



CITY OF KIRKLAND
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MEMORANDUM

To: Kurt Triplett, City Manager
From: Tracey Dunlap, Director of Finance and Administration
Date: March 7, 2011
Subject: City Council Retreat – Financial Context for Kirkland’s Next Budget Process

The purpose of this memo is to provide a brief recap of the year-end 2010 financial results, a discussion of the 2011 outlook, present the 2013-2018 financial forecast, and provide financial context looking ahead to the City’s next budget process.

2010 Year-End Results

The year-end results for 2010 are discussed in detail in the Financial Management Report (FMR), which is included as **Attachment A**. This section provides a brief overview of the General Fund results versus the budget and a discussion of the resources available at the beginning of 2011:

- Actual 2010 **General Fund revenues** ended the year \$440,000 under the budgeted level (\$54.27 million versus budget of \$54.71 million). General Fund sales tax was up 4.3%, but that gain was offset by utility tax and revenue generating regulatory licensing revenues that fell short of budgeted levels. The 2011-2012 budget was developed based on an estimate of revenues in September that anticipated the shortfall. The actual results were better than the estimate by \$38,000.
- Actual 2010 **General Fund expenditures** ended the year about \$1 million under budget. Position vacancies and staff efforts to reduce costs were the primary causes of the under-expenditures. All departments under-expended their budgets except for Fire & Building, which exceeded their 2010 budget by over \$200,000 due to fire suppression overtime. The actual under-expenditures are \$580,000 higher than the estimates used in developing the 2011-2012 budget.
- One of the key assumptions in development of the 2011-2012 budget is the **beginning fund balance** (cash), which was estimated in September 2010. Now that 2010 is complete, the estimates are adjusted to reflect the actual 2010 ending results (these budget adjustments are scheduled for Council action at the March 15 Council Meeting). The adjustment recognizes unobligated cash of \$618,000 (\$38,000 from revenues and \$580,000 from under-expenditures). There are a number of potential uses for the unobligated General Fund balance, including:
 - Set aside funding for the remaining deficit to restore firefighter overtime brown-outs if needed (\$379,195). The March 15 budget adjustments reflect the implementation of the Emergency Management Services Transport Fees and the attendant

restoration of part of the Fire Suppression overtime that would have resulted in rolling brown-outs (per the memo presented to City Council on 12/07/2010). The anticipated revenue is short \$379,195 to provide full restoration (\$248,000 in 2011 and \$131,000 in 2012).

- Seed money for establishing sinking funds to begin to address unfunded periodic replacement costs (such as public safety equipment and major systems). The analysis of these needs is a follow-up to the 2011-12 budget process and is scheduled to be completed during the second half of 2011.
- If there are funds remaining, additional replenishments to reserves that remain below target (such as the Revenue Stabilization Reserve and Contingency Fund).

The staff recommendation is to set the unobligated cash aside until further analysis is completed and then specific recommendations will be brought forward later in the year for Council consideration.

2011 Outlook

As we proceed into 2011, there continue to be signs that revenues may be stabilizing, although at much reduced levels than prior to the recession. The Council Finance Subcommittee reviewed the January "dashboard" results at their February 22 meeting, which are provided as **Attachment B**.

As noted in the dashboard highlights, it will be difficult to interpret trends in 2011 due to annexation, which will impact expenditures and revenues at different times throughout the year. In particular, the City will incur increasing expenses month-by-month as we are gearing up for annexation, but no revenue from the annexation area will be collected until July and the bulk of the revenue will not be received until the fourth quarter. As a result, in the first part of the year, we will provide two versions of the dashboard: one that includes the annexation-related budget and one that excludes it. As the year progresses, there may need to be other adaptations to assist in interpreting the month-by-month financial results.

While there is not sufficient data to determine trends so early in the year, the following observations provide some initial insights:

- The initial **sales tax** receipts in January were promising, up 14.4 percent compared to January 2010. However, a substantial portion of the gain is one-time field recoveries and large one-time receipts. The increase is 7.8 percent after factoring out these one-time events. However, we received the February sales tax results recently, which are summarized in **Attachment C**. February sales tax revenue is up 0.2 percent compared to February 2010. Year-to-date revenue performance is up 6.0 percent compared to the same period last year. Factoring out the significant field recoveries in January results in a normalized increase of 4.6 percent over last year. While this is still positive news, it highlights the inherent volatility of this revenue source and its sensitivity to economic conditions.
- **Business license fees** in January were noticeably higher than the January 2010 receipts, partly due to the renewal of Google's business license reflecting their ramp up in staffing and increased staffing reported by Microsoft.
- The availability of **interest earnings** toward potential one-time uses is expected to be minimal during 2011-2012. The decline in interest rates over the last few years has significantly reduced this revenue source, specifically:

| | |
|--------------------------------------|---------------|
| 2007-2008 Actual Interest Earnings | \$9.4 million |
| 2009-2010 Actual Interest Earnings | \$4.6 million |
| 2011-2012 Budgeted Interest Earnings | \$1.3 million |

While Kirkland's results have been better than those experienced by the State Investment Pool based on our active investment strategy, the loss in resources is significant. For most funds, this simply means a reduced share of allocated interest, which is generally not budgeted for on-going needs. For mandated uses such as capital funding, debt service payments, or other General Fund needs, some backfill from general resources has been required.

- The transition to self-insured **medical benefits** began in January 2011 and we are tracking program expenditures closely, although it is too early to draw any conclusions on trends. Staff will provide a status report to the City Council once we have several months of data available. The hope is that this approach will allow us to stabilize our medical benefit costs over time.
- There are some **fiscal flexibility bills** under consideration in the State Legislature to provide City's with tools to help cope with current economic conditions. On the downside, the State is struggling to close its own budget deficit and some options could negatively impact cities, such as changes in the liquor profits/tax apportionments or limitations on the annexation sales tax credit. The City will continue to actively participate in the legislative session and any opportunities or impacts from the final outcome will be brought forward as part of the mid-year budget adjustments.

Forecast

The 6-year financial forecast has been updated to reflect the adopted 2011-2012 budget, which includes the impacts of annexation. It is important to note that the budget was developed based on the assumption that annexation revenues and expenditures (including the state sales tax credit) would be in balance and would not contribute to any bottom line shortfall. This "revenue-based" approach to annexation applies to the entire forecast period and recognizes that the state sales tax credit is only available to fund any actual shortfalls between annexation revenues and expenses.

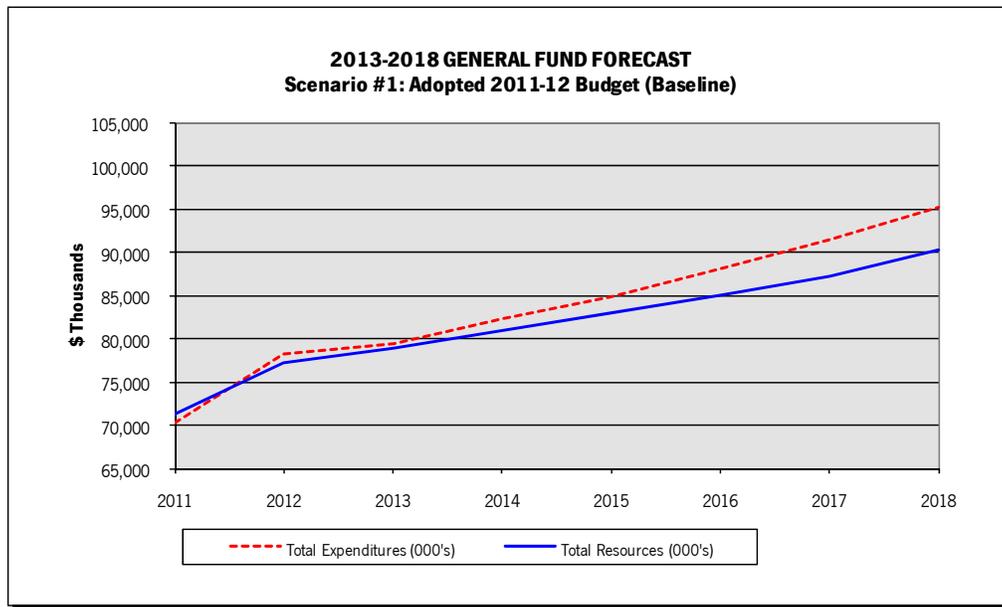
The key assumptions in the baseline forecast (Scenario #1) are intended to recognize a slow recovery in revenues during 2011-2012 and more conservative growth estimates than those used in previous forecasts thereafter. Expenditure growth factors have been reduced to recognize more of a "total compensation" model for wages and benefits and account for potential impacts of the changes to the medical program, specifically:

- Using a 5% overall wage growth rate rather than the 6% wage growth rate applied in the past (comprised of assumed cost of living adjustment of 3.5%, steps of 1.1%, and market/other adjustments of 1.4%), and
- Using a 7% growth rate in benefit costs, rather than the 10% annual trend from recent years.

The key assumptions in the Scenario #1 - Baseline Forecast include:

- Revenues
 - 1% optional property tax and 1% annual growth in new construction property tax in 2011-2018 (versus 2% growth in new construction in prior forecasts),
 - Sales tax equal to 2010 in 2011, 3% growth in 2012, and 4% annual growth reflected in 2013-2018 projections,
 - 3% annual growth in utility taxes in 2011-2018,
 - 1% growth in other taxes (revenue generating regulatory license and gambling taxes) over 2011 reflected in 2012, and 2% annual growth in these categories in 2013-2018,
 - 2% growth in other revenue in 2013-2018,
 - No diversion of current revenue sources to/from CIP and no additional use of reserves.
- Expenditures
 - 2011-2012 Adopted Budget, excluding one-time annexation-related service packages,
 - The City's existing labor contracts call for annual increases based on the June-to-June Consumer Price Index (CPI-W) with a minimum of zero and no maximum and provides for step and longevity increases. The CPI-W decreased as of June 2010, so the cost of living increase in 2011 is zero and budgeted step increases are included averaging about 1.1%. CPI of 2.5% is assumed for 2012, in addition to planned step increases. For 2013-2018, a total annual growth rate of 5% in wages is assumed, as highlighted above,
 - 7% annual increase in all benefit costs for 2013-2018, which includes medical and pension contributions,
 - No annual growth in supplies, services & capital in 2013-2018,
 - Annexation-related expenditures in 2013-2018 set equal to anticipated annexation revenue in 2013-2018.

The summary results for Scenario #1 are shown on the following page and the graph and related assumptions is contained in **Attachment D**.



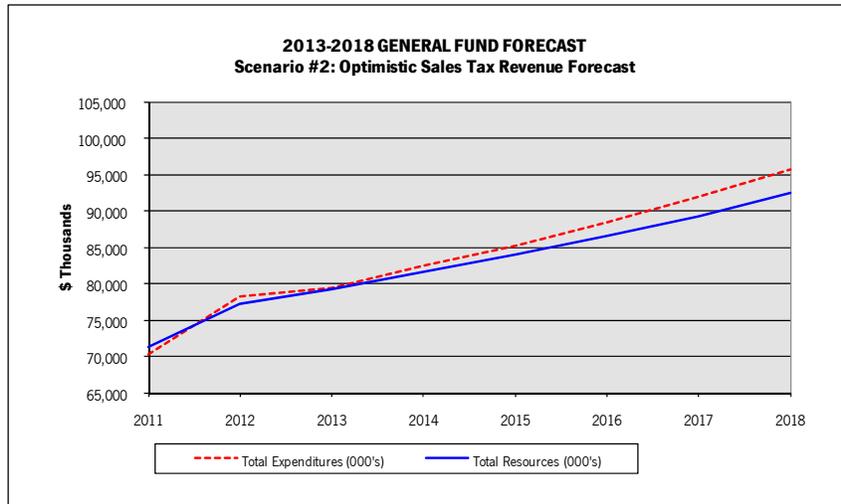
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Total Resources (000's) | 71,335 | 77,166 | 78,915 | 80,908 | 82,959 | 85,068 | 87,240 | 90,292 |
| Total Expenditures (000's) | 70,332 | 78,169 | 79,424 | 82,299 | 84,910 | 88,109 | 91,473 | 95,186 |
| Net Resources (000's) | 1,003 | (1,003) | (509) | (1,391) | (1,951) | (3,040) | (4,233) | (4,894) |
| Biennium Total (000's) | 0 | | (1,899) | | (4,992) | | (9,128) | |

Given that any economic recovery is fragile and that a variety of forecast assumptions could be made, the table below provides the impacts of changing each of the key assumptions by 1%. The figures reflect the annual impact of each 1% change on the net resources.

