



Financial Management Report

AS OF SEPTEMBER 30, 2007

AT A GLANCE:

General Fund revenues ahead of last year by 4.7 percent

Sales tax revenue performance weakens (see page 5)

Development revenue down overall (see page 3)

Mixed economic trends may be signals of cooling local economy (see pages 7-8)

Google pre-leases 190,000 square feet of space in new Kirkland office complex (see page 7)

Costco confirms Bellevue store opening in late 2008 (see page 7)

Eastside house sales fall 28 percent; however prices rise 6.1 percent (see page 8)

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Summary of All Operating Funds: *Revenue*

- General Fund** revenue is budgeted to increase 6.8 percent in 2007 over 2006, largely from expectations of higher sales and utility tax revenue and property tax dedicated to public safety staffing. Actual revenues are trailing the budgeted increase at 4.7 percent ahead of the same period last year, largely due to a dip in development-related permit and fee revenues, weakening sales tax revenue, and despite strong utility tax revenue. A more detailed analysis of sales tax revenue performance can be found beginning on page 5.
- Water Sewer Operating Fund** revenue is budgeted 4.3 percent higher in 2007 than 2006 due to water and sewer rate increases and normal growth. Actual revenue is tracking higher than expected, at 15.8 percent due to strong water sales this year.
- Surface Water Management Fund** revenue collection is budgeted 4.9 percent higher in 2007 than 2006 due to rate increases and normal growth. Actual revenue is close to expected at 4.2 percent ahead of the same period last year. Surface Water fees are paid through property tax collection, which are primarily received in April and October.
- Solid Waste Fund** revenue collection is budgeted to increase 5.6 percent in 2007 over 2006 due to higher rates and normal growth. Actual revenue is close to expected, at 5.1 percent ahead of the same period last year.
- Other General Government Funds** revenues are budgeted 10 percent higher in 2007 than last year largely due to increased internal charges and the move of Multi-media Services from the General Fund to the Information Technology Fund. Actual collections are tracking higher than planned, at 14.5 percent ahead of the same period last year, mostly due to the receipt of 2006 cable tax revenue in 2007 and higher than expected lodging tax receipts.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2006	9/30/2007	% Change	2006	2007	% Change	2006	2007
General Gov't Operating:								
General Fund	35,414,457	37,094,860	4.7%	49,091,816	52,445,710	6.8%	72.1%	70.7%
Other General Gov't Operating Funds	10,025,933	11,484,313	14.5%	15,170,554	16,683,646	10.0%	66.1%	68.8%
Total General Gov't Operating	45,440,390	48,579,173	6.9%	64,262,370	69,129,356	7.6%	70.7%	70.3%
Utilities:								
Water/Sewer Operating Fund	10,536,675	12,204,438	15.8%	15,802,180	16,474,571	4.3%	66.7%	74.1%
Surface Water Management Fund	2,824,721	2,943,672	4.2%	4,977,108	5,222,394	4.9%	56.8%	56.4%
Solid Waste Fund	5,503,490	5,784,335	5.1%	7,449,930	7,864,908	5.6%	73.9%	73.5%
Total Utilities	18,864,886	20,932,445	11.0%	28,229,218	29,561,873	4.7%	66.8%	70.8%
Total All Operating Funds	64,305,276	69,511,618	8.1%	92,491,588	98,691,229	6.7%	69.5%	70.4%

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



Kirkland's innovative pedestrian safety program (part of the City's Public Works Transportation division) includes pedestrian flags and flashing pavement markings, among other tools that support the City's goal of encouraging a safe "walkable" community. The pedestrian flag program was the first of its kind in the nation and has been duplicated by many other cities. The City implemented the new "Take it to Make It" campaign recently in an effort to raise safety awareness and increase the use of the safety flags by pedestrians at crosswalks.

