## City Revenue Sources – September 2006

### City Revenues

Seattle City government has four main sources of revenue supporting the services and programs the City provides its residents. First, taxes, license fees, and fines support activities typically associated with City government, such as police and fire services, parks, and libraries. Second, certain City activities are partially or completely supported by fees for services, regulatory fees, or dedicated property tax levies. Examples of City activities funded in whole or in part with fees include certain facilities at the Seattle Center, recreational facilities, and building inspections. Third, City utility services (electricity, water, drainage and wastewater, and solid waste) are supported by charges to customers for services provided. Finally, grant revenues from private, state or federal agencies support a variety of City services, including social services, street and bridge repair, and targeted police services.

In 2005, general government revenue totaled approximately $727.7 million. General government revenue is projected to total $750.3 million in 2006; $784.9 million in 2007; and $806.6 million in 2008. A portion of the growth from 2006 to 2007 is a result of reclassifying revenues to the General Subfund that previously were deposited in other funds.

### City Funds

The City allocates its financial resources into a variety of accounting entities called “funds” or “subfunds” to account for revenues and expenditures. The use of multiple funds is necessary to ensure compliance with state budget and accounting rules, and to promote accountability for specific projects or activities.

The majority of expenditures for services typically associated with the City, such as police and fire, are accounted for in one of two subfunds of the City’s General Fund. Operating expenses for these services are accounted for in the General Subfund (comparable to the “General Fund” in budgets prior to 1996) and capital expenditures are accounted for in the Cumulative Reserve Subfund.

Many departments or programs have separate funds or subfunds. For example, operating revenues and expenditures for the City’s parks are accounted for in the Park and Recreation Fund. Expenditures of revenues from the City’s Families and Education Property Tax Levy are accounted for in the Educational and Development Services Fund. In addition, the City maintains separate funds for debt service and capital projects. The City of Seattle has an obligation to ensure revenues from utility use charges are spent on costs specifically associated with providing utility services. As a result, each of the City-operated utilities has its own operating fund.

Finally, the City maintains pension trust funds, including the Employees’ Retirement Fund, the Firemen’s Pension Fund, and the Police Relief and Pension Fund. The City holds these funds in a trustee capacity, or as an agent, for current and former City employees.

This section describes the current outlook for the national and Puget Sound economies, General Subfund forecasts, and forecasts for the Cumulative Reserve Subfund’s most important revenue, the Real Estate Excise Tax.

## The National and Local Economy

### National Economic Conditions and Outlook

***The current expansion is now in its fifth year.*** The decade of the 1990s saw the longest national economic expansion on record, one that lasted a full 10 years. The expansion was characterized by rising productivity, a booming stock market, an expanding high-tech sector, and strong investment. During the high-growth years of the late 1990s, optimists talked of the arrival of a “new economy,” which would usher in a future characterized by rapid economic growth, soaring incomes, and an end to the business cycle.

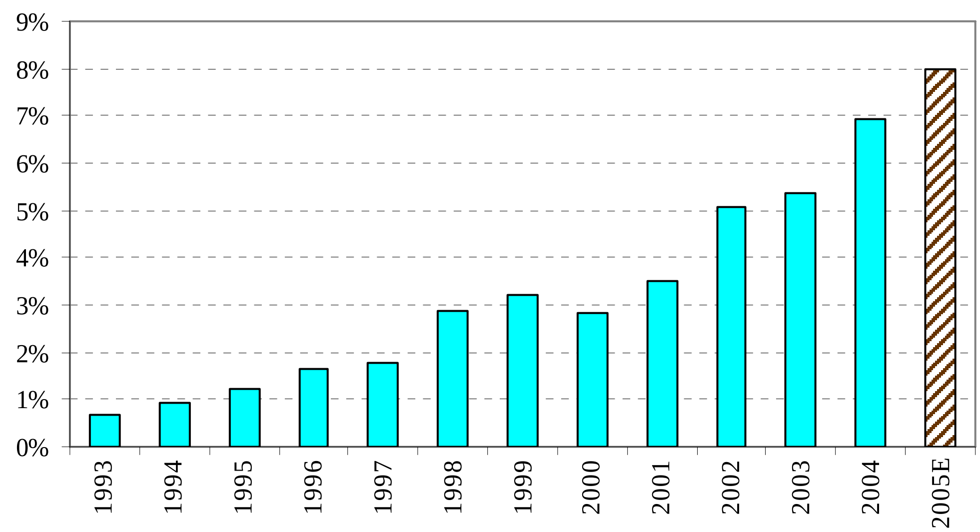
The dream of a "new economy" ended in early 2000, when the stock market bubble burst. With stock prices no longer rising, businesses cut back on investment spending. Consumer spending also slowed as falling stock prices led to a drop in household wealth. The slowing economy slipped into recession in March 2001, and was weakened further by the September 11 terrorist attacks. Due to aggressive interest rate cuts by the Federal Reserve, the recession was both short and mild.