Summary Impact of 1% Change in Key Variables

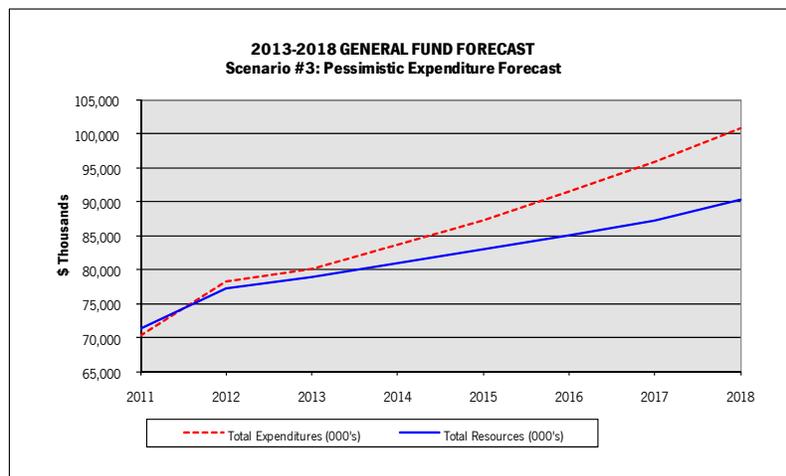
| Variable | Impact of 1% Change in 2012 |
|------------------------------|-----------------------------|
| Resources | |
| Sales Tax | 128,887 |
| Property Tax | 160,290 |
| Utility Taxes | 110,371 |
| Other Taxes | 23,870 |
| Expenditures | |
| Salaries | 294,178 |
| Benefits | 123,915 |
| Supplies, Services & Capital | 179,568 |

To provide some context on the sensitivity of the forecast to selected assumptions, two alternative scenarios were generated. The first is an optimistic scenario with annual growth in sales tax returning to 6% per year starting in 2013 (rather than 4% shown in the baseline). The results for this scenario are shown below and the projected budget gaps become smaller.



| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|--------------|----------------|----------------|----------------|----------------|
| Total Resources (000's) | 71,335 | 77,166 | 79,240 | 81,589 | 84,032 | 86,571 | 89,212 | 92,382 |
| Total Expenditures (000's) | 70,332 | 78,169 | 79,491 | 82,439 | 85,130 | 88,417 | 91,878 | 95,616 |
| Net Resources (000's) | 1,003 | (1,003) | (251) | (849) | (1,099) | (1,846) | (2,666) | (3,233) |
| Biennium Total (000's) | 0 | | (1,100) | | (2,945) | | (5,900) | |

A pessimistic scenario leaves sales tax growth at 4%, but places the wage growth rate at 6% and the benefit growth rate at 10%. As expected, the compound effects of these changes cause the outlook to become significantly worse, underscoring the need to control cost growth.



| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|----------------|-----------------|----------------|-----------------|-----------------|
| Total Resources (000's) | 71,335 | 77,166 | 78,915 | 80,908 | 82,959 | 85,068 | 87,240 | 90,292 |
| Total Expenditures (000's) | 70,332 | 78,169 | 80,089 | 83,724 | 87,202 | 91,386 | 95,866 | 100,842 |
| Net Resources (000's) | 1,003 | (1,003) | (1,174) | (2,816) | (4,243) | (6,317) | (8,626) | (10,550) |
| Biennium Total (000's) | 0 | | (3,990) | | (10,561) | | (19,177) | |

The graphs and related assumptions for these scenarios are also in Attachment D.

Financial Context Looking Ahead

While the financial situation appears to be stabilizing, there are a number of major issues and uncertainties facing the City as it moves toward the next budget process:

- While the **economy** is showing signs of improvement, recent discussions have raised the potential of inflation increasing from its historically low levels in recent years. Since inflation is the basis for the City's contractual cost of living adjustments, each 1% increase in inflation adds almost \$300,000 to the City's wage costs.
- The City's **revenues** seem to be stabilizing but there continues to be uncertainty as to how much recovery might be expected in revenues and whether such a recovery can be sustained. The revenue declines experienced over the past few years were unprecedented in the past 20 years. For example, sales tax revenues in 2010 are at a level similar to that collected in 2000, reversing all of the gains from the intervening years.
- The City's ability to control **cost growth** is also a challenge. Given that salaries and benefits constitute the majority of the City's costs, establishing control over those elements needs to be a focus.
- Uncertainties related to **annexation** will become clearer during this biennium as the City takes jurisdiction for serving the area, including:
 - Revenues – The current budget is based on estimates of revenues that can be expected from the annexation area. Once actual revenues are known, the budget and attendant service levels can be revisited.
 - Service needs and expectations – After the City begins providing services to the annexation area, the actual service needs and the expectations of the annexation area residents should become clearer, allowing for adjustments as necessary.
 - Capital improvement needs – As the City becomes more familiar with the infrastructure in the annexation area, staff will begin to identify the capital improvement needs. These needs will be incorporated into the CIP budget process and will need to be matched with funding sources.
- Existing **unfunded needs** fall in a variety of categories that will need to be addressed as financial conditions improve:
 - As mentioned earlier in this memo, several of the City's reserves were used during the recent economic downturn and need to be replenished as revenues improve. In addition, the reserve targets will increase with the addition of annexation to the City's budget. The Finance Subcommittee is in the process of reviewing reserve targets and will forward recommendations on whether the targets should be revised and input on replenishment strategies later this year.
 - During the 2011-2012 budget process, the issue of establishing sinking funds for the replacement of public safety equipment and information technology infrastructure and systems was identified as a priority. Staff and the Finance Subcommittee will be evaluating the needs and funding level required during the second half of 2011 and will be developing recommendations for consideration by the full Council as part of the next budget process.
 - An additional underfunded activity is infrastructure maintenance, particularly in the area of street preservation. While the Public Works Department has identified a variety of strategies to consider to increase funding, such as the potential establishment of a Transportation Benefit District, several strategies will need to be employed simultaneously to generate additional funding to make progress on this issue.



Financial Management Report as of December 31, 2010

AT A GLANCE:

2010 Sales tax revenue continues positive trend (page 5)

Building permits remain down and Planning fees still positive (page 4)

City Council adopts 2011-12 Budget (page 2 sidebar)

Recession has ended, but what about recovery? (pages 7-8)

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Summary of All Operating Funds: *Revenue*

- General Fund** actual 2010 revenue ended the year **0.2 percent behind** 2009. Increased revenue from sales and property taxes, franchise fees, and internal charges were generally offset by declines in utility taxes, building revenue, Other Intergovernmental Services as well as significantly lower interest earnings revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- Other General Government Funds** actual 2010 revenue ended the year **4.7 percent lower** when compared to 2009 primarily due to lower internal rates resulting from expenditure reductions taken in these funds, as well as reallocation of property tax from the Street Operating Fund to the General Fund. Fleet rates were reduced recognizing lower fuel prices and technology rates were reduced recognizing lower personnel costs and use of fund cash for replacement charges as a budget reduction strategy. Lodging tax revenue is up 2.6 percent compared to 2009, indicating stabilization from last year, which was down 16.2 percent compared to the same period in 2008. Motor vehicle fuel tax is essentially flat compared to the same period last year. However, this revenue is down 17.9 percent compared to the same period in 2007 (a peak year). Fuel tax is collected on a flat rate per gallon, so more moderate fuel prices have helped stabilize this revenue's performance.
- Water Sewer Operating Fund** actual 2010 revenue ended the year **0.5 percent behind** 2009 primarily due to lower water revenue and interest earnings and despite a slight increase in sewer revenue. An Excise Tax refund in 2009 also skews the comparison. The impact of reduced water usage from the cooler and damper spring and summer offset some of the effects of higher water and sewer rates.
- Surface Water Management Fund** actual 2010 revenue is **3.9 percent lower** compared to 2009 primarily due to less engineering time spent on Surface Water Capital Improvement Projects.
- Solid Waste Fund** actual 2010 revenue is **3.6 percent lower** compared to 2009 primarily due to a decrease in commercial revenue collection, reflecting lower business activity.

| Resources by Fund | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--------------------------------------|---------------------|--------------------|--------------|--------------------|--------------------|--------------|---------------|--------------|
| | 12/31/2009 | 12/31/2010 | % Change | 2009 | 2010 | % Change | 2009 | 2010 |
| General Gov't Operating: | | | | | | | | |
| General Fund | 54,392,698 | 54,265,938 | -0.2% | 54,549,760 | 54,706,544 | 0.3% | 99.7% | 99.2% |
| Other General Gov't Operating Funds | 16,979,375 | 16,181,305 | -4.7% | 16,563,457 | 15,798,095 | -4.6% | 102.5% | 102.4% |
| Total General Gov't Operating | 71,372,073 | 70,447,243 | -1.3% | 71,113,217 | 70,504,639 | -0.9% | 100.4% | 99.9% |
| Utilities: | | | | | | | | |
| Water/Sewer Operating Fund | 18,594,828 | 18,501,163 | -0.5% | 19,807,210 | 20,660,066 | 4.3% | 93.9% | 89.6% |
| Surface Water Management Fund | 5,418,423 | 5,207,761 | -3.9% | 5,350,962 | 5,270,500 | -1.5% | 101.3% | 98.8% |
| Solid Waste Fund | 8,623,258 | 8,312,328 | -3.6% | 8,612,724 | 8,627,630 | 0.2% | 100.1% | 96.3% |
| Total Utilities | 32,636,509 | 32,021,252 | -1.9% | 33,770,896 | 34,558,196 | 2.3% | 96.6% | 92.7% |
| Total All Operating Funds | 104,008,582 | 102,468,495 | -1.5% | 104,884,113 | 105,062,835 | 0.2% | 99.2% | 97.5% |

Budgeted and actual revenues exclude resources forward and interfund transfers.



City Council Adopts 2011-12 Budget

Service Reductions Effective Jan. 1

On December 7 the Kirkland City Council adopted the 2011-2012 Budget, the 2011-2016 Capital Improvement Program (CIP) and the 2011 Property Tax Levy.

The two-year budget totals approximately \$449 million which is a 12.8% increase from the previous biennial budget due to increases in revenue and expenditures to serve the annexation area. The Budget is comprised of 24 separate funds that are independently balanced (i.e. revenues equal expenditures). The 2011-2012 Budget was balanced primarily through service reductions.

The CIP is a six-year plan that addresses construction, repair, maintenance and acquisition of major capital facilities and equipment to improve transportation, utilities, parks, and buildings in the City.

The Property Tax Levy establishes the total dollars in property tax to be received by the City, which is translated into a rate per \$1,000 of assessed valuation.

To view the legislation adopted by the Council and the video of the meeting, visit the "[Watch City Council Meetings](http://www.ci.kirkland.wa.us)" webpage at www.ci.kirkland.wa.us.

Summary of All Operating Funds: *Expenditures*

- **General Fund** actual 2010 expenditures are **0.3 percent behind** 2009 primarily due to lower personnel and internal service costs and despite an increase in contracted services. A regional agency (NORCOM) began providing dispatch services as of July 1, 2009, which resulted in a shift from salaries and benefits to contracted services, which is the reason for the increased contracted costs and one of the reasons for reduced personnel costs. Personnel costs are also down due to reduced 2010 salaries taken by most employees (who received furlough days in return) as a budget reduction strategy, as well as reduction in staffing and lower overtime costs. The reduction in overtime costs is largely the result of the elimination of the dispatch staffing. To complicate comparisons even more, the City started to hire staff in 2010 (especially in the Police Department), in anticipation of providing services to the annexation area as of June 1, 2011. The annexation will add over 33,000 people and about 7 miles of land area. A more detailed analysis of General Fund expenditures by department is found on page 4.
- **Other Operating Funds** actual 2010 expenditures are **1.3 percent behind** 2009 due to generally lower personnel costs and internal rates (primarily due to expenditure reductions), reduced Street and Parks Maintenance operating supplies, lower facility utility costs, and the elimination of the lease payment for the municipal court building, which was purchased in 2009. 2010 expenditures ended the year behind 2009 despite higher vehicle/equipment purchases. Facility utility costs are down, partially due to milder winter weather, but also from staff conservation efforts and the pay-off from investments in updated controls and equipment at various locations. Vehicle replacement costs vary year-to-year depending on the planned replacement cycle.
- **Water/Sewer Operating Fund** actual 2010 expenditures are **0.6 percent behind** 2009 primarily due to a decrease in water connection charges from the Cascade Water Alliance. There is a corresponding decrease in revenue.
- **Surface Water Management Fund 2010** actual expenditures are **2.2 percent ahead** of 2009 due to higher personnel costs related to National Pollutant Discharge Elimination System (NPDES) requirements, which requires public outreach and monitoring of surface water discharge, and normal variability in the timing of payment for various services.
- **Solid Waste Fund 2010** actual expenditures are **0.1 percent ahead** of 2009, an increase in personnel costs and other expenses in 2010 balanced out with a decrease in disposal contract costs for a minimal change in expenditures from 2009 to 2010.

| Expenditures by Fund | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--------------------------------------|---------------------|-------------------|--------------|--------------------|-------------------|--------------|--------------|--------------|
| | 12/31/2009 | 12/31/2010 | % Change | 2009 | 2010 | % Change | 2009 | 2010 |
| General Gov't Operating: | | | | | | | | |
| General Fund | 57,293,487 | 57,125,733 | -0.3% | 59,167,520 | 58,149,798 | -1.7% | 96.8% | 98.2% |
| Other General Gov't Operating Funds | 13,155,462 | 12,989,483 | -1.3% | 15,415,335 | 13,326,213 | -13.6% | 85.3% | 97.5% |
| Total General Gov't Operating | 70,448,949 | 70,115,216 | -0.5% | 74,582,855 | 71,476,011 | -4.2% | 94.5% | 98.1% |
| Utilities: | | | | | | | | |
| Water/Sewer Operating Fund | 14,613,569 | 14,528,419 | -0.6% | 15,555,212 | 15,903,927 | 2.2% | 93.9% | 91.4% |
| Surface Water Management Fund | 3,194,709 | 3,265,943 | 2.2% | 3,605,721 | 3,387,458 | -6.1% | 88.6% | 96.4% |
| Solid Waste Fund | 8,215,505 | 8,225,753 | 0.1% | 8,455,673 | 8,596,408 | 1.7% | 97.2% | 95.7% |
| Total Utilities | 26,023,783 | 26,020,115 | 0.0% | 27,616,606 | 27,887,793 | 1.0% | 94.2% | 93.3% |
| Total All Operating Funds | 96,472,732 | 96,135,331 | -0.3% | 102,199,461 | 99,363,804 | -2.8% | 94.4% | 96.8% |