Summary of All Operating Funds: *Expenditures*

- General Fund** expenditures are budgeted to increase 8.2 percent in 2007 over 2006 largely due to increased personnel costs and additional staffing, as well as budgets for unfinished projects "carried over" from the prior year. Actual expenditures are 11.6 percent ahead of the same period last year primarily due to the settlement of a labor contract from 2006 in 2007, resulting in distribution of market and cost of living increases and higher than expected firefighter overtime costs.
- Other Operating Funds** expenditures are budgeted to increase 15 percent over 2006 primarily due to increased personnel, operating and fuel costs, and the shift of Multi-media Services from the General Fund. Actual expenditures are 7.3 percent behind the same period last year due to several large vehicle purchases made in the first quarter of 2006 (such as a fire engine and dump trucks) and despite the settlement of a labor contract from 2006 in 2007.
- Water/Sewer Operating Fund** expenditures are budgeted to increase 9.1 percent in 2007 over 2006 due to higher water purchases and sewer treatment costs and increased regional connection charges paid to Cascade Water Alliance (covered by connection charge revenue). Actual expenditures are lower, at 5.5 percent ahead of the same period in 2006, primarily due to position vacancies and despite the settlement of a labor contract from 2006 in 2007.
- Surface Water Management Fund** expenditures are budgeted to increase 14.1 percent in 2007 over 2006 largely due to increased funding for capital projects and additional plans generated from the completed Surface Water Master Plan, and increased personnel costs. Actual expenditures are tracking higher than planned at 15.9 percent ahead of the same period in 2006 due to the settlement of a labor contract from 2006 in 2007 and position vacancies in 2006.
- Solid Waste Fund** expenditures are budgeted to increase 7.8 percent in 2007 over 2006 due to higher solid waste contract rates. Actual 2007 expenditures are slightly behind the planned increase at 3.9 percent over the same period in 2006 due to normal variability in disposal contract billing payment amounts.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2006	9/30/2007	% Change	2006	2007	% Change	2006	2007
General Gov't Operating:								
General Fund	34,162,720	38,137,707	11.6%	49,962,235	54,040,016	8.2%	68.4%	70.6%
Other General Gov't Operating Funds	12,449,347	11,537,630	-7.3%	15,072,831	17,336,488	15.0%	82.6%	66.6%
Total General Gov't Operating	46,612,067	49,675,337	6.6%	65,035,066	71,376,504	9.8%	71.7%	69.6%
Utilities:								
Water/Sewer Operating Fund	11,537,412	12,177,562	5.5%	15,492,943	16,899,618	9.1%	74.5%	72.1%
Surface Water Management Fund	2,798,998	3,243,474	15.9%	4,939,600	5,635,234	14.1%	56.7%	57.6%
Solid Waste Fund	4,982,848	5,178,934	3.9%	7,247,024	7,815,745	7.8%	68.8%	66.3%
Total Utilities	19,319,258	20,599,970	6.6%	27,679,567	30,350,597	9.6%	69.8%	67.9%
Total All Operating Funds	65,931,325	70,275,307	6.6%	92,714,633	101,727,101	9.7%	71.1%	69.1%

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

Many revenues are subject to seasonal variability and timing of large receipts can also skew year-to-year comparisons

General Fund Revenue

- A detailed analysis of **sales tax** revenue can be found starting on page 5.
- Utility tax** revenue is budgeted to increase 10.9 percent ahead of 2006 primarily due to higher utility rates. Actual revenue collection is ahead of target at 11.9 percent ahead of the same period last year due to higher than expected telephone utility tax.
- Business licenses and franchise fees** are budgeted to increase 19.8 percent over 2006 primarily due to franchise fees. Actual revenue, at 5.2 percent ahead of 2006, is running lower than planned so far this year due to a 7 percent decline in license issuances compared to last year and lower than expected franchise fee revenue. The **revenue generating regulatory license** fee is budgeted to increase 8.3 percent over 2006. Actual revenue is down 1.9 percent compared to the same period last year, also due to the number of license issuances.
- Development-related** revenue trends are lagging behind the same period in 2006. **Building/structural permits** are budgeted 4.7 higher than 2006, but actual revenue is 11.5 percent lower than the same period in 2006. **Engineering development charges** are budgeted 56.3 percent higher than 2006 and actual revenues are trailing 2006, down 3.1 percent compared to the same period. **Plan check/development** fees are faring better; budgeted 19.8 percent lower than 2006, but actual revenue is only 2.2 percent lower compared to 2006. The trends for development-related revenue this year reflect the volatility that is inherent in development activity and also are reflected in sales tax revenue performance (see page 5).
- Other intergovernmental services** performance comparison is skewed due to a large reimbursement payment received from FEMA in 2006 for firefighters who worked during the Hurricane Katrina relief efforts.
- Fines/forfeits** revenue was expected to remain flat, budgeted 0.4 percent lower than 2006. Actual revenue is up 21.2 percent compared to the same period in 2006 as a result of an increased number of traffic cases as well as revenue from the new false alarm program.
- Note: Fire District #41 is received semiannually and EMS revenue is normally received in the second half of the year.*

General Fund revenues as of September 30th are almost \$1.7 million ahead of the same period in 2006 primarily due to sales and utility taxes.

General Fund revenue is budgeted to increase 6.7 percent over 2006. Actual revenue is trailing, up only 4.7 percent over the same period last year due to lower than expected sales tax and development-related permits and fees.