The recovery, which began in December 2001, has been relatively weak by historical standards. During the recovery's 4½ years, the U.S. economy added 4.5 million jobs, an increase of 3.4%. Wage growth has also been weak, and during the past year the growth rate of employee compensation, which includes salaries and benefits, has lagged the rate of inflation.

***Housing has led the recovery.*** The housing market has been a key driver of the economy during the current expansion. The very low interest rates set by the Federal Reserve to soften the downturn and spur a recovery stimulated the housing market by enabling buyers to afford larger mortgages. As housing became more affordable, home sales increased, home ownership rose to record levels, and prices were pushed upward due to increased demand. In addition, the housing market received a further boost as many Americans decided that real estate was a more attractive investment than the stock market.

As the housing market flourished, it stimulated growth in industries involved in residential construction, the financing and sale of residential properties, and the sale of home furnishings, appliances, and building materials. In addition, rising home values supported an expansion of consumer spending via the wealth effect. Rising home values increase household wealth, and when people feel wealthier they tend to save less and spend more out of their current income. Rising home values also create an opportunity for home owners to extract some of their home equity via home equity borrowing or cash-out refinancing. Home equity extraction has risen sharply since the 2001 recession to an estimated 8% of disposable income in 2005, providing a further stimulus to consumer spending (see Figure 1).

**Figure 1. Net Home Equity Extraction as a Percent of Disposable Income**




Source: Federal Reserve Board. 2005 estimate based on data from Moody's Economy.com.

In June 2004, the Federal Reserve began a campaign of interest rate increases by raising rates by 0.25% at each of its meetings. This led to a rise in mortgage rates, which, along with rapidly escalating house prices, caused housing affordability to decline. With affordability declining, the national housing market peaked in the third quarter of 2005, and has slowed sharply since then. As of June 2006, the number of home sales was down 8.9%

from June of the previous year, and year-over-year price growth had fallen to 0.9%. Inventories of unsold homes were at their highest level since 1997, and single-family housing starts had dropped by 14% in the past year.

The Seattle area housing market lagged the national market on the upswing and is lagging in the slowdown as well. During the first half of 2006, home sale prices increased at a double digit pace, but the number of sales dropped below the previous year's level and the inventory of active listings began to grow.

***The forecast is for slower national growth.*** As of mid-2006, there is growing evidence that the U.S. economy is slowing, as the housing market shifts from a source of growth to a drag on the economy. The growth rate of real Gross Domestic Product (GDP) fell to 2.5% in the second quarter, the rate of employment growth has weakened in recent months, and the unemployment rate posted a modest increase in July. Causes of the economy's slowdown include the slowing housing market, rising interest rates, and high energy prices.

Most forecasters expect the economy to grow at a slower pace for the next several quarters. Global Insight, for example, forecasts that real GDP growth will range between 2% and 3% through the end of 2007.