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

Financial Management Report as of December 31, 2010

General Fund Revenue

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

- **Sales tax** revenue allocated to the General Fund for 2010 was adjusted to reflect lower projections as a result of the economic recession. However, 2010 ended the year **4.3 percent ahead** of 2009. A detailed analysis of **sales tax** revenue can be found starting on page 5.
- **Property tax** is **6.5 percent ahead** due to a planned reallocation from the Street Operating Fund in 2010.
- **Utility tax** actual revenue collection is **2.9 percent behind** the same period last year primarily due to significantly lower revenue from natural gas (down 22.4 percent) most likely the result of milder winter weather compared to the previous year along with lower natural gas rates. Telephone utility taxes were also down 4.0 percent compared to 2009. Water and sewer utility taxes are up from the same period last year reflecting higher utility rates, but revenues from these sources ended 2010 lagging budget expectations.
- **Other taxes** actual revenue is **45.9 percent behind** the same period last year due to lower gambling tax revenue and revenue from the Enhanced 911 Access Line charge moving to NORCOM.
- The **business licenses (base fee) and franchise fees** actual revenue ended 2010 **6.9 percent ahead** of 2009 due to higher franchise fee revenue.
- The **revenue generating regulatory license** fee is **4.5 percent ahead** of the same period last year. This fee was restructured and substantially increased in 2009. The increase in 2010 is a combination of fully realizing the restructured fees, as well as changes in timing for renewal of larger employers, but revenue from this source still lagged budget expectations.
- **Development-related fee** revenues, which collectively ended the year **down 7.5 percent** compared to 2009, experienced contrasting trends. Compared to the same period last year, **building permits are 24.3 percent lower** and **engineering services** revenue is **28.1 percent lower**, while **plan check revenue** is **ahead 39.7 percent** and **planning fees** revenue is **ahead 33.2 percent** due to a significant increase in pre-submittal process applications. The increase in the latter two revenues may be a hopeful sign of improvement in future development activity. Note this increase is in comparison to very low collections during 2009.
- Compared to the same period last year: **Grant** revenue is **54.9 percent higher** due to federal stimulus grants for court security, fire station window replacements and home energy reports contracted with Puget Sound Energy; State shared revenue is down 3.1 percent due to lower streamline sales tax mitigation revenue and despite higher liquor control board profits and liquor taxes. **Other intergovernmental services** revenue is **33.3 percent below** last year's actual due to the elimination of the contract providing dispatching services to other cities caused by the formation of NORCOM and despite an increase to revenue received from providing staffing to the regional Criminal Justice Training Center.
- **Internal Charges** are **6.4 percent ahead** compared to the same period last year primarily due to an increase in capital project engineering charges.
- **Miscellaneous** revenue is **79.1 percent behind** last year due to substantially lower interest earnings.
- **Other financing sources** are behind last year due to the funding transferred from other funds in 2009 to balance the 2009-10 budget.

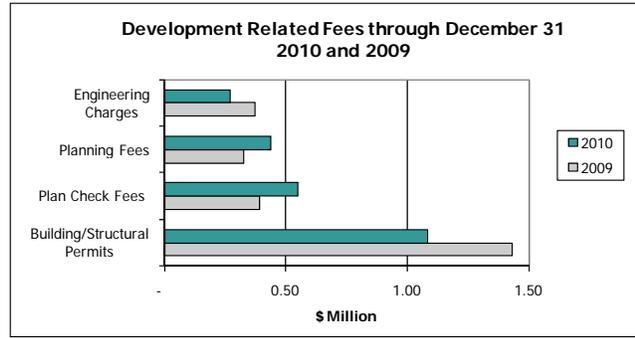
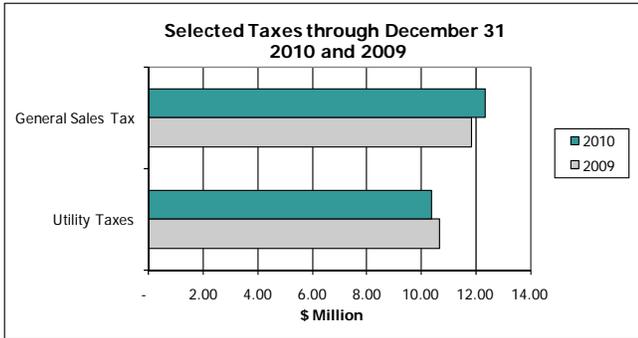
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 377 of the City's 474 regular (full-time equivalent) employees are budgeted within this fund.

| General Fund Resource Category | Year-to-Date Actual | | | Budget | | | % of Budget | |
|------------------------------------------|---------------------|-------------------|---------------|-------------------|-------------------|--------------|---------------|---------------|
| | 12/31/2009 | 12/31/2010 | % Change | 2009 | 2010 | % Change | 2009 | 2010 |
| Taxes: | | | | | | | | |
| Retail Sales Tax: General | 11,824,929 | 12,336,886 | 4.3% | 11,564,551 | 11,464,179 | -0.9% | 102.3% | 107.6% |
| Retail Sales Tax: Criminal Justice | 967,304 | 941,944 | -2.6% | 1,107,000 | 1,129,140 | 2.0% | 87.4% | 83.4% |
| Property Tax | 9,396,769 | 10,009,911 | 6.5% | 9,264,941 | 9,904,815 | 6.9% | 101.4% | 101.1% |
| Utility Taxes | 10,672,711 | 10,363,718 | -2.9% | 10,604,676 | 10,965,526 | 3.4% | 100.6% | 94.5% |
| Rev Generating Regulatory License | 1,936,606 | 2,024,640 | 4.5% | 2,599,920 | 2,567,468 | -1.2% | 74.5% | 78.9% |
| Other Taxes | 608,619 | 328,968 | -45.9% | 591,779 | 466,129 | -21.2% | 102.8% | 70.6% |
| Total Taxes | 35,406,938 | 36,006,067 | 1.7% | 35,732,867 | 36,497,257 | 2.1% | 99.1% | 98.7% |
| Licenses & Permits: | | | | | | | | |
| Building, Structural & Equipment Permits | 1,429,965 | 1,081,952 | -24.3% | 1,645,600 | 1,436,990 | -12.7% | 86.9% | 75.3% |
| Business Licenses/Franchise Fees | 1,678,466 | 1,794,322 | 6.9% | 1,654,903 | 1,720,921 | 4.0% | 101.4% | 104.3% |
| Other Licenses & Permits | 184,076 | 181,586 | -1.4% | 183,500 | 175,460 | -4.4% | 100.3% | 103.5% |
| Total Licenses & Permits | 3,292,507 | 3,057,860 | -7.1% | 3,484,003 | 3,333,371 | -4.3% | 94.5% | 91.7% |
| Intergovernmental: | | | | | | | | |
| Grants | 275,116 | 426,125 | 54.9% | 218,754 | 503,699 | 130.3% | 125.8% | 84.6% |
| State Shared Revenues & Entitlements | 869,176 | 842,585 | -3.1% | 908,404 | 809,010 | -10.9% | 95.7% | 104.2% |
| Fire District #41 | 3,904,235 | 3,580,280 | N/A | 3,850,077 | 3,598,238 | N/A | 101.4% | 99.5% |
| EMS | 838,397 | 831,434 | N/A | 836,938 | 866,231 | N/A | 100.2% | 96.0% |
| Other Intergovernmental Services | 819,115 | 546,222 | -33.3% | 654,713 | 547,394 | -16.4% | 125.1% | 99.8% |
| Total Intergovernmental | 6,706,039 | 6,226,646 | -7.1% | 6,468,886 | 6,324,572 | -2.2% | 103.7% | 98.5% |
| Charges for Services: | | | | | | | | |
| Internal Charges | 4,764,301 | 5,070,809 | 6.4% | 4,905,963 | 4,707,822 | -4.0% | 97.1% | 107.7% |
| Engineering Services | 375,245 | 269,722 | -28.1% | 357,134 | 225,000 | -37.0% | 105.1% | 119.9% |
| Plan Check Fee | 392,094 | 547,562 | 39.7% | 520,000 | 408,252 | -21.5% | 75.4% | 134.1% |
| Planning Fees | 327,772 | 436,740 | 33.2% | 247,157 | 245,420 | -0.7% | 132.6% | 178.0% |
| Other Charges for Services | 908,653 | 849,612 | -6.5% | 756,426 | 770,890 | 1.9% | 120.1% | 110.2% |
| Total Charges for Services | 6,768,065 | 7,174,445 | 6.0% | 6,786,680 | 6,357,384 | -6.3% | 99.7% | 112.9% |
| Fines & Forfeits | 1,504,982 | 1,651,358 | 9.7% | 1,407,595 | 1,539,268 | 9.4% | 106.9% | 107.3% |
| Miscellaneous | 714,167 | 149,562 | -79.1% | 669,729 | 654,692 | -2.2% | 106.6% | 22.8% |
| Total Revenues | 54,392,698 | 54,265,938 | -0.2% | 54,549,760 | 54,706,544 | 0.3% | 99.7% | 99.2% |
| Other Financing Sources: | | | | | | | | |
| Interfund Transfers | 4,477,317 | 2,341,992 | N/A | 3,899,053 | 2,275,530 | N/A | 114.8% | 102.9% |
| Total Other Financing Sources | 4,477,317 | 2,341,992 | N/A | 3,899,053 | 2,275,530 | N/A | 114.8% | 102.9% |
| Total Resources | 58,870,015 | 56,607,930 | -3.8% | 58,448,813 | 56,982,074 | -2.5% | 100.7% | 99.3% |

Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued*



General Fund Expenditures

| General Fund Department Expenditures | Year-to-Date Actual | | | Budget | | | % of Budget | |
|--------------------------------------------|---------------------|-------------------|---------------|-------------------|-------------------|---------------|---------------|---------------|
| | 12/31/2009 | 12/31/2010 | % Change | 2009 | 2010 | % Change | 2009 | 2010 |
| Non-Departmental | 1,170,201 | 1,452,541 | 24.1% | 1,254,877 | 1,525,820 | 21.6% | 93.3% | 95.2% |
| City Council | 343,678 | 345,605 | 0.6% | 353,175 | 353,130 | 0.0% | 97.3% | 97.9% |
| City Manager's Office | 3,221,365 | 2,947,807 | -8.5% | 3,434,631 | 3,115,861 | -9.3% | 93.8% | 94.6% |
| Human Resources | 1,009,257 | 1,006,757 | -0.2% | 1,081,720 | 1,124,972 | 4.0% | 93.3% | 89.5% |
| City Attorney's Office | 1,002,792 | 983,610 | -1.9% | 993,790 | 984,121 | -1.0% | 100.9% | 99.9% |
| Parks & Community Services | 6,959,926 | 6,605,932 | -5.1% | 7,621,687 | 6,722,519 | -11.8% | 91.3% | 98.3% |
| Public Works (Engineering) | 3,485,236 | 3,123,823 | -10.4% | 3,629,985 | 3,340,832 | -8.0% | 96.0% | 93.5% |
| Finance and Administration | 3,509,598 | 3,529,461 | 0.6% | 3,671,314 | 3,743,652 | 2.0% | 95.6% | 94.3% |
| Planning & Community Development | 2,733,663 | 2,610,736 | -4.5% | 2,835,702 | 2,730,557 | -3.7% | 96.4% | 95.6% |
| Police | 16,117,610 | 16,988,616 | 5.4% | 16,557,994 | 17,188,807 | 3.8% | 97.3% | 98.8% |
| Fire & Building | 17,740,161 | 17,530,845 | -1.2% | 17,732,645 | 17,319,527 | -2.3% | 100.0% | 101.2% |
| Total Expenditures | 57,293,487 | 57,125,733 | -0.3% | 59,167,520 | 58,149,798 | -1.7% | 96.8% | 98.2% |
| Other Financing Uses: | | | | | | | | |
| Interfund Transfers | 1,705,441 | 1,024,920 | -39.9% | 1,705,441 | 1,024,920 | -39.9% | 100.0% | 100.0% |
| Total Other Financing Uses | 1,705,441 | 1,024,920 | -39.9% | 1,705,441 | 1,024,920 | -39.9% | 100.0% | 100.0% |
| Total Expenditures & Other Uses | 58,998,928 | 58,150,653 | -1.4% | 60,872,961 | 59,174,718 | -2.8% | 96.9% | 98.3% |

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

Personnel costs in most General Fund departments ended 2010 down compared to 2009 due to the combination of the implementation of furloughs (which reduced salaries and benefit costs) and reduction in staffing as strategies to balance the budget in response to declining revenues (except for staffing added in anticipation of the annexation occurring in 2011—primarily in Police). In addition, specific factors for individual departments are noted below:

Comparing to the same period last year:

- Actual 2010 expenditures for the **City Council** are **0.6 percent ahead** of last year primarily due to a one-time citizen survey paid this year.
- Actual 2010 expenditures for the **City Manager's Office** are **8.5 percent lower** due to reduced facilities charges resulting from the purchase of the Municipal Court and lower professional services costs, such as the federal lobbyist (which was funded for 2009 only), as well as the timing of outside agency funding payments and other one-time 2009 expenditures.
- Actual 2010 expenditures for the **Parks & Community Services Department** are **5.1 percent lower** primarily due to the timing of human service agency grants and reductions to staffing levels.
- Actual 2010 expenditures for the **Public Works Department** are **10.4 percent lower** almost entirely due to staffing reductions and reallocations.
- Actual 2010 expenditures for the **Finance and Administration Department** ended the year **0.6 percent ahead** of 2009 largely due to 2009 election costs which were paid in 2010.