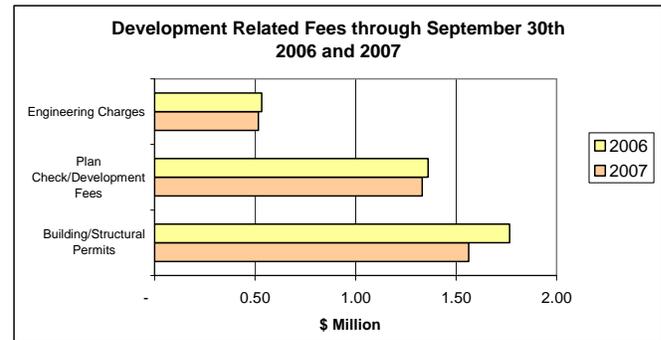
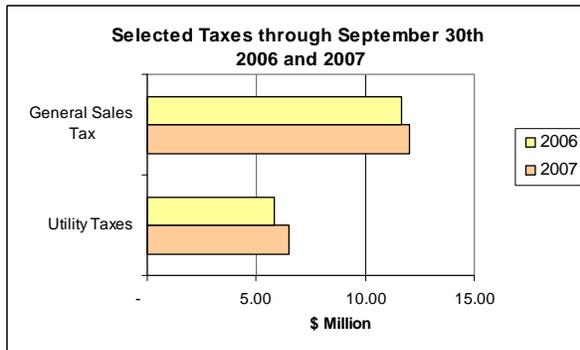
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 372 of the City's 467 permanent employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	9/30/2006	9/30/2007	% Change	2006	2007	% Change	2006	2007
Taxes:								
Retail Sales Tax: General	11,660,712	12,022,001	3.1%	14,132,692	15,736,923	11.4%	82.5%	76.4%
Retail Sales Tax: Criminal Justice	770,795	851,707	10.5%	890,000	1,025,000	15.2%	86.6%	83.1%
Property Tax	4,448,807	4,719,810	6.1%	8,117,113	8,790,086	8.3%	54.8%	53.7%
Utility Taxes	5,804,890	6,495,072	11.9%	7,171,200	7,950,034	10.9%	80.9%	81.7%
Rev Generating Regulatory License	786,061	771,034	-1.9%	900,000	975,000	8.3%	87.3%	79.1%
Other Taxes	384,952	343,650	-10.7%	464,800	461,000	-0.8%	82.8%	74.5%
Total Taxes	23,856,217	25,203,274	5.6%	31,675,805	34,938,043	10.3%	75.3%	72.1%
Licenses & Permits:								
Building, Structural & Equipment Permits	1,766,250	1,562,497	-11.5%	2,084,742	2,183,450	4.7%	84.7%	71.6%
Business Licenses/Franchise Fees	1,038,314	1,092,343	5.2%	1,184,775	1,418,950	19.8%	87.6%	77.0%
Other Licenses & Permits	173,363	144,030	-16.9%	169,020	169,900	0.5%	102.6%	84.8%
Total Licenses & Permits	2,977,927	2,798,870	-6.0%	3,438,537	3,772,300	9.7%	86.6%	74.2%
Intergovernmental:								
Grants	80,359	163,860	103.9%	207,017	169,454	-18.1%	38.8%	96.7%
State Shared Revenues & Entitlements	400,256	472,666	18.1%	590,033	606,715	2.8%	67.8%	77.9%
Fire District #41	1,466,881	1,647,207	N/A	3,141,052	3,329,121	N/A	46.7%	49.5%
EMS	-	-	N/A	489,685	504,376	N/A	N/A	N/A
Other Intergovernmental Services	516,360	424,620	-17.8%	438,539	423,870	-3.3%	117.7%	100.2%
Total Intergovernmental	2,463,856	2,708,353	9.9%	4,866,326	5,033,536	3.4%	50.6%	53.8%
Charges for Services:								
Internal Charges	2,470,590	2,531,279	2.5%	3,531,586	3,365,127	-4.7%	70.0%	75.2%
Engineering Services	533,193	516,753	-3.1%	400,000	625,000	56.3%	133.3%	82.7%
Plan Check & Planning Fees	1,360,945	1,330,846	-2.2%	2,276,836	1,825,900	-19.8%	59.8%	72.9%
Recreation	83,048	81,932	-1.3%	74,000	81,000	9.5%	112.2%	101.2%
Other Charges for Services	485,067	664,803	37.1%	674,199	752,591	11.6%	71.9%	88.3%
Total Charges for Services	4,932,843	5,125,613	3.9%	6,956,621	6,649,618	-4.4%	70.9%	77.1%
Fines & Forfeits	745,491	903,205	21.2%	1,157,550	1,152,750	-0.4%	64.4%	78.4%
Miscellaneous	438,123	355,545	-18.8%	590,991	408,065	-31.0%	74.1%	87.1%
Total Revenues	35,414,457	37,094,860	4.7%	48,685,830	51,954,312	6.7%	72.7%	71.4%
Other Financing Sources:								
Interfund Transfers	-	-	N/A	405,986	491,398	N/A	N/A	N/A
Total Other Financing Sources	-	-	N/A	405,986	491,398	N/A	N/A	N/A
Total Resources	35,414,457	37,094,860	4.7%	49,091,816	52,445,710	6.8%	72.1%	70.7%

* 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	
	9/30/2006	9/30/2007	% Change	2006	2007	% Change	2006	2007
Non-Departmental	826,755	722,353	-12.6%	851,614	1,128,527	32.5%	97.1%	64.0%
City Council	245,612	235,517	-4.1%	311,733	316,392	1.5%	78.8%	74.4%
City Manager's Office	1,783,532	2,156,454	20.9%	2,431,813	3,343,442	37.5%	73.3%	64.5%
Human Resources	662,119	730,029	10.3%	855,969	1,036,649	21.1%	77.4%	70.4%
City Attorney's Office	615,034	650,598	5.8%	881,406	997,460	13.2%	69.8%	65.2%
Parks & Community Services	3,608,964	4,133,948	14.5%	5,096,976	5,867,551	15.1%	70.8%	70.5%
Public Works (Engineering)	2,110,073	2,624,936	24.4%	2,887,753	3,782,206	31.0%	73.1%	69.4%
Finance and Administration	2,091,216	2,367,335	13.2%	2,891,824	3,420,668	18.3%	72.3%	69.2%
Planning & Community Development	2,141,009	2,386,928	11.5%	2,965,328	3,834,113	29.3%	72.2%	62.3%
Police	9,000,007	9,842,041	9.4%	12,962,506	13,812,086	6.6%	69.4%	71.3%
Fire & Building	10,953,777	11,912,338	8.8%	14,578,689	15,795,562	8.3%	75.1%	75.4%
Total Expenditures	34,038,098	37,762,477	10.9%	46,715,611	53,334,656	14.2%	72.9%	70.8%
Other Financing Uses:								
Interfund Transfers	124,622	375,230	201.1%	3,246,624	705,360	-78.3%	3.8%	53.2%
Total Other Financing Uses	124,622	375,230	201.1%	3,246,624	705,360	-78.3%	3.8%	53.2%
Total Expenditures & Other Uses	34,162,720	38,137,707	11.6%	49,962,235	54,040,016	8.2%	68.4%	70.6%