As always, there are numerous risk factors that could cause growth to deviate from expectations. One major risk arises from the Federal Reserve's attempt to contain inflation by raising interest rates in order to slow the economy. The Fed's goal is to slow the economy enough to reduce inflation but not so much that a recession ensues. This balancing act is difficult to achieve in part because it takes 12 to 18 months for the effects of the Fed's interest rate changes to work their way through the economy. Other risks to the economy include the housing market slowing too sharply and the potential for further energy price hikes or a supply disruption. With the economy slowing and the housing market decelerating, most economists believe that the chances of a recession occurring are rising.

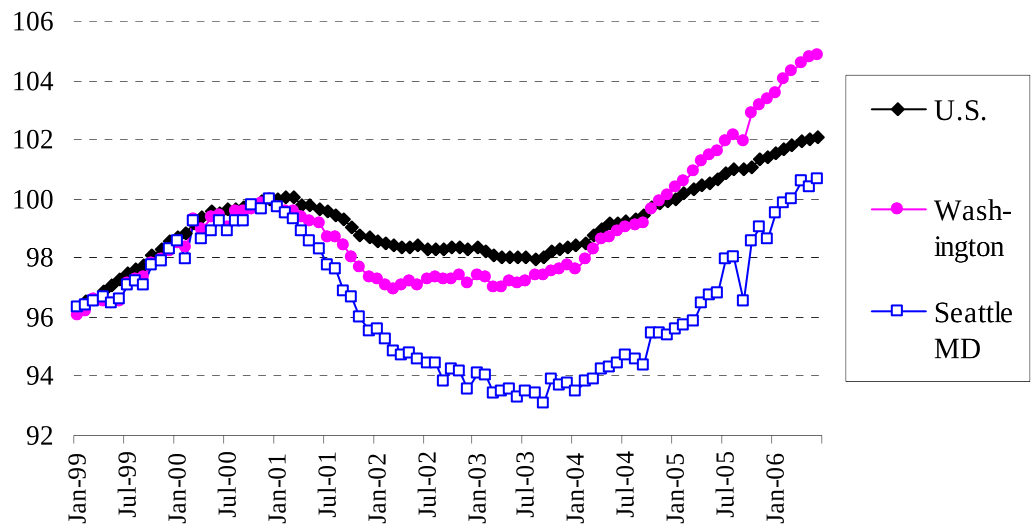
## Puget Sound Region Economic Conditions and Outlook

***The region is now growing faster than the nation and the rest of the state.*** The Puget Sound region suffered more from the 2001 recession than almost any region in the nation because of its concentration of high-tech firms, which were hammered by the deflation of the stock market bubble, and the impact on Boeing of the September 11 terrorist attacks. The sharp drop in air travel that followed September 11 created financial distress for the world's airlines and a decline in the demand for airliners. Forced to sharply reduce it production levels, Boeing eliminated 27,200 of its Washington state jobs over the next 2¾ years.

During the recession, the region lost 97,800 jobs, a 6.9% decline, between December 2000 and September 2003 (see Figure 2). The recovery started out slowly but growth has picked up steadily over time, reaching a 3.6% growth rate during the first half of 2006. The Puget Sound region is now growing at a faster pace than the nation and the rest of the state.

**Figure 2. Non-Agricultural Wage & Salary Employment**

(December 2000 = 100)