Compared to 2009, 2010 General Fund actual expenditures are 0.3 percent lower primarily due to lower personnel costs and despite higher costs for jail costs and fire suppression overtime as noted in the explanation of Police and Fire Department expenditures.

(Continued on page 5)

Financial Management Report as of December 31, 2010

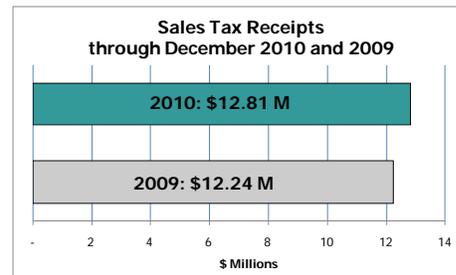
- Actual 2010 expenditures for the **Planning and Community Development Department** are **4.5 percent behind** due to one-time 2009 costs for the Shoreline Master Plan update, as well as staffing reductions.
- Actual 2010 expenditures for the **Police Department** ended the year **5.4 percent ahead** of 2009 due to personnel costs. Several positions were filled throughout 2010 in anticipation of annexation, which commences June 1, 2011. Total annexation personnel expenditures include increases for equipment and supplies for the new staff. Jail costs are 1.7 percent ahead of 2009. These costs have been a concern over the last few years. The City has negotiated new contracts with other agencies for lower rates than those charged by King County, although the total jail population and bed days continues to increase, causing expenses to outpace the budget. The overage was offset by savings in other Police functions.
- Actual 2010 expenditures for the **Fire & Building Department** are **1.2 percent behind 2009** due to lower personnel costs due to reduced building staff resulting from declining development activity and related revenue. Fire suppression overtime expenses in 2010 exceeded the annual budget by more than 42 percent, pushing the fire portion of the department over budget for the biennium. Salary savings from a vacant Fire position and under-expenditures in other City departments helped absorb the overage.



Kirkland Transit Center Design

Sales Tax Revenue Analysis

Year-to-date revenue performance ended **up 4.6 percent** compared to the same period last year, which continued the positive trend experienced for most of 2010. Strong performance in the automotive/gas retail, wholesale services and other retail sector revenue are the primary factors. However, the normalized increase drops to about 3.8 percent ahead of last year when field recoveries (one-time collections resulting from Washington State Department of Revenue audits) are factored out. (see tables on page 6).



Business sector comparison to the same period last year:

The **auto/gas retail** sector ended **up 14.4 percent** compared to last year. Positive performance was experienced throughout most of the year. October (December receipts) was the strongest month in 2010 nationally (February receipts were the strongest month for local dealers). National auto sales in 2009 were at their lowest in more than 25 years as a result of the recession. Several analysts predict that 2011 will be even better, increasing to 13 million vehicles from an estimated 12 million vehicles in 2010. Hopefully this will be reflected locally as this sector has been the primary driver in the recovery of 2010 sales tax revenue—providing more than two thirds of the dollar gain.

Other retail was **up 4.1 percent** compared to last year primarily due to internet retailers, health care, furniture, food retail, and electronics (even though electronic and furniture have slumped in recent months).

The **retail eating/drinking** sector continued to struggle, **down 5.6 percent** compared to last year.

Even though the fourth quarter of 2010 showed improvement, the **general merchandise/miscellaneous retail** sector ended the year **down 9.5 percent** compared to last year. This sector continues to be the largest drain on revenue performance this year. Hopefully this sector will remain stable in 2011 and contribute to the continuing recovery of sales tax revenue in 2011.

Wholesale finished **up 33.2 percent** compared to last year. However, this sector has been significantly impacted by field recoveries—factoring these out reduces the increase to about 23 percent. The change in the streamlined sales tax sourcing rule change (which may also be a factor in the substantial amount in field recoveries) is benefitting this sector and there are some signs of increased development activity.

The **services** sector was **up 12.3 percent** compared to last year, largely due to temporary agency and consulting services, software, and publishing, all impacted by streamlined sales tax rule changes. The accommodations sector continues to improve, up 13.2 percent compared to last year.

The **miscellaneous** sector ended **up 5.3 percent** compared to last year due to manufacturing (most likely due to changes in streamlined sales tax sourcing) and despite declines in finance/insurance and real estate.

The **contracting** sector performance was **up 0.5 percent** compared to last year. However, this sector has been significantly impacted by field recoveries. Factoring these out, the sector would be down 0.8 percent. Although this sector stabilized in 2010, revenue is 42 percent down from 2007 (almost \$1.3 million).

The **communications** sector finished **down 9.5 percent** compared to last year due to changes in development activity as well as declining revenue from telecommunications companies.

Streamlined Sales Tax

Washington State implemented new local coding sales tax rules as of July 1, 2008 as a result of joining the national Streamlined Sales Tax Agreement. Negative impacts from this change are mitigated by the State of Washington. About \$115,000 of revenue was received for 2010.

Neighboring Cities

Bellevue and Redmond 2010 sales tax revenue through December is down 4.8 percent and 3.5 percent respectively compared to the same period in 2009.

City of Kirkland Actual Sales Tax Receipts

| Business Sector Group | January-December | | Dollar Change | Percent Change | Percent of Total | |
|------------------------|-------------------|-------------------|----------------|----------------|------------------|---------------|
| | 2009 | 2010 | | | 2009 | 2010 |
| Services | 1,450,142 | 1,628,449 | 178,307 | 12.3% | 11.8% | 12.7% |
| Contracting | 1,727,379 | 1,735,361 | 7,982 | 0.5% | 14.1% | 13.6% |
| Communications | 481,053 | 435,142 | (45,911) | -9.5% | 3.9% | 3.4% |
| Auto/Gas Retail | 2,650,594 | 3,031,778 | 381,184 | 14.4% | 21.6% | 23.7% |
| Gen Merch/Misc Retail | 1,929,745 | 1,746,268 | (183,477) | -9.5% | 15.8% | 13.6% |
| Retail Eating/Drinking | 1,126,930 | 1,063,668 | (63,262) | -5.6% | 9.2% | 8.3% |
| Other Retail | 1,546,911 | 1,610,387 | 63,476 | 4.1% | 12.6% | 12.6% |
| Wholesale | 546,513 | 728,195 | 181,682 | 33.2% | 4.5% | 5.7% |
| Miscellaneous | 785,660 | 827,608 | 41,948 | 5.3% | 6.4% | 6.5% |
| Total | 12,244,927 | 12,806,856 | 561,929 | 4.6% | 100.0% | 100.0% |

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2009 and 2010 year-to-date sales tax receipts in the table to the left.

City of Kirkland Actual Monthly Sales Tax Receipts

| Month | Sales Tax Receipts | | Dollar Change | Percent Change |
|--------------|--------------------|-------------------|----------------|----------------|
| | 2009 | 2010 | | |
| January | 994,146 | 945,992 | (48,154) | -4.8% |
| February | 1,224,935 | 1,364,023 | 139,088 | 11.4% |
| March | 954,492 | 937,460 | (17,032) | -1.8% |
| April | 867,726 | 953,914 | 86,188 | 9.9% |
| May | 1,007,790 | 1,094,845 | 87,055 | 8.6% |
| June | 900,630 | 1,009,111 | 108,481 | 12.0% |
| July | 945,877 | 1,035,279 | 89,402 | 9.5% |
| August | 1,091,599 | 1,136,223 | 44,624 | 4.1% |
| September | 1,107,188 | 1,142,588 | 35,400 | 3.2% |
| October | 1,109,409 | 1,053,781 | (55,628) | -5.0% |
| November | 1,076,996 | 1,089,394 | 12,398 | 1.2% |
| December | 964,139 | 1,044,246 | 80,107 | 8.3% |
| Total | 12,244,927 | 12,806,856 | 561,929 | 4.6% |

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 example, sales tax received by the City in December is for sales activity in October. Monthly sales tax receipts through December 2009 and 2010 are compared in the table above.

- Monthly revenue performance in 2010 has improved from the mostly double digit declines experienced throughout 2009.
- The dampening of automobile sales comparisons to last year caused by the "cash for clunkers" sales spike is indicated by the smaller gains in August and September.
- October 2010 was down 5% from October 2009, which was the first negatively impacted month in 2010 since March. The downturn was largely due to significant declines in auto/gas retail sales. This comparison was largely impacted by the spike in sales in 2009 due to the "cash for clunkers" program.
- December revenue increased significantly after experiencing soft performance in the previous two months. The increase is largely caused by higher auto/gas retail sales, a large receipt from a software company, and improvement in the general merchandise/miscellaneous retail sector. Negative performance continued in contracting, other retail, retail eating/drinking and communications sectors.

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

Comparing to the same period last year:

Totem Lake, which accounts for over 30 percent of the total sales tax receipts, was **up 4.4 percent** primarily due to significant improvement in automotive/gas retail sales and retail furniture/electronics. About 66 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for almost 16 percent of the total sales tax receipts, was **up 0.3 percent** primarily due to an increase in the automotive/gas retail and despite declines in the general merchandise/miscellaneous retail sectors. These two sectors contribute over 85 percent of this business district's revenue.

Downtown, which accounts for 7 percent of the total sales tax receipts, was **down 3.7 percent** due to the loss of several retailers and declines in the retail eating/drinking sector. The retail eating/drinking, accommodations, and other retail

sectors provide over 68 percent of this business district's revenue.

Carillon Point & Yarrow Bay, which account for 2.8 percent of the total sales tax receipts, was **up 11.1 percent** compared to last year primarily due to a strong performance in the retail eating/drinking sector and a positive performance in other retail and the accommodations sectors. About 65 percent of this business district's revenue comes from business services, retail eating/drinking and accommodations.

Houghton & Bridle Trails, which accounts for 2.5 percent of the total sales tax receipts, was **up 3.2 percent** collectively almost entirely due to miscellaneous retail and other retail. A major supermarket was re-opened in May, which positively impacted this sector during the third and fourth quarters. These sectors provide over 71 percent of these business districts' revenue.

Juanita, which accounts for about 2 percent of the total sales tax receipts, was **down 2.9 percent** primarily due to a poor performance in the retail automotive/gas sector and the retail eating/drinking sectors. Retail eating/drinking, miscellaneous retail and personal services provide almost 71 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that about 41 percent of the revenue received in 2010 is in the "unassigned or no district" category largely due to contracting revenue and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

| Business District | Jan - Dec Receipts | | Dollar Change | Percent Change | Percent of Total | |
|----------------------------|--------------------|-------------------|----------------|----------------|------------------|---------------|
| | 2009 | 2010 | | | 2009 | 2010 |
| Totem Lake | 3,796,711 | 3,962,956 | 166,245 | 4.4% | 31.0% | 30.9% |
| NE 85th St | 2,034,787 | 2,040,857 | 6,070 | 0.3% | 16.6% | 15.9% |
| Downtown | 929,004 | 894,343 | (34,661) | -3.7% | 7.6% | 7.0% |
| Carillon Pt/Yarrow Bay | 321,163 | 356,940 | 35,777 | 11.1% | 2.6% | 2.8% |
| Houghton & Bridle Trails | 304,671 | 314,411 | 9,740 | 3.2% | 2.5% | 2.5% |
| Juanita | 273,208 | 265,373 | (7,835) | -2.9% | 2.2% | 2.1% |
| Unassigned or No District: | | | | | | |
| Contracting | 1,727,807 | 1,735,759 | 7,952 | 0.5% | 14.1% | 13.6% |
| Other | 2,857,575 | 3,236,217 | 378,642 | 13.3% | 25.6% | 27.3% |
| Total | 12,244,927 | 12,806,856 | 561,930 | 4.6% | 100.0% | 100.0% |

Sales Tax Revenue Outlook Sales tax receipts have been positive for most of 2010 compared to 2009, as illustrated in the monthly chart on the previous page. One-time field recoveries have supplemented the increase by almost a full percentage point. Upside trends pose potential risks—the automotive/gas retail sector has contributed the largest amount of gain, but this sector is very sensitive to economic conditions. Contracting has stabilized from the severe downturn it experienced last year, but it is also sensitive to the economy and revenue trends are much lower than just a few years ago. Performance in key retail sectors—general merchandise/miscellaneous retail—has been stable the last three months of 2010, while retail eating/drinking has not shown signs of recovery. The impact from streamlined sales tax sourcing rule changes has negatively impacted some sectors, but is offset by gains in others. The shaky economic recovery poses significant risk to the City's ability to maintain services, since sales tax remains the largest general fund revenue source this year. Changes in revenue structure over the last few years has provided some balance to offset the volatility inherent in sales tax.