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

- The **Non-departmental** division expenditures are budgeted 32.5 percent higher than 2006 due to a relocation of the Multi-media Services functions to Information Technology resulting in a change in accounting for the internal charges. Actual expenditures are 12.6 percent behind the same period in 2006 primarily due to the timing of outside agency payments and lower than expected postage costs.

Budgeted and current year actual expenditures compared to 2006 for the following departments are up primarily due to higher personnel costs, including an unsettled labor contract from 2006 that settled in 2007 and additional positions added in 2007. In addition to this general trend, specific highlights by selected department are listed below:

- The **City Manager's** expenditures are budgeted 37.5 percent higher than 2006 due the addition of a communications program manager and municipal court staffing, and additional funding for economic development, outside agencies and one-time annexation studies. Actual expenditures are only 20.9 percent ahead of the same period last year primarily due to the normal delay in hiring newly approved positions and uncompleted projects such as consulting for NORCOM and annexation.
- The **Human Resources Department** expenditures are budgeted 21.1 percent higher than 2006 due to an additional temporary human resources analyst. Actual expenditures are only 10.3 percent ahead of the same period last year due to the delay of hiring the new position, timing of public safety assessment centers, and unfinished projects such as health care consulting.

Compared to budget, 2007 General Fund actual expenditures are tracking slightly below the same trend as last year (70.8 percent of budget in 2007 compared to 72.9 percent of budget in 2006) largely due to the normal delayed hiring of newly approved 2007 positions, position vacancies, and timing of major projects.

General Fund expenditures *continued*

- The **Public Works Department** expenditures are budgeted 31.0 percent higher than 2006 due to additional positions, service packages for traffic counts and transportation management plans, as well as one-time annexation studies. Actual expenditures are lower than planned, 24.4 percent higher than the same period in 2006, due to position vacancies, the delay of hiring new positions, and unfinished projects such as the annexation analysis and transportation management plans.
- The **Finance & Administration Department** expenditures are budgeted 18.3 percent higher than 2006 due to additional utility billing staff and one-time annexation studies. Actual expenditures are trailing the budgeted increase, at 13.2 percent higher than the same period in 2006, due to uncompleted projects such as the annexation fiscal analysis.
- The **Planning Department** expenditures are budgeted 29.3 percent higher than 2006 due to additional development-related staffing and one-time annexation studies. Actual expenditures are lower than planned, only 11.5 percent ahead compared to the same period last year, due to the delay in hiring additional staffing and uncompleted projects such as the Shoreline Master Plan and timing of payments to ARCH (A Regional Coalition for Housing).
- The **Police Department** actual expenditures are running higher than budgeted (9.4 percent actual compared to 6.6 percent budget) because of undistributed cost of living budget for recently settled and pending contracts. The distribution of the COLA for the settled contract is expected to occur before year-end.
- The **Fire Department** expenditures are budgeted 8.3 percent higher than 2006 due to additional development staff and a temporary emergency preparedness coordinator. Actual expenditures are slightly higher than planned, 8.8 percent ahead compared to the same period last year, primarily due to 2006 staff vacancies, higher than expected overtime costs, and one-time computer expenditures.



The City supports community celebrations with its

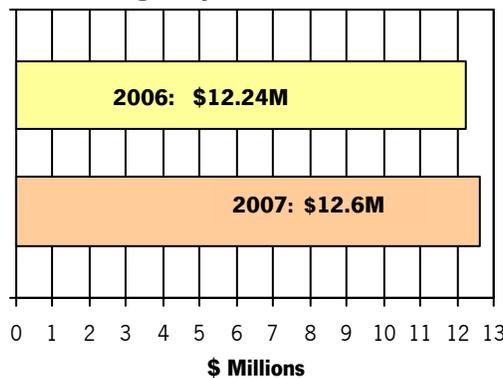
Sales Tax Revenue Analysis

2007 sales tax revenue performance has slipped since the last report in June, up only 3 percent compared to the same period last year primarily due to significant softening in contracting revenue (see table on page 6).

Review by business sectors:

- The **miscellaneous** sector is **up 53.2 percent** due to a significant one-time receipt.
- **Auto/gas retail** remains the largest “ongoing” contributor to the sales tax revenue increase so far this year, **up 13.6 percent** compared to the same period last year due to strong performance of several key retailers, as well as two new smaller retailers.
- **General merchandise/miscellaneous retail** is **up 3.5 percent** over the same period last year due to moderately strong performance by key retailers.
- **Retail eating/drinking** is **up 6.8 percent** compared to the same period last year due to positive improvement over the summer months and the collection of a past-due account from prior years.
- **Other retail declined 2.2 percent** over the same period last year due to closure of two major retailers and one-time anomalies in the retail food and health care sectors in 2006 that skew comparisons between the years.
- All business sectors but one impacted by development-related activity (contracting, wholesale, services and communications) are posting negative results in 2007 compared to the same period last year: The **services** sector is **up 5.4 percent** reflecting continued strong performance in this sector from development as well as a new hotel; **contracting** is **down 3.3 percent**, which is still considerably ahead of normal revenues since 2006 was such an extraordinary year; the **communications** sector is **down 20.3 percent** due to a decline in development-related activity compared to 2006; and **wholesale** is **down 17.1 percent**, also reflective more of the unusually strong performance in 2006 rather than a weakness in 2007.