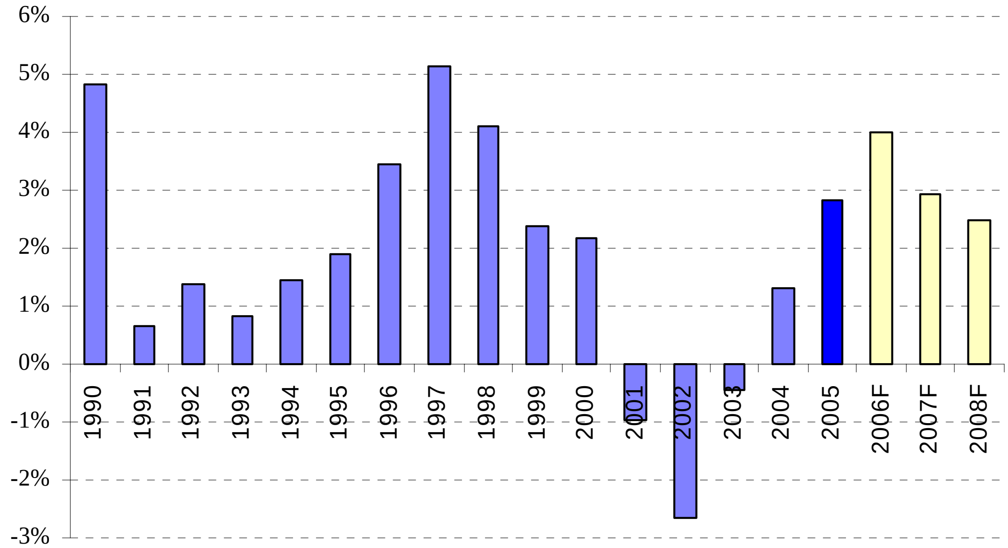



NOTE: Data are seasonally adjusted. Seattle MD = King & Snohomish Counties.

Contributing to the region's healthy growth over the past 1½ years has been an upturn at Boeing, which added 12,800 jobs since June 2004, and continued growth at Microsoft. Boeing has been adding workers as it increases production rates for existing models and ramps up research and development activity for its popular new 787 model. In the year ending June 30, 2006, Microsoft added a record 10,081 employees worldwide and 3,938 in the Seattle area. Microsoft is preparing new versions of its Windows and Office software products to be released next year, and is investing heavily in online services. Other sources of growth in the local economy include construction and professional & business services, an industry in which Seattle specializes.

***The region's pace of growth is expected to slow.*** The region's current expansion is expected to continue, but the rate of growth is expected to slow over time as the real estate market cools and the pace of national economic growth slows (see Figure 3). According to the Puget Sound Economic Forecaster, employment growth will peak at 4.0% this year, then decline to 2.9% in 2007 and 2.5% in 2008.

**Figure 3. Annual Growth of Puget Sound Region Employment**




Note: 2006-08 forecasts are from Puget Sound Economic Forecaster.
Puget Sound Region is King, Kitsap, Pierce, and Snohomish Counties.

## Consumer Price Inflation

***Consumer price inflation has risen as oil prices have climbed.*** The 2001 national recession and the subsequent weak recovery helped to bring U.S. inflation down to its lowest level since the early 1960s. However, after falling to a 1.6% rate during 2002, inflation has risen gradually, reaching 3.4% in 2005 and 3.8% in the first six months of 2006. Much of the rise in inflation is due to the relentless increase in energy prices that began in early 2002 and has yet to abate. Core inflation, which excludes volatile energy and food prices, has largely remained under control despite the rise in energy prices. However, core inflation started to rise early this year and by July had reached 2.7% measured on a year-over-year basis.

The Federal Reserve has been raising short-term interest rates since mid-2004 in order to keep inflation under control. The Fed paused at its August 2006 meeting, holding the Fed Funds rate steady at 5.25%, as it attempts to determine if rates have risen enough to control inflation. The forecasts presented below are based on the assumption that inflation is near its peak and will begin to fall in late 2006 and continue to decline in 2007.

Due to the severity of the local recession, Seattle area inflation, which was higher than national inflation in every year but one between 1990 and 2002, dropped below U.S. inflation beginning in late 2002 and remained lower until mid-2006. Local inflation has now risen back to national levels, largely because the region's economy has improved. Looking to the future, local economists expect Seattle area inflation to outpace national inflation as the region continues to grow faster than the nation.

Figure 4 presents historical data and forecasts of inflation for the U.S. and Seattle metropolitan area through 2007. The forecasts are for the CPI-W, which measures price changes for urban wage and clerical workers (the CPI-U measures price changes for all urban consumers). The specific growth rate measures shown in Figure 4 are used as the basis of cost-of-living adjustments in City of Seattle wage agreements.