OFFICE VACANCIES:

According to CB Richard Ellis Real Estate Services, the Eastside vacancy rate is 18 percent for the fourth quarter 2010 which is slightly less than the same quarter last year (18.3 percent). Kirkland's 2010 vacancy rate is 24.2 percent.

The Puget Sound regional market recovery appears to continue with 304,220 square feet of positive absorption during the fourth quarter, with less than 1 percent occurring on the Eastside. Positive absorption occurs when the total amount of available office space decreases during a set period.

Looking ahead to 2011 there is expected growth in technology companies, which is the Eastside's major strength in the market.

Brokers agree that as the economy improves vacancy rates will continue to drop and rental rates will increase.

LODGING TAX REVENUE:

Lodging tax 2010 revenue ended the year ahead 2.6 percent compared to the same period last year.

Economic Environment Update While the state economy continues to expand, the fourth quarter continues the slow recovery after a strong growth last spring. Employment growth has continued at a slow pace with about 1,000 private sector jobs added per month, too slow to reduce the state's unemployment rate. At the end of 2010, the state had 177,000 less non-farm jobs than it did at the peak of 2008. The state's chief economist concurs with the national assertion that the recession has ended in Washington State, but recovery remains fragile and volatile. The state's latest economic and revenue update points out that while the recession may have ended, it continues to weigh on the economy. The housing market is expected to remain depressed for quite a while due to foreclosures and hesitant buyers. Banking is also expected to struggle with more consolidations and failures. On the positive side, consumers have begun spending more, Boeing is predicting a 20% increase in production and maintains a backlog of orders, software sectors are projected to begin growing again in 2011, and the demand for overseas exports appears to be increasing.

The U.S. **consumer confidence index** dropped to **53.3** in December compared to 54.3 in November, primarily due to continuing high unemployment and other negative economic news. The monthly index changes have been particularly volatile in 2010, reflecting the uncertain economic conditions. An index of 90 indicates a stable economy and one at or above 100 indicates growth.

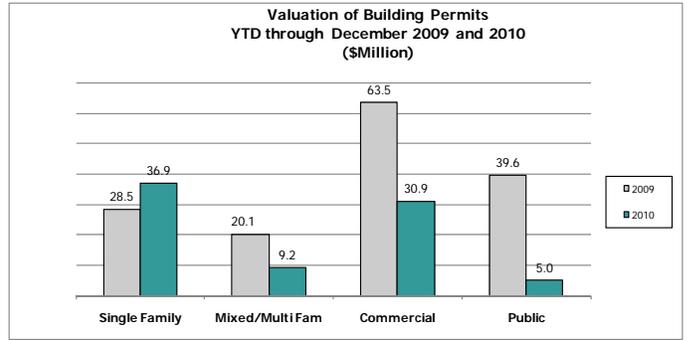
King County's **unemployment rate** was **8.4 percent** in December 2010, which was the same rate experienced in December 2009. While remaining high, King County is lower than both Washington State and national rates, which are 9.2 and 9.1 percent respectively.

The **Western Washington chapter of Purchasing Managers survey index** short-term outlook rose to 64.2 in December from 62.6 in November. The long-term outlook index also rose to 71.1 from 59.5. An index reading greater than 50 indicates a growing economy, while scores below suggest a shrinking economy.

(Continued on page 8)

Economic Environment Update *continued*

Local **development activity** through December comparing 2010 to 2009, as measured by the valuation of City of Kirkland building permits, is illustrated in the chart to the right. Activity remains improved in the single family sector. However, activity in the mixed use/multifamily, commercial and public sectors is low and the 2010 building permit valuation is 46 percent below the same period in 2009.



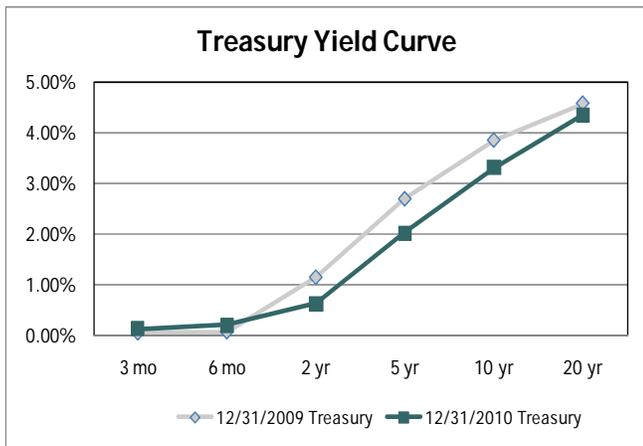
Closed sales of **new and existing single-family homes** on the Eastside are up 1.3 percent in December 2010 compared to December 2009, and the median price increased 1.9 percent (\$530,000 compared to \$520,000). Closed sales for condominiums were also up 9.2 percent, but the median price dropped 11.6 percent (to \$248,500 from \$281,200). December year-over-year sales was the largest since the federal tax credits expired, with just four fewer houses selling in December 2010 than in December 2009. In December, all areas of King County, except the Eastside, saw the median price of single family homes decline.

Seattle metro consumer price index (CPI) annual average was up 0.80 percent compared to 2009. The June index is the contractual basis for budgeting COLA increases, the June index was down 0.10 percent compared to June 2009, which means that employees will receive no cost of living adjustment in 2011, which is the second consecutive year with no adjustment. Looking ahead to 2011, a Reuters poll of economists suggests an eventual rise in inflation as economic growth strengthens. Inflation is the rise of the general price resulting in a reduced value of the dollar and purchasing power.

Investment Report

MARKET OVERVIEW

Throughout 2010, investment earning opportunities continued at all time lows. The Fed Funds rate remained in the range of 0.00 percent to 0.25 percent for all of 2010. As can be seen in the accompanying graph, the treasury yield curve remained low on the short end of the curve and dropped about one half percent in the middle of the curve.



CITY PORTFOLIO

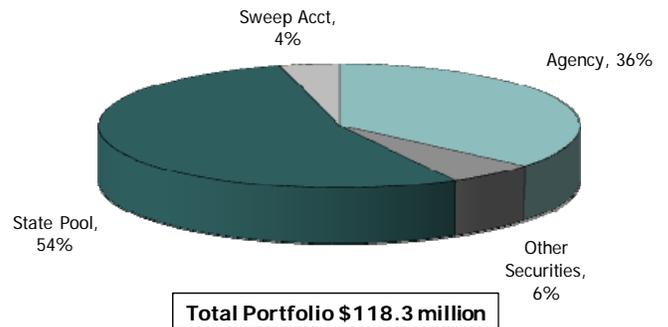
It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security, while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maxi-

imum 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 to \$118.3 million at the end of 2010 with the issuance of \$35 million in Build America Bonds for the Public Safety Building. Apart from the bond issuance, the portfolio would have decreased about \$10 million primarily due to the purchase of the property for the Public Safety Building.

Investments by Category



Diversification

The City's current investment portfolio is composed of Government Sponsored Enterprises (GSEs) bonds, State and Local Government bonds, the State Investment Pool and an overnight bank sweep account. Kirkland's Investment Policy allows up to 100% of the portfolio to be invested in US Treasuries or US Government Sponsored Enterprises (GSEs) securities with a limit of 30% of the portfolio invested in any one agency.

2010 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The professional forecasters of the Federal Reserve Bank of Philadelphia expect economic growth of 3.2 percent in 2011 following an approximate 2.9 percent increase in 2010. CPI inflation for 2011 is expected to be 2.5 percent. The unemployment rate is expected to average 9.1 percent for 2011. The Fed Funds rate, currently at 0.00 to 0.25 percent, is expected to stay at this level throughout 2011 and possibly through the first quarter of 2012.

Investment opportunities which provide greater yield are limited during this period of very low interest rates. The goal for 2011 will be to watch the movement of the interest rates and determine the best time to begin increasing the duration of the portfolio by purchasing longer term, higher yielding securities. Total investment income for 2011 is estimated to be \$785,000, less than half of the interest income for 2010 of \$1,621,752.

Investment Report *continued*

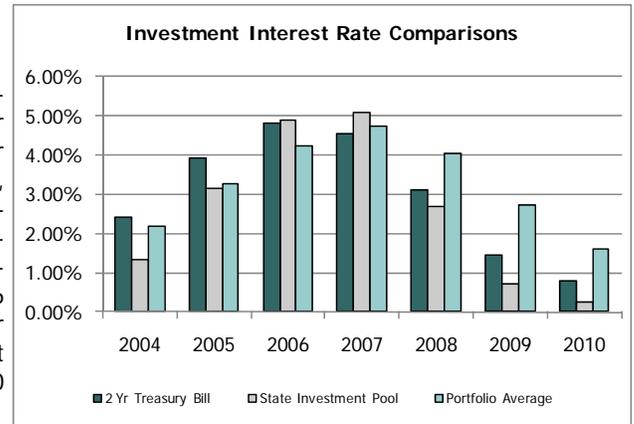
Liquidity

During 2010, the average maturity of the City's investment portfolio increased from 0.72 years to 1.07 years. This was a result of the purchase of securities with longer maturities in order to achieve greater return. The effective duration, if the bonds with call features are called, is about 0.34 years. A shorter duration in times of low interest is preferable so that the portfolio is positioned to invest as rates increase. The 2 year treasury rate is used to establish the target duration of the City's portfolio as seen in the table to the right.

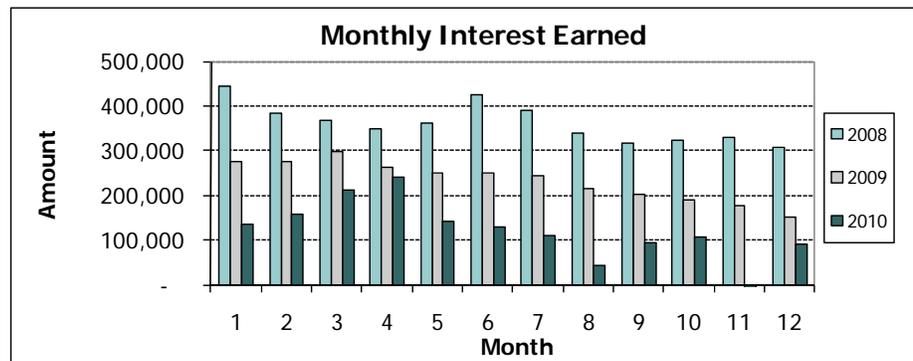
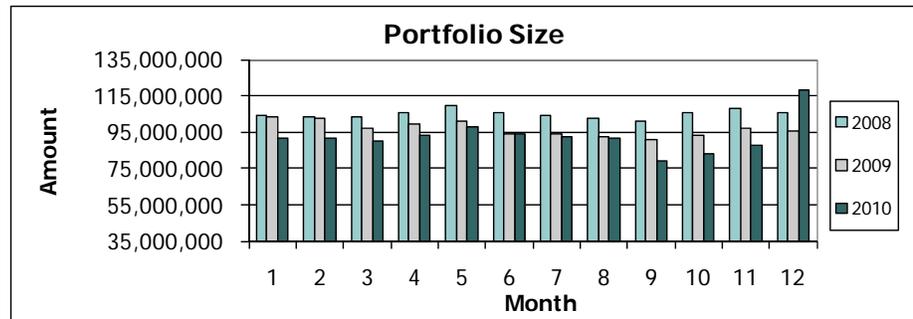
| Benchmark Comparison | December 31, 2009 | December 31, 2010 |
|------------------------------|-------------------|-------------------|
| City Yield to Maturity (YTM) | 1.66% | 1.00% |
| City Average YTM | 2.74% | 1.61% |
| City Year to Date Cash Yield | 3.04% | 1.75% |
| 90 Day Treasury Bill | 0.70% | 0.26% |
| 2 yr Rolling Avg 2 yr T Note | 1.44% | 0.80% |

Yield

The City Portfolio yield to maturity decreased from 1.66 percent on December 31, 2009 to 1.00 percent on December 31, 2010. Through December 31, 2010, the City's annual average yield to maturity was 1.61 percent, which significantly outperformed the State Investment Pool annual average yield at 0.26 percent and as well as the 2-Year Treasury Note 2-year rolling average at December 31, 2010 which was 0.80 percent.



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



Reserve Summary

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 at the end of the biennium.

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.