Sales Tax Receipts through September 2006 & 2007



Auto/gas retail remains the largest contributor to revenue growth this year.

Development-related sales tax revenue is falling behind 2006, but remains strong compared to historical trends (up 81 percent over 2004 revenue).

Kent and Redmond have also experienced a drop in construction sales tax as of third quarter 2007 compared to 2006; however **Bellevue** is up 63 percent over the same period in 2006 and **Seattle and King County** are also both up over 19 percent from the same period last year.

City of Kirkland Total Actual Sales Tax Receipts

Business Sector Group	Jan - Sep		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Services	1,277,678	1,346,370	68,692	5.4%	10.4%	10.7%
Contracting	2,371,768	2,292,720	-79,048	-3.3%	19.4%	18.2%
Communications	650,372	518,250	-132,122	-20.3%	5.3%	4.1%
Auto/Gas Retail	2,157,801	2,450,342	292,541	13.6%	17.6%	19.4%
Gen Merch/Misc Retail	1,906,655	1,973,221	66,566	3.5%	15.6%	15.7%
Retail Eating/Drinking	908,341	969,947	61,606	6.8%	7.4%	7.7%
Other Retail	1,325,377	1,296,044	-29,333	-2.2%	10.8%	10.3%
Wholesale	1,082,175	897,385	-184,790	-17.1%	8.8%	7.1%
Miscellaneous	558,145	855,246	297,101	53.2%	4.7%	6.8%
Total	12,238,312	12,599,525	361,213	3.0%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2006 and 2007 year-to-date sales tax receipts in the table to the left.

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2006	2007		
January	1,116,572	1,267,021	150,449	13.5%
February	1,821,021	1,525,665	(295,356)	-16.2%
March	1,126,328	1,154,890	28,562	2.5%
April	1,061,134	1,604,395	543,261	51.2%
May	1,309,595	1,496,755	187,160	14.3%
June	1,311,259	1,422,662	111,403	8.5%
July	1,285,154	1,428,250	143,096	11.1%
August	1,749,896	1,253,921	(495,975)	-28.3%
September	1,457,353	1,445,966	(11,387)	-0.8%
Total	12,238,312	12,599,525	372,600	3.0%

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 September 2007 is for sales actually made in July 2007. Monthly sales tax receipts through September 2006 and 2007 are compared in the table to the left.

One-time spikes (in development-related revenue in February and August 2006 and the miscellaneous category and development-related revenue in April 2007) skew monthly comparisons between the years. August was also impacted by a significant correction by the Department of Revenue to contracting revenue that had been received in April 2007.

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.

Totem Lake, which accounts for over 30 percent of the total sales tax receipts, is **up 9.1 percent** over the same period last year primarily due to strong performance in auto/gas retail, a new hotel and sporting goods store, and despite the closure of a major supermarket and elec-

tronics store. Almost 60 percent of this business district's revenue comes from the auto/gas retail and general merchandise/retail apparel sectors.

NE 85th Street, which accounts for over 14 percent of the total sales tax receipts, is **up 6.4 percent** over the same period last year primarily due to the retail automotive/gas and general merchandise/miscellaneous retail sectors. Over 80 percent of this business district's revenue comes from these two business sectors.

Downtown, which accounts for over 6 percent of the total sales tax

receipts, is **up 4.7 percent** over the same period last year primarily due to strong performance in the retail eating/drinking sector, which provides over 40 percent of this business district's revenue.

Carillon Point & Yarrow Bay, which accounts for almost 3 percent of the total sales tax receipts, is **up 3.8 percent** primarily due to strong performance in the business services and hotel sectors. Almost 80 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for almost 4 percent of the total sales tax receipts, is **up 21.8 percent** almost entirely due to miscellaneous retail, which also provides almost 40 percent of these business districts' revenue.

Juanita, which accounts for almost 2 percent of the total sales tax receipts, is **up 9.7 percent** largely due to the retail eating/drinking sector, which also provides 44 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that over 42 percent of the revenue received in 2007 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), 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 - Sep Receipts		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Totem Lake	3,498,780	3,816,827	318,047	9.1%	28.6%	30.3%
NE 85th St	1,732,428	1,843,529	111,101	6.4%	14.2%	14.6%
Downtown	782,166	819,045	36,879	4.7%	6.4%	6.5%
Carillon Pt & Yarrow Bay	344,077	357,117	13,040	3.8%	2.8%	2.8%
Houghton & Bridle Trails	383,357	467,061	83,704	21.8%	3.1%	3.7%
Juanita	195,707	214,747	19,040	9.7%	1.6%	1.7%
Unassigned or No District:						
Contracting	2,371,768	2,292,720	-79,048	-3.3%	19.4%	18.2%
Other	2,930,029	2,788,479	-141,550	-4.8%	25.5%	23.9%
Total	12,238,312	12,599,525	361,213	3.0%	100.0%	100.0%

Sales Tax Revenue Outlook The double-digit sales tax revenue increases experienced over the previous two years have disappeared this year largely due to the decline in development-related activity. However, a large percentage of sales tax revenue continues to come from this one-time activity, which cannot be relied upon to fund ongoing services. Illustrating this point, only 12 percent of sales tax revenue was generated from the contracting sector in 2003 compared to over 18 percent in 2007. Also, as mentioned previously, other sectors such as wholesale and services are currently experiencing significant impacts from a decline in development activity.