**Figure 4. Consumer Price Index Forecast**

| | **U.S. CPI-W** (June-June growth rate) | **Seattle CPI-W** (June-June growth rate) | **Seattle CPI-W** (growth rate for 12 months ending in June) |
|---|---|---|---|
| 2004 (actual) | 3.2% | 2.5% | 1.3% |
| 2005 (actual) | 2.6% | 2.3% | 2.3% |
| 2006 (actual) | 4.5% | 4.6% | 3.4% |
| 2007 | 2.6% | 2.9% | 3.5% |

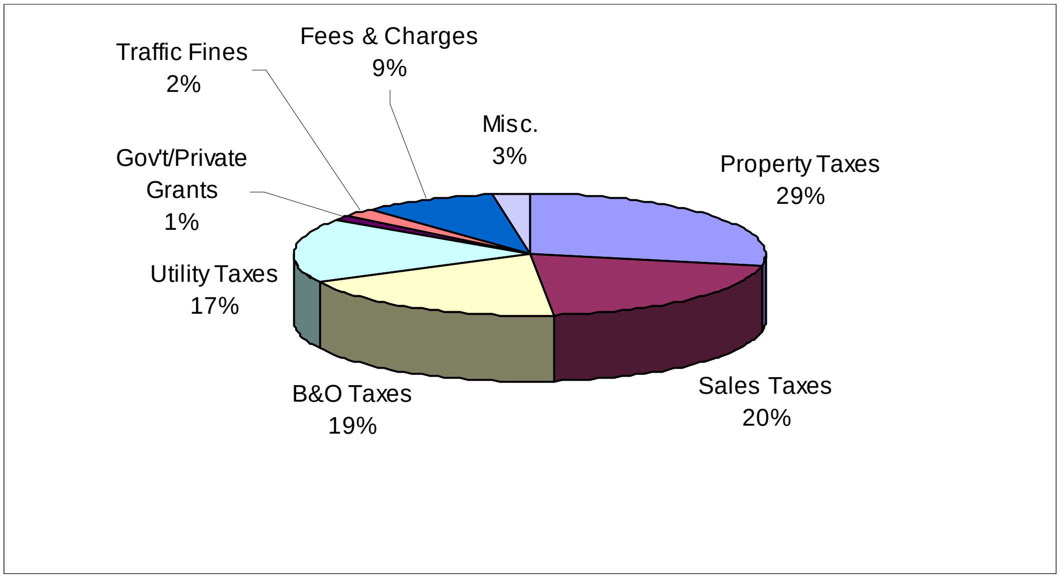
The first two forecasts in Figure 4 measure the change in consumer prices from June of one year to June of the following year. These changes are for the U.S. and the Seattle metropolitan area, respectively. The third forecast measures the growth rate of the Seattle CPI-W over a one year period ending in June (i.e., July – June). Because the Seattle CPI is published on a bimonthly basis, this growth rate reflects the average rate of inflation for August, October and December of one year and February, April and June of the following year.

## General Subfund Revenue Forecasts

Expenses assigned to the General Subfund are supported primarily by taxes. As Figure 5 illustrates, the most significant revenue source is the property tax, which accounts for 29%, followed by sales taxes, and the Business and Occupation (B&O) tax.

Revenue collections from sales, business and occupation, and utility taxes, which together account for 56% of General Subfund revenue, fluctuate significantly as economic conditions in the Puget Sound region change.

**Figure 5. 2006-Revised General Subfund Revenue Forecast by Source - $750.3M**




## Revenue Overview

Figure 6 shows General Subfund actual revenues for 2005, as well as the revised forecast for 2006, and the proposed forecasts for 2007 and 2008. Tax revenues are expected to grow by a robust 6.5% in 2006 and by 3.5% in both 2007 and 2008. The main drivers of these growth rates are the B&O and sales taxes. Revenues from the B&O tax for 2006 are expected to be 10.3% higher than 2005, with growth slowing to 4.3% in 2007. This forecast excludes the effect of changes in state law that could reduce City B&O tax revenues by $20 million in 2008. Sales tax revenues, led by construction, hotels and retail sales, should experience similar patterns with 7% growth in 2006, leveling off only slightly to a rate of 5.5% in 2007.

