
Water/Sewer Debt Service Reserve	845,962	845,962			845,962	845,962	0
Water/Sewer Capital Contingency	1,766,520	1,519,020			1,519,020	1,766,520	(247,500)
Water/Sewer Construction Reserve	4,599,401	3,873,639	130,000		3,743,639	N/A	N/A
Surface Water Operating Reserve	252,187	252,187			252,187	252,187	0
Surface Water Capital Contingency	569,490	525,490	3,000		522,490	569,490	(44,000)
Surface Water Construction Reserve	1,008,603	957,948			957,948	N/A	N/A
Total Special Purpose Reserves	33,550,838	32,520,296	147,800	0	32,372,496	23,902,434	(1,590,195)