Developing ongoing business activity is critical to ensure the City's financial health. Opportunities for growth in ongoing revenue exist from the redevelopment of Totem Lake Mall and Park Place, the recently completed expansions of major car dealerships, and the two new hotels. A major new risk on the horizon is the plan by Costco to locate stores in Redmond and Bellevue (the Bellevue store is expected to be completed by the end of next year). These factors serve as reminders that sales tax is an economically sensitive revenue source. In good times, sales tax growth easily outpaces the rate of inflation and is an attractive funding source for service packages. On the other hand, an economic recession and the return of more normal development-related activity can quickly threaten the City's financial ability to maintain existing services (as it did in 2002). Additional volatility is created by gaining or losing significant businesses and one-time field audit recoveries.

OFFICE VACANCIES:
The Eastside vacancy rate remains low at 8.9 percent and Kirkland's rate is 3.83 percent as of the third quarter of 2007 according to CB Richard Ellis Real Estate Services.

Google has pre-leased 190,000 square feet of space in Kirkland set to open next year.

LODGING TAX REVENUE:
Lodging tax revenue is up 48 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel in Totem Lake.

Economic Environment Update Local job growth remains strong in 2007 with more than 112,000 jobs added in the Seattle-Tacoma metropolitan area since January 2005. The unemployment rate in King County dropped to 3.9 percent as of September 2007, below the national average of 4.5 percent. Conway & Pedersen Economics forecasts a continued increase in employment, 2.8 percent during the rest of this year and 2.3 percent next year. Employment growth has helped insulate the Puget Sound economy so far from the troubles of the national job and income outlook. While home sales have declined compared to last year, home prices continue to rise in contrast to most of the rest of the country.

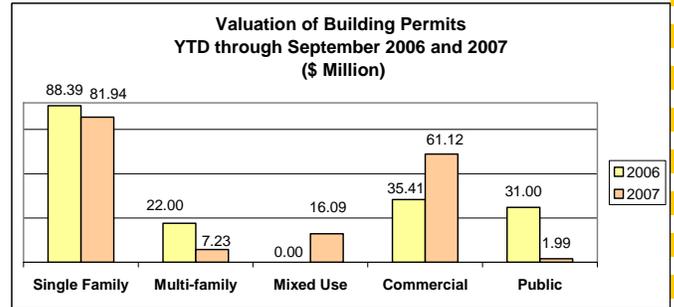
Taxable retail sales in King County remain strong, up 8.6 percent for the third quarter 2007 compared to third quarter of 2006 largely due to strong development activity in Bellevue, Seattle and unincorporated King County. As of the third quarter of 2007, the Puget Sound office market saw its 17th quarter of positive absorption. Over 900,000 square feet of space was filled and an additional one million square feet was added over the quarter. There is four million square feet currently under construction to meet expansion demands of local companies for office space and demand is expected to remain high over the next two to three years.

However, all is not rosy. The local purchasing managers' index dropped 11.2 percent in September to 57. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.) About 60 percent of local executives believe the current economic expansion won't last longer than 12 months according to the recent Key Bank Business Confidence Index survey conducted by Hebert Research, Inc.

Local economists are concerned that the sub-prime melt-down and stock market volatility could negatively

impact consumer spending, which in turn could contribute to an economic downturn. Economist Dick Conway recently finished studying the relationship between housing appreciation and retail sales and is predicting a slowdown in retail sales growth as a result of the cooling housing market. However, he's optimistic that the state won't face a recession before 2011 if the local housing market stabilizes.

Local **development-activity** through September 2006 and 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity remains relatively strong, especially in the commercial /mixed use sectors, but may show signs of weakening. While single family activity in 2007 falls below 2006 levels, it still remains very strong compared to normal historical trends. The significant spike in 2006 public activity reflects the permitting for Evergreen Hospital.



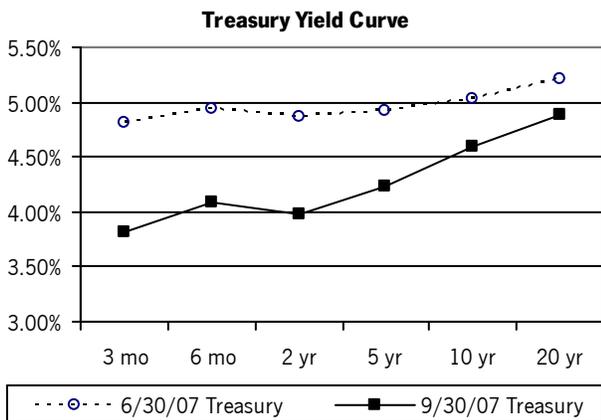
Pending sales of **new and existing homes** in King County are down 32 percent in September 2007 compared with a year earlier, while prices rose 5.9 percent compared to the same month last year. The median price in September was \$450,000—down from this year's high of \$481,750 set in July. On the Eastside, sales are down 28.1 percent and prices are up 6.1 percent. Contributing factors to the slow-down in sales are housing prices overshooting wages and the mortgage market turmoil. The strong regional job and population growth is expected to moderate the housing slump experienced across the country. The National Association of Realtors' national forecast predicts a 10.8 percent drop in home sales and a 1.3 percent decline in median price by year end. This year's nation-wide sales would be the lowest since 2002.