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). The City's reserves are listed with their revised budgeted balances at the end of the biennium in the table below:

General Government & Utility Reserves Summary

| Reserves | 2009-10 Est End Balance | 2009-10 Auth. Uses | 2009-10 Auth. Additions | Revised 2009-10 End Balance |
|---------------------------------------|----------------------------|-----------------------|----------------------------|--------------------------------|
| GENERAL PURPOSE RESERVES | | | | |
| Contingency | 2,324,515 | 607,837 | 320,600 | 2,037,278 |
| General Capital Contingency | 2,444,561 | 338,317 | | 2,106,244 |
| Park & Municipal Reserve: | | | | |
| General Oper. Reserve (Rainy Day) | 2,712,836 | | | 2,712,836 |
| Revenue Stabilization Reserve | 1,082,380 | 1,082,380 | | 0 |
| Building & Property Reserve | 2,059,669 | 125,000 | | 1,934,669 |
| Council Special Projects Reserve | 271,960 | 150,426 | 80,000 | 201,534 |
| Total General Purpose Reserves | 10,895,921 | 2,303,960 | 400,600 | 8,992,561 |
| SPECIAL PURPOSE RESERVES | | | | |
| Excise Tax Capital Improvement: | | | | |
| REET 1 | 8,370,417 | 2,349,314 | 266,078 | 6,287,181 |
| REET 2 | 8,134,095 | | 361,336 | 8,495,431 |
| Equipment Rental: | | | | |
| Vehicle Reserve | 6,421,787 | | | 6,421,787 |
| Radio Reserve | 36,000 | 36,000 | | 0 |
| Information Technology: | | | | |
| PC Replacement Reserve | 494,373 | | | 494,373 |
| Major Systems Replacement Reserve | 247,900 | 200,000 | 197,600 | 245,500 |
| Facilities Maintenance: | | | | |
| Operating Reserve | 550,000 | | | 550,000 |
| Facilities Sinking Fund | 1,051,963 | | | 1,051,963 |
| Impact Fees | | | | |
| Roads | 3,429,578 | | | 3,429,578 |
| Parks | 237,809 | | | 237,809 |
| Park Bond Reserve | 558,981 | | | 558,981 |
| Cemetery Improvement | 523,405 | | | 523,405 |
| Off-Street Parking | 204,410 | | | 204,410 |
| Tour Dock | 70,175 | | | 70,175 |
| Street Improvement | 994,576 | 32,567 | | 962,009 |
| Firefighter's Pension | 1,590,102 | | | 1,590,102 |
| Park & Municipal Reserve: | | | | |
| Litigation Reserve | 51,329 | | | 51,329 |
| Labor Relations Reserve | 67,183 | | | 67,183 |
| Police Equipment Reserve | 48,093 | | | 48,093 |
| LEOFF 1 Police Reserve | 612,029 | | | 612,029 |
| Facilities Expansion Reserve | 800,000 | | | 800,000 |
| Development Services Reserve | 457,331 | | | 457,331 |
| Tree Ordinance | 28,980 | | | 28,980 |
| Donation Accounts | 161,257 | | | 161,257 |
| Revolving Accounts | 86,175 | | | 86,175 |
| Water/Sewer Operating Reserve | 1,799,424 | | | 1,799,424 |
| Water/Sewer Debt Service Reserve | 826,759 | | | 826,759 |
| Water/Sewer Capital Contingency | 3,018,240 | 359,200 | 68,998 | 2,728,038 |
| Water/Sewer Construction Reserve | 9,444,066 | 89,787 | | 9,354,279 |
| Surface Water Operating Reserve | 394,485 | | | 394,485 |
| Surface Water Capital Contingency | 617,690 | | | 617,690 |
| Surface Water-Transp. Related Rsv | 1,302,179 | 38,126 | | 1,264,053 |
| Surface Water Construction Reserve | 3,186,434 | | | 3,186,434 |
| Total Special Purpose Reserves | 55,817,225 | 3,104,994 | 894,012 | 53,606,243 |
| Grand Total | 66,713,146 | 5,408,954 | 1,294,612 | 62,598,804 |

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

| RESERVE | AMOUNT | DESCRIPTION | RESERVE | AMOUNT | DESCRIPTION |
|----------------------------------------|-------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-----------|--------------------------------------------------------------|
| 2009-10 Council Authorized Uses | | | 2009-10 Council Authorized Additions | | |
| Contingency | \$54,750 | Verizon franchise negotiations | Contingency | \$50,000 | Reimbursement from Verizon for franchise negotiations |
| | \$188,262 | Hydrant Costs | | \$270,600 | Replenish reserve from 2009 General Fund expenditure savings |
| | \$272,000 | 2009 Firefighter Overtime | | \$80,000 | Replenish reserve from 2009 General Fund expenditure savings |
| | \$3,545 | Return 2008 Interest Backfill to General Fund | Council Special Projects Reserve | | Closed Capital Projects |
| | \$89,280 | Reserve Fire Fighter Compensation | | \$266,078 | Closed Capital Projects |
| General Capital Contingency | \$64,000 | Downtown Transit Center | Excise Tax Capital REET 1 | | Closed Capital Projects |
| | \$43,800 | NE 73rd Street Sidewalk additional funding | Excise Tax Capital REET 2 | \$361,336 | Closed Capital Projects |
| | \$98,544 | Return 2008 Interest Backfill to General Fund | Major Systems Replacement Reserve | \$197,600 | Closed Capital Projects |
| | \$60,170 | Pandemic Flu Supplies | Water Sewer Capital Contingency | \$68,998 | Closed Capital Projects |
| | \$71,803 | NE 73rd Street Sidewalk | | | |
| Revenue Stabilization Reserve | \$1,082,380 | Backfill General Fund revenue deficit | | | |
| Building & Property Reserve | \$125,000 | Return 2008 Interest Backfill to General Fund | | | |
| Council Special Projects Reserve | \$2,000 | Council Retreat facilitator | | | |
| | \$26,000 | Funding for federal lobbyist services for 2009 | | | |
| | \$25,000 | Funding for Neighborhood Connections in 2010 | | | |
| | \$20,000 | Hopelink relocation | | | |
| | \$13,770 | Flexpass program | | | |
| | \$12,506 | Bank of America project review process | | | |
| | \$5,000 | Council special investigation | | | |
| | \$12,400 | Medical transport fee consultant contract | | | |
| | \$20,000 | ParkPlace Development Agreement Legal/Financial | | | |
| | \$13,750 | Annexation Shoreline Master Plan Services | | | |
| Excise Tax Capital REET 1 | \$2,349,314 | Municipal Court Building purchase | | | |
| Equipment Rental Radio Reserve | \$36,000 | Police radios purchase | | | |
| IT Major Systems Repl. Reserve | \$200,000 | Permit Plan System replacement | | | |
| Street Improvement Fund | \$23,000 | 99th Place NE/100th Ave NE Sidewalk | | | |
| | \$9,567 | 2009 Annual Striping Program | | | |
| Water/Sewer Capital Contingency | \$54,000 | Additional funding of \$54,000 for telemetry system upgrades at Supply Station #2 to coincide with a City-wide upgrade of telemetry panels at other water facility sites. | | | |
| | \$128,000 | Funding for the completion of the 2009 Water System Improvement Project. | | | |
| | \$17,200 | NE 73rd Street Sidewalk (watermain replacement) additional funding | | | |
| | \$40,000 | 3rd Street Watermain Replacement | | | |
| | \$120,000 | 116th Ave NE (Highlands) Sidewalk Project Water System Upgrades | | | |
| Water/Sewer Construction Reserve | \$21,787 | Bridle View Annexation Water System Purchase from Redmond | | | |
| | \$68,000 | NE 116th Str Interchange Water Line Upgrade w/WSDOT | | | |
| Surface Water-Transp. Related Rsv | \$23,000 | Downtown Transit Center (surface water component) | | | |
| | \$15,126 | NE 124th Street/124th Ave NE Intersection Improvements (surface water component) | | | |

General Government & Utility Reserves Targets Summary

| Reserves | Revised 2009-10 End Balance | 2009-10 Target | Over (Under) Target |
|----------------------------------------------|-----------------------------|-------------------|---------------------|
| GENERAL PURPOSE RESERVES | | | |
| Contingency | 2,037,278 | 4,915,571 | (2,878,293) |
| General Capital Contingency | 2,106,244 | 9,032,430 | (6,926,186) |
| Park & Municipal Reserve: | | | |
| General Oper. Reserve (Rainy Day) | 2,712,836 | 3,567,649 | (854,813) |
| Revenue Stabilization Reserve | 0 | 2,188,803 | (2,188,803) |
| Council Special Projects Reserve | 201,534 | 250,000 | (48,466) |
| General Purpose Reserves with Targets | 7,057,892 | 19,954,453 | (12,896,561) |
| SPECIAL PURPOSE RESERVES | | | |
| Excise Tax Capital Improvement: | | | |
| REET 1 | 6,287,181 | 1,653,500 | 4,633,681 |
| REET 2 | 8,495,431 | 8,477,130 | 18,301 |
| Firefighter's Pension | 1,590,102 | 1,103,000 | 487,102 |
| Park & Municipal Reserve: | | | |
| Litigation Reserve | 51,329 | 50,000 | 1,329 |
| Water/Sewer Operating Reserve | 1,799,424 | 1,799,424 | 0 |
| Water/Sewer Debt Service Reserve | 826,759 | 826,759 | 0 |
| Water/Sewer Capital Contingency | 2,728,038 | 3,018,240 | (290,202) |
| Surface Water Operating Reserve | 394,485 | 394,485 | 0 |
| Surface Water Capital Contingency | 617,690 | 617,690 | 0 |
| Special Purpose Reserves with Targets | 22,790,439 | 17,940,228 | 4,850,211 |
| Reserves without Targets | 32,750,473 | n/a | n/a |
| Total Reserves | 62,598,804 | n/a | n/a |

The summary above details all Council authorized uses and additions to each reserve for the biennium through December 2010.

Use of the Revenue Stabilization Reserve was part of the budget-balancing strategy for the 2009-10 biennial budget. Replenishment of this reserve will be the first priority for use of available year-end funds.

The table to the left compares the revised ending balance to the targets established in the budget process for those reserves with targets.



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- ◆ Tracey Dunlap, Director of Finance & Administration
- ◆ Michael Olson, Deputy Director of Finance & Administration
- ◆ Sri Krishnan, Financial Planning Manager
- ◆ Neil Kruse, Senior Financial Analyst
- ◆ Tammy McCorkle, Budget Analyst
- ◆ Karen Terrell, Budget Analyst

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

- It provides a **summary budget to actual comparison** for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis** report takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

- Carol A. Kujawa, *NAPM-Western Washington Report On Business*, National Assoc. of Purchasing Management, December, 2010
- Eric Pryne, *Hot December for King County Home Sales*, The Seattle Times, January 5, 2011
- Eric Engleman, *WA's economic outlook: Washington is growing again, but at an 'erratic' pace*, December 31, 2010
- Leah Schnurr, *U.S. growth, inflation seen strengthening in 2011: Reuters poll*, News Daily, February 09, 2011
- CB Richard Ellis Real Estate Services, *Market View Puget Sound*, Fourth Quarter 2010
- Economic & Revenue Update— Washington State Economic & Revenue Forecast Council
- Consumer Board Confidence Index
- U.S. Bureau of Labor Statistics
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- City of Kirkland Building Division
- City of Kirkland Finance & Administration Department

January 2011 Financial Dashboard Highlights

February 17, 2011

- The dashboard report reflects the 2011 annual budget adopted by City Council December 7, 2010. The actual revenues and expenditures summarized in the dashboard reflect one month of data, which represents 8.33% of the calendar year. For many line items only one month of data makes it difficult to assess the trend. In addition, January results are preliminary as Finance is in the final stages of closing out 2010 in the financial system.

This report will be a challenge to interpret in 2011 due to annexation, which will impact expenditures and revenues at different times throughout the year. In particular, the City will incur increasing expenses month-by-month as we are gearing up for annexation, but no revenue from the annexation area will be collected until July and the bulk of the revenue will not be received until the fourth quarter. As a result, in the first part of the year, we will provide two dashboards versions: one that includes the annexation-related budget and one that excludes it.

- Total General Fund revenues are slightly below expectations but higher than January 2010 due to the following:
 - The 2011 budget includes revenues projected for the annexation area. If annexation revenues are removed from the budget January revenues received would be at 5.81 percent of budget. In 2010 January revenues were at 5.63 percent of budget.
 - Revenues for January do not reflect planned transfers into the General Fund, many of which are done on a quarterly basis. In addition, selected large General Fund revenues are received in periodic increments including property tax (mostly received in April/May and October/November) and Fire District 41 and King County EMS payments (quarterly or semi-annually).
 - January sales tax revenue is up 14.4 percent compared to January 2010. However, a substantial portion of the gain is one-time. Field recoveries and large one-time receipts account for almost half of the gain. The increase is 7.8 percent after factoring out these one-time events. Sales tax revenue received this month is for activity in November.
 - Utility tax receipts are within budget expectations, with annexation revenues removed from the budget, utility taxes would be at 8.4 percent of budget.
 - The business license revenues year-to-date are ahead of last year by \$56,602, and ahead of budget expectations. Part of the increase is due to the renewal of Google's business license in January, reflecting their ramp up in staffing.
 - Development revenues are below budget expectations, although higher than revenues in January 2010 by \$174,624. With projected annexation revenues removed from the budget, development revenues would be at 8.2 percent of budget. More information about development activity in January is available at the end of the dashboard report.
 - Gas tax revenues fell short of expectations due to reduced usage resulting from increased prices (gas tax is collected on a per gallon basis). With projected annexation revenues removed from the budget gas tax continues to fall short of expectations at 7.8 percent of budget.
- Total General Fund expenditures are within expectations.
 - Overall, General Fund expenditures are trailing the budget. With 2011 annexation service packages removed from the budget January expenditures would be at 8.1 percent of budget.
 - Fire Suppression overtime in January was \$77,692. Note that the budget does not currently reflect EMS transport fees or the associated overtime budget that will be added as part of the March adjustments.
 - Jail contract costs are in line with budget expectations and fuel costs do not reflect most of the January activity, which was paid on February 1 (and will appear in next month's report).