Other factors contributing to this growth are sizable increases in drainage/wastewater rates charged by Seattle Public Utilities (SPU) to its customers. Because of these rate increases, 2007 tax revenues from the drainage/wastewater fund are forecast to grow by 8.2% over 2006. Natural gas revenues are forecast to continue positive growth due to anticipated increases in gas rates. Parking pay stations have seen strong growth in revenues and this trend is expected to continue. New pay stations are added over the next few years, particularly in the South Lake Union area where pay stations are expected to be operational by mid-2007.

Finally, beginning in 2007 certain revenues the City receives from patrons of the Key Arena will be deposited in the General Subfund rather than the Seattle Center Fund. These revenues partially offset Key Arena debt service expenses which become the obligation of the General Subfund in 2007 as well.

**Figure 6. General Subfund Revenue, 2005 – 2008***
(in thousands of dollars)

| Revenue Source | 2005 Actual | 2006 Revised | 2007 Proposed | 2008 Proposed |
|---|---|---|---|---|
| General Property Tax (1) | 183,497 | 187,883 | 194,918 | 199,452 |
| Property Tax - Medic One Levy | 20,109 | 20,669 | 21,185 | 21,715 |
| Retail Sales Tax | 131,011 | 140,143 | 147,805 | 154,558 |
| Retail Sales Tax - Criminal Justice Levy | 12,282 | 13,138 | 13,856 | 14,490 |
| B&O Tax (90%) (2) | 130,471 | 143,886 | 150,006 | 158,337 |
| Utilities Business Tax - Telephone (90%) | 26,591 | 26,856 | 26,035 | 25,733 |
| Utilities Business Tax - City Light (90%) | 30,340 | 31,373 | 30,642 | 31,315 |
| Utilities Business Tax - SWU & priv.garb. (90%) | 8,217 | 9,090 | 9,793 | 10,373 |
| Utilities Business Tax - City Water (90%) | 12,783 | 15,373 | 15,514 | 16,346 |
| Utilities Business Tax - DWU (90%) | 18,071 | 19,757 | 21,368 | 22,108 |
| Utilities Business Tax - Natural Gas (90%) | 12,120 | 14,296 | 14,980 | 14,339 |
| Utilities Business Tax - Other Private (90%) | 10,639 | 12,744 | 11,952 | 12,231 |
| Admission Tax | 6,664 | 7,214 | 7,201 | 7,399 |
| Other Tax | 4,851 | 4,795 | 4,795 | 4,795 |
| **Total Taxes** | **607,646** | **647,216** | **670,051** | **693,191** |
| Licenses and Permits | 15,303 | 12,979 | 12,684 | 12,400 |
| Parking Meters/Meter Hoods | 15,333 | 16,586 | 18,288 | 19,596 |
| Court Fines (90%) | 16,255 | 17,550 | 16,981 | 16,261 |
| Interest Income | 3,200 | 4,371 | 4,284 | 3,577 |
| Revenue from Other Public Entities (3) | 22,312 | 8,950 | 9,728 | 9,512 |
| Service Charges & Reimbursements | 41,982 | 40,172 | 46,156 | 46,450 |
| All Else | 1,208 | 1,422 | 1,040 | 1,089 |
| **Total: Revenue and Other Financing Sources** | **723,239** | **749,247** | **779,212** | **802,077** |
| Interfund Transfers | 4,455 | 1,037 | 1,954 | 937 |
| Key Arena Revenues (4) | - | - | 3,743 | 3,618 |
| **Total, General Subfund** | **727,694** | **750,284** | **784,910** | **806,632** |

**NOTES:**

(1) Includes property tax levied for the Firemen's Pension Fund per RCW 41.16.060.

(2) The 2008 Proposed figures for B&O tax assume that anticipated losses due to House Bill 2030 will be mitigated.

(3) Included in 2005 Actual are the pass-through revenues that are not appropriated in the 2005 Adopted Budget.