Seattle metro CPI continues to track higher than the national average (2.5 percent compared to the national average of 1.8 percent as of August). However, this is a dip from the Seattle index for June, which was 3.31 percent. The June 2007 CPI is used to calculate City employee cost of living adjustments for 2008. As a result, 2008 COLA's will range from 2.98 to 3.31 percent depending on the bargaining unit contract.

Investment Report

MARKET OVERVIEW

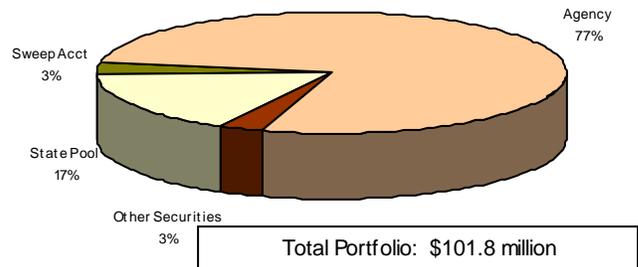
With economic news mixed and problems in the sub-prime mortgage market the yield curve dropped and steepened as short term rates fell further than long term rates. The Fed Funds rate reduced to 4.75 percent on September 18, the first reduction since June of 2003. It is anticipated that the Fed Funds rate will drop again on October 31 (which has occurred) and in January, 2008.



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.

Investments by Category



The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio was fairly stable in the 3rd quarter of 2007. On June 30, 2007 the total portfolio was \$102.6 million compared to \$101.8 million on September 30, 2007.

Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, US Treasury notes, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Government obligations.

Investment Report *continued*

2007 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The forecast for the U.S. economy growth continues to be reduced. GDP growth for fourth quarter 2007 is now expected to be 1.9 percent and CPI inflation at 2.2 percent. Beyond the very short term, the forecasters see little threat of accelerating inflation. The unemployment rate is expected to average 4.6 percent this year and 4.7 percent in 2008. The Fed Funds rate, currently at 4.75 percent, is expected to be reduced at the October 31, 2007 meeting and reduced again at the January 2008 meeting.

Investments have been purchased as opportunities are available to obtain a return above the State Pool, which is currently near 4.9 percent. We will continue to watch the economy closely and maintain portfolio duration as interest rates continue to decline. Total estimated investment income for 2007 is \$4.6 million.

Liquidity

The target duration for the City's portfolio is based on the 2 year treasury rate which decreased from 4.87 percent on June 30, 2007 to 3.97 percent on September 30, 2007. The average maturity of the City's investment portfolio decreased from 1.62 years on June 30, 2007 to 1.56 years on September 30, 2007. The duration remained above the target as the 2 year treasury rate slipped below 4 percent briefly at the end of September and longer term securities with one time call dates have been purchased to sustain higher earnings in this declining rate market.

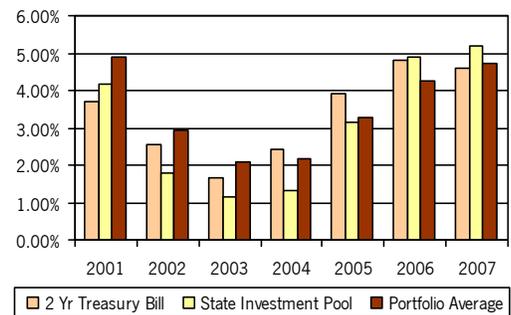
Yield

The City Portfolio yield to maturity increased from 4.79 percent on June 30, 2007 to 4.89 percent on September 30, 2007. Through September 30, 2007, the City's annual average yield to maturity was 4.72 percent, which performed under the State Investment Pool annual average yield to maturity at 5.21 percent and above the 2 Year Treasury note annual average for 2007 at 4.58 percent.

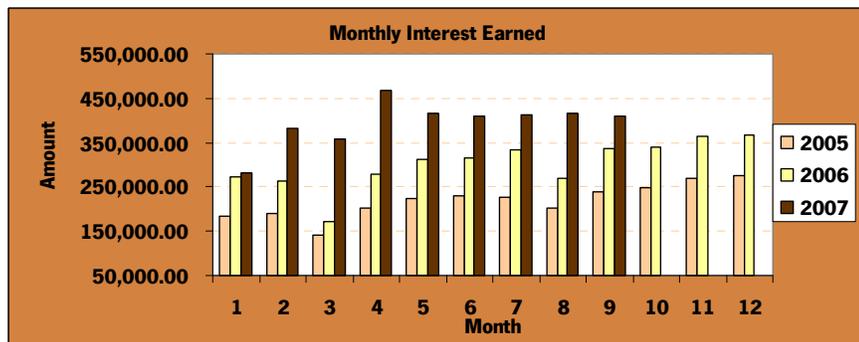
Benchmark Comparison	June 30, 2007	Sept. 30, 2007
City Yield to Maturity (YTM)	4.79%	4.89%
City Annual Average YTM	4.65%	4.72%
City Year to Date Cash Yield	4.40%	4.32%
State Pool Average Yield	5.23%	5.21%
2 yr Treasury Note Avg YTM	4.76%	4.58%