Attachments: January Dashboard
Development Services Highlights

City of Kirkland Budget Dashboard

**REFLECTS BUDGET
INCLUDING ANNEXATION
REVENUES AND EXPENSES**

2/17/2011

Annual Budget Status as of 1/31/2011 (Note 1)

Percent of Year Complete 8.33%

| | 2011 Budget | Year-to-Date Actual | % Received/ % Expended | Status | | Notes |
|------------------------|----------------|------------------------|---------------------------|------------------|---------------|-----------------------------------|
| | | | | Current Month | Last Month | |
| General Fund | | | | | | |
| Total Revenues | 68,552,198 | 3,353,425 | 4.9% | | n/a | Property tax/FD41/EMS spike in 2Q |
| Total Expenditures (2) | 69,123,399 | 4,969,638 | 7.2% | | n/a | |

Key Indicators (All Funds)

| | | | | | | |
|---------------------------|------------|-----------|-------|--|-----|-------------------------------------------------------------|
| <i>Revenues</i> | | | | | | |
| Sales Tax | 13,355,899 | 1,082,224 | 8.1% | | n/a | Prior YTD = \$ 945,992; January was 7.39% of budget in 2010 |
| Utility Taxes | 12,436,696 | 910,189 | 7.3% | | n/a | |
| Business License Fees | 2,841,234 | 302,979 | 10.7% | | n/a | |
| Development Fees | 3,961,939 | 274,430 | 6.9% | | n/a | |
| Gas Tax | 1,253,253 | 83,271 | 6.6% | | n/a | |
| <i>Expenditures</i> | | | | | | |
| GF Salaries/Benefits | 46,752,444 | 3,582,298 | 7.7% | | n/a | Excludes Fire Suppression Overtime |
| Fire Suppression Overtime | 489,872 | 77,692 | 15.9% | | n/a | |
| Contract Jail Costs | 1,620,868 | 82,127 | 5.1% | | n/a | |
| Fuel Costs | 418,500 | 14,607 | 3.5% | | n/a | |

Status Key

Revenue is higher than expected or expenditure is lower than expected

Revenue/expenditure is within expected range

WATCH - Revenue/expenditure outside expected range



Note 1 - Report shows annual values during the first year of the biennium (2011).

Note 2 - Total budgeted expenditures exceed revenues due to planned use of reserves/cash balances to balance the budget.

n/a - not applicable

City of Kirkland Budget Dashboard

Annual Budget Status as of 1/31/2011 (Note 1)

Percent of Year Complete 8.33%

**REFLECTS BUDGET
EXCLUDING ANNEXATION
REVENUES AND EXPENSES**

2/17/2011

| | 2011 Budget | Year-to-Date Actual | % Received/ % Expended | Status | | Notes |
|------------------------|----------------|------------------------|---------------------------|------------------|---------------|-----------------------------------|
| | | | | Current Month | Last Month | |
| General Fund | | | | | | |
| Total Revenues | 57,720,734 | 3,353,425 | 5.8% | | n/a | Property tax/FD41/EMS spike in 2Q |
| Total Expenditures (2) | 61,675,897 | 4,969,638 | 8.1% | | n/a | |

Key Indicators (All Funds)

| | | | | | | |
|---------------------------|------------|-----------|-------|--|-----|-------------------------------------------------------------|
| <i>Revenues</i> | | | | | | |
| Sales Tax | 12,986,200 | 1,082,224 | 8.3% | | n/a | Prior YTD = \$ 945,992; January was 7.39% of budget in 2010 |
| Utility Taxes | 10,823,609 | 910,189 | 8.4% | | n/a | |
| Business License Fees | 2,469,064 | 302,979 | 12.3% | | n/a | |
| Development Fees | 3,334,566 | 274,430 | 8.2% | | n/a | |
| Gas Tax | 1,063,853 | 83,271 | 7.8% | | n/a | |
| <i>Expenditures</i> | | | | | | |
| GF Salaries/Benefits | 43,282,461 | 3,582,298 | 8.3% | | n/a | Excludes Fire Suppression Overtime |
| Fire Suppression Overtime | 436,267 | 77,692 | 17.8% | | n/a | |
| Contract Jail Costs | 1,248,300 | 82,127 | 6.6% | | n/a | |
| Fuel Costs | 418,500 | 14,607 | 3.5% | | n/a | |

Status Key

Revenue is higher than expected or expenditure is lower than expected

Revenue/expenditure is within expected range

WATCH - Revenue/expenditure outside expected range



Note 1 - Report shows annual values during the first year of the biennium (2011).

Note 2 - Total budgeted expenditures exceed revenues due to planned use of reserves/cash balances to balance the budget.

n/a - not applicable

Development Services Report – January, 2011

A review of the January 2011 permit data allows us to offer the following:

- As in 2010, the January 2011 statistics continue to be reversing the downward trend that we witnessed in 2009. New single-family residential permit applications for January were up significantly with 10 applications received compared to 1 in January of last year. There was a slight decrease in commercial tenant improvement permits and single-family remodel permits (20 applications year to date compared to 22 last year).
- The monthly average of total permits received so far in 2011 (175) was down compared to the monthly average for 2010 (208), but the total number of permits received in January 2011 (175) was higher than January 2010 (165).
- Building Department revenue for January was \$175,323, just slightly below (2%) our Base Budget projected monthly revenue average of \$179,391 for the first 5 months of 2011. This projected monthly average will increase to \$237,946 beginning in June with the additional projected revenue of \$58,555 due to annexation area permitting. This projected monthly average will increase again to \$416,911 for November and December with the additional projected revenue of \$178,965 for the redevelopment of Parkplace. We hope to see some of this revenue sooner if Touchstone agrees to the Progressive Plan Review approach to provide review services during the design process. Revenue of \$7,932 was generated in January by loaning one Building Inspector to the City of Issaquah. This agreement will terminate on March 1, 2011.
- Public Works Department development revenue for January 2011 was \$55,384, which is \$11,177 above our monthly projected revenue average of \$44,208.
- Planning Department revenue for January 2011 was \$40,517 which is \$2,920 above our adjusted monthly projected revenue average of \$37,597 for 2011.



CITY OF KIRKLAND

Department of Finance & Administration

123 Fifth Avenue, Kirkland, WA 98033 425.587.3100

www.ci.kirkland.wa.us

MEMORANDUM

To: Kurt Triplett, City Manager

From: Tracey Dunlap, Director of Finance & Administration
Neil Kruse, Senior Financial Analyst

Date: February 28, 2011

Subject: February Sales Tax Revenue Analysis

February sales tax revenue is **up 0.2 percent** compared to February 2010. **Year-to-date** revenue performance is **up 6.0 percent** compared to the same period last year. Significant field recoveries last month skew the comparison. The normalized increase drops to 4.6 percent ahead of last year when field recoveries are factored out. Sales tax revenue received this month is for activity in December.

Comparing February 2011 performance to February 2010, the following business sector trends are noteworthy:

- **Communications** is up 151.3 percent (over \$56,000) apparently due to development-related activity from one key business.
- The **services** sector is up 6.1 percent (about \$11,000) primarily due to the impact from streamlined sales tax sourcing rule changes.
- **Auto/gas retail** sales remained positive, but the rate of increase was relatively flat for the second month in a row. The sector is up only 2.5 percent this month (about \$7,000). This compares to a range of 15.8 percent to 38.3 percent experienced from May to August of last year (comparisons in September and October were skewed by the cash for clunkers program the previous year, but rebounded in November and December to 12.1 percent and 21.7 percent respectively). The adjacent table displays this sector's performance monthly performance since January 2010. Performance among local dealerships is inconsistent this month. Some experienced very strong sales, which were unfortunately offset by negative performance by others. Nationally, car sales were about 14 percent higher than the same month of the previous year. This sector was key in supporting positive sales tax revenue performance throughout 2010.
- **Retail eating/drinking** sector remains is down 2.2 percent (about \$2,000) as many restaurants continue to experience negative performance.
- The **general merchandise/miscellaneous retail** sector is down 1.6 percent (about \$3,600) due to disappointing performance from key retailers.
- **Wholesale** is down 9.6 percent (almost \$7,000) most likely due to differences in development-related activity and despite positive impacts from streamlined sales tax sourcing rule changes.
- The **miscellaneous** sector performance is down 11.6 percent (almost \$9,000) due to declines in real estate and finance.
- **Other retail** is down 10.4 percent (almost \$20,000) primarily due to a large development-related receipt received last year. Normalized, this sector would still be down about 2 percent as most retail businesses, including internet retailers, posted negative performance.

| | % Change 2009 to 2010 | % Change 2010 to 2011 |
|---------------|--------------------------|--------------------------|
| January | 8.9% | 22.1% |
| February | 32.3% | 2.5% |
| March | 1.0% | |
| April | 12.3% | |
| May | 38.3% | |
| June | 33.9% | |
| July | 34.2% | |
| August | 15.8% | |
| September | 3.4% | |
| October | -16.0% | |
| November | 12.1% | |
| December | 21.7% | |
| Annual | 14.4% | 10.9% |

- **Contracting** sector is down 15.5 percent (about \$30,000), illustrating this sector's inherent volatility. A large one-time receipt from a mixed-used development skewed last year's performance. Factored out, the sector would be up about 13 percent. Several large projects continue to contribute substantial revenue, so hopefully this sector will return to positive performance as the year progresses.

Year-to-Date Business sector review:

- Retail sectors sales tax revenue collectively are up 5.9 percent compared to 2010.
 - The **general merchandise/miscellaneous retail** sector is **up 16.4 percent** compared to last year despite disappointing performance this month. This sector had the largest declines in revenue performance in 2010, so the positive year-to-date performance is encouraging.
 - The **auto/gas retail** sector is **up 10.9 percent** compared to last year. Although remaining positive, this sector has slowed over the last few months.
 - The **retail eating/drinking** sector performance is **down 0.9 percent** compared to last year as many restaurants continue to struggle to return to positive performance.
 - **Other retail is down 9.4 percent** compared to last year due to declines in electronics, furniture, and health/personal retailers despite increased revenues to food and beverage retailers.
- The **contracting** is **up 2.3 percent** compared to last year despite negative performance this month. While this is a significant improvement from last year, the sector is still below the performance of the previous three years (40.4 percent below the peak year of 2007).
- The **services** sector is **up 7.5 percent** compared to last year, largely due to software services. The accommodations sector is up 7.3 percent or about \$2,400.
- The **miscellaneous** sector is **down 5.3 percent** compared to last year due declines in the finance/insurance and real estate sectors.
- The **communications** sector is **up 74.8 percent** compared to last year due to the previously mentioned development related activity from a telecommunications company.
- **Wholesale** is **down 14.4 percent** compared to last year due to lower levels of development-related activity and despite positive impact from the streamlined sales tax sourcing rule change.

City of Kirkland Actual Sales Tax Receipts

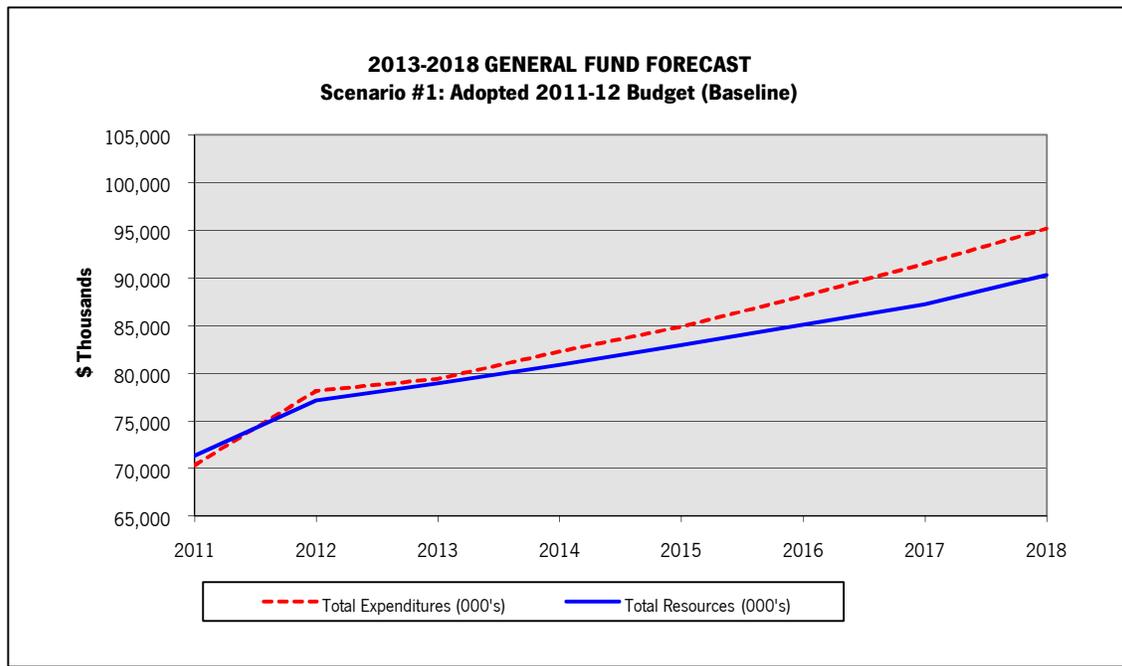
| Business Sector Group | January-February | | Dollar Change | Percent Change | Percent of Total | |
|------------------------|------------------|------------------|----------------|----------------|------------------|---------------|
| | 2010 | 2011 | | | 2010 | 2011 |
| Services | 287,491 | 309,090 | 21,599 | 7.5% | 12.4% | 12.6% |
| Contracting | 309,348 | 316,429 | 7,081 | 2.3% | 13.4% | 12.9% |
| Communications | 71,474 | 124,947 | 53,473 | 74.8% | 3.1% | 5.1% |
| Auto/Gas Retail | 510,455 | 566,317 | 55,862 | 10.9% | 22.1% | 23.1% |
| Gen Merch/Misc Retail | 359,805 | 418,664 | 58,859 | 16.4% | 15.6% | 17.1% |
| Retail Eating/Drinking | 180,605 | 179,016 | (1,589) | -0.9% | 7.8% | 7.3% |
| Other Retail | 329,671 | 298,619 | (31,052) | -9.4% | 14.3% | 12.2% |
| Wholesale | 124,863 | 106,873 | (17,990) | -14.4% | 5.4% | 4.4% |
| Miscellaneous | 136,303 | 129,120 | (7,183) | -5.3% | 5.9% | 5.3% |
| Total | 2,310,015 | 2,449,075 | 139,060 | 6.0% | 100.0% | 100.0% |

Conclusion

While the year continues on a positive note, performance for February is disappointing. Receipts for this month reflect activity during the critical holiday retail sales month of December. Positive performance for holiday shopping experienced both nationally and regionally may have contributed to January's good result, but were not experienced in Kirkland in February. As mentioned last month, 2011 sales tax revenue was budgeted to remain the same as 2010, so positive performance is a net gain to offset volatility that may be experienced later this year in this revenue source or in other revenue sources.

The February consumer confidence index increased to 70.4 from 64.8 in January. Lynn Franco, Director of The Conference Board Consumer Research Center says: "The Consumer Confidence Index is now at a three-year high (Feb. 2008, 76.4), due to growing optimism about the short-term future. Consumers' assessment of current business and labor market conditions has improved moderately, but still remains rather weak. Looking ahead, consumers are more positive about the economy and their income prospects, but feel somewhat mixed about employment conditions." Though the consumer confidence index reached its highest point in three years, it remains well below the more than 90.0 benchmark of a stable economy.

The latest economic update from the Washington State Economic and Revenue Forecast Council shows the economy's gross output of goods and services continues to recover, but there are several areas of weakness, and uncertainty remains high. Despite decreasing in each of the past two months, the unemployment rate remains elevated. That has prevented any more than a modest improvement in consumer confidence. Credit conditions for small businesses are easing, but still remain tight. On the positive side, there was an uptick in consumer spending over the holidays; equity markets have made robust gains over the last month; and overseas demand for U.S. products is growing.



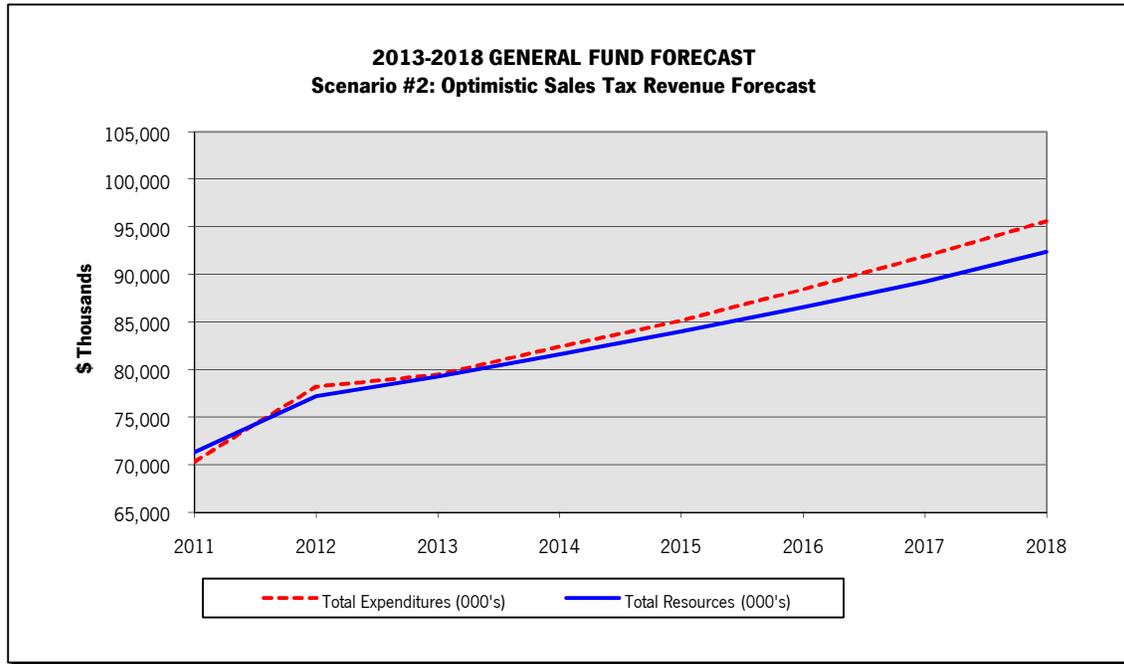
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Total Resources (000's) | 71,335 | 77,166 | 78,915 | 80,908 | 82,959 | 85,068 | 87,240 | 90,292 |
| Total Expenditures (000's) | 70,332 | 78,169 | 79,424 | 82,299 | 84,910 | 88,109 | 91,473 | 95,186 |
| Net Resources (000's) | 1,003 | (1,003) | (509) | (1,391) | (1,951) | (3,040) | (4,233) | (4,894) |
| Biennium Total (000's) | 0 | | (1,899) | | (4,992) | | (9,128) | |

Key Revenue Assumptions:

- Based on 2011-2012 Budget with annexation-related revenues starting in 2011
- No diversion of current revenue sources to CIP
- No use of reserves in 2013-2018
- 1% optional property tax and 1% annual growth in new construction property tax in 2012-2018
- **Sales tax growth of 3% growth in 2012 over 2011, and 4% annual growth reflected in 2013-2018 projections**
- 3% annual growth in utility taxes in 2012 over 2011; 3% annual growth in utility taxes in 2013-2018
- 1% growth in other taxes (revenue generating regulatory license and gambling taxes) over 2011 reflected in 2012; 2% annual growth in 2013-2018
- 2% annual growth in other revenue in 2013-2018
- Annual growth in annexation-related revenue projected at the same growth rate as the current City for 2013-2018

Key Expenditure Assumptions:

- Based on 2011-2012 Budget including annexation expenses, excluding one-time annexation-related service packages
- **COLA at 0% in 2011 and 2.5% in 2012 – 5% annual growth in wages in 2013-2018**
- **7% annual increase in total benefits in 2013-2018**
- No annual growth in supplies, services & capital in 2013-2018
- Annexation-related expenditures in 2013-2018 set to equal anticipated revenue in 2013-2018



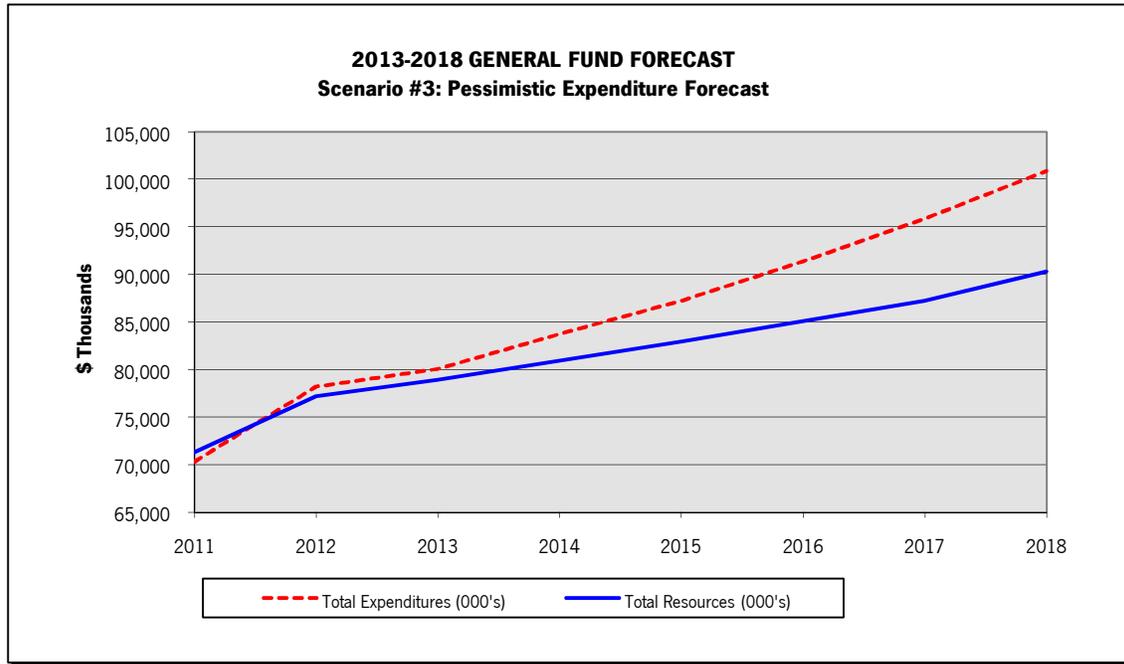
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|--------------|----------------|----------------|----------------|----------------|
| Total Resources (000's) | 71,335 | 77,166 | 79,240 | 81,589 | 84,032 | 86,571 | 89,212 | 92,382 |
| Total Expenditures (000's) | 70,332 | 78,169 | 79,491 | 82,439 | 85,130 | 88,417 | 91,878 | 95,616 |
| Net Resources (000's) | 1,003 | (1,003) | (251) | (849) | (1,099) | (1,846) | (2,666) | (3,233) |
| Biennium Total (000's) | 0 | | (1,100) | | (2,945) | | (5,900) | |

Key Revenue Assumptions:

- Based on 2011-2012 Budget with annexation-related revenues starting in 2011
- No diversion of current revenue sources to CIP
- No use of reserves in 2013-2018
- 1% optional property tax and 1% annual growth in new construction property tax in 2012-2018
- Sales tax growth of 3% growth in 2012 over 2011, and 6% annual growth reflected in 2013-2018 projections
- 3% annual growth in utility taxes in 2012 over 2011; 3% annual growth in utility taxes in 2013-2018
- 1% growth in other taxes (revenue generating regulatory license and gambling taxes) over 2011 reflected in 2012; 2% annual growth in 2013-2018
- 2% annual growth in other revenue in 2013-2018
- Annual growth in annexation-related revenue projected at the same growth rate as the current City for 2013-2018

Key Expenditure Assumptions:

- Based on 2011-2012 Budget including annexation expenses, excluding one-time annexation-related service packages
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- No annual growth in supplies, services & capital in 2013-2018
- Annexation-related expenditures in 2013-2018 set to equal anticipated revenue in 2013-2018



| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|--------------|----------------|----------------|----------------|-----------------|----------------|-----------------|-----------------|
| Total Resources (000's) | 71,335 | 77,166 | 78,915 | 80,908 | 82,959 | 85,068 | 87,240 | 90,292 |
| Total Expenditures (000's) | 70,332 | 78,169 | 80,089 | 83,724 | 87,202 | 91,386 | 95,866 | 100,842 |
| Net Resources (000's) | 1,003 | (1,003) | (1,174) | (2,816) | (4,243) | (6,317) | (8,626) | (10,550) |
| Biennium Total (000's) | 0 | | (3,990) | | (10,561) | | (19,177) | |

Key Revenue Assumptions:

- Based on 2011-2012 Budget with annexation-related revenues starting in 2011
- No diversion of current revenue sources to CIP
- No use of reserves in 2013-2018
- 1% optional property tax and 1% annual growth in new construction property tax in 2012-2018
- Sales tax growth of 3% growth in 2012 over 2011, and 4% annual growth reflected in 2013-2018 projections
- 3% annual growth in utility taxes in 2012 over 2011; 3% annual growth in utility taxes in 2013-2018
- 1% growth in other taxes (revenue generating regulatory license and gambling taxes) over 2011 reflected in 2012; 2% annual growth in 2013-2018
- 2% annual growth in other revenue in 2013-2018
- Annual growth in annexation-related revenue projected at the same growth rate as the current City for 2013-2018

Key Expenditure Assumptions:

- Based on 2011-2012 Budget including annexation expenses, excluding one-time annexation-related service packages
- COLA at 0% in 2011 and 2.5% in 2012 – 6% annual growth in wages in 2013-2018
- 10% annual increase in total benefits in 2013-2018
- No annual growth in supplies, services & capital in 2013-2018
- Annexation-related expenditures in 2013-2018 set to equal anticipated revenue in 2013-2018