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

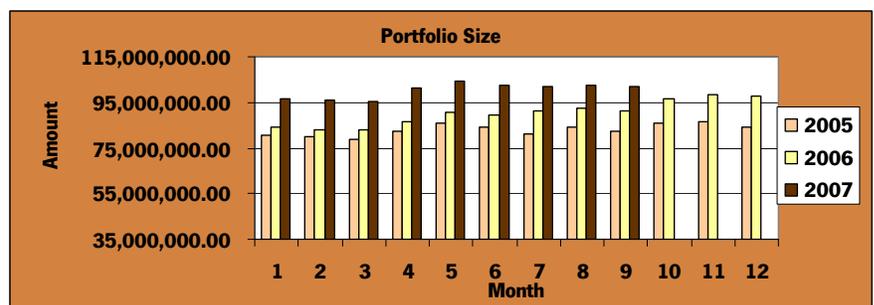
Investment Interest Rate Comparisons



Monthly Interest Earned



Portfolio Size



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.

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. project).

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 estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2007 Auth. Uses	2007 Auth. Additions	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826	310,936		2,882,890
General Capital Contingency	3,312,834			3,312,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,921,002	10,000		1,911,002
Council Special Projects Reserve	309,960	33,000		276,960
Total General Purpose Reserves	13,532,838	353,936	0	13,178,902
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678	796,394		5,877,284
REET 2	6,067,898			6,067,898
Equipment Rental:				
Vehicle Reserve	5,907,138			5,907,138
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	453,670			453,670
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498	161,100		960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245			1,511,245
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640	500,200		1,203,440
Water/Sewer Construction Reserve	8,738,358	350,000		8,388,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	202,000		674,760
Surface Water-Transp. Related Rsv	1,417,365			1,417,365
Surface Water Construction Reserve	1,240,563			1,240,563
Total Special Purpose Reserves	48,011,479	2,009,694	0	46,001,785
Grand Total	61,544,317	2,363,630	0	59,180,687

Reserve Summary *continued*

RESERVE	AMOUNT	DESCRIPTION
2007 Council Authorized Uses	\$2,363,630	
Contingency Fund	\$31,500	Funding for phase 1 of the Permit Process Improvement Project to review the single family building permit process.
	\$54,436	Funding for continued public outreach for Phase II of the annexation study.
	\$225,000	Funding for Park Place Planned Action Environmental Impact Statement/Fiscal review
Building/Property Reserve	\$10,000	Funding for a study of the Peter Kirk restroom to coincide with the timing of the design for the downtown transit center.
Council Special Projects Reserve	\$15,000	Funding for the Assistance League of the Eastside's Operation School Bell program.
	\$18,000	Affording housing regulations work plan
Real Estate Excise Tax (REET) 1 Reserve	\$235,840	Funding for the purchase of the Irvin Property in the Yarrow Bay Wetlands.
	\$362,354	Funding for purchase of greenbelt property near Everest Park.
	\$193,200	Funding for purchase of Niedermeier property near Everest Park.
	\$5,000	Shelton property purchase appraisal and closing costs
Street Improvement Reserve	\$91,100	Additional funding for completion of the Central Way Improvements project (street portion).
	\$70,000	Additional funding for the 2007 Pavement Striping Program.
Water/Sewer Capital Contingency	\$113,900	Additional funding for completion of the Central Way Improvements project (utilities portion).
	\$250,000	Additional funding for water system improvements projects
	\$81,000	Additional funding for Waverly Beach Lift Station project
	\$55,300	Additional funding for 7th Avenue/114th Avenue NE Watermain Replacement
Water/Sewer Construction Reserve	\$350,000	Additional funding to complete the 2007 Emergency Sewer Program.
Surface Water Capital Contingency	\$202,000	Additional funding for the Juanita Creek Channel Enhancement project.
2007 Council Authorized Additions	\$0	

No Council Authorized Additions as of September 30, 2007.

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,882,890	3,698,455	(815,565)
General Capital Contingency	3,312,834	5,822,280	(2,509,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	276,960	250,000	26,960
General Purpose Reserves with Targets	11,267,900	15,048,936	(3,781,036)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	5,877,284	1,435,000	4,442,284
REET 2	6,067,898	4,959,200	1,108,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,511,245	1,511,245	0
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	1,203,440	1,703,640	(500,200)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	674,760	876,760	(202,000)
Special Purpose Reserves with Targets	20,438,030	15,950,130	4,487,900
Reserves without Targets	27,474,757	n/a	n/a
Total Reserves	59,180,687	n/a	n/a

The summary schedule in the table above details all Council authorized uses and additions to each reserve through September 2007.

The table to the left compares the revised ending balance to the targets established in the budget process.



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- ◆ Sri Krishnan, Senior Financial Analyst
- ◆ Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

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:

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- Alan Zibel-Associated Press, *Projected drop grows steeper for home sales*, The Seattle Times, October 11, 2007
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- Washington State Department of Revenue
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- City of Kirkland Building Division
- City of Kirkland Finance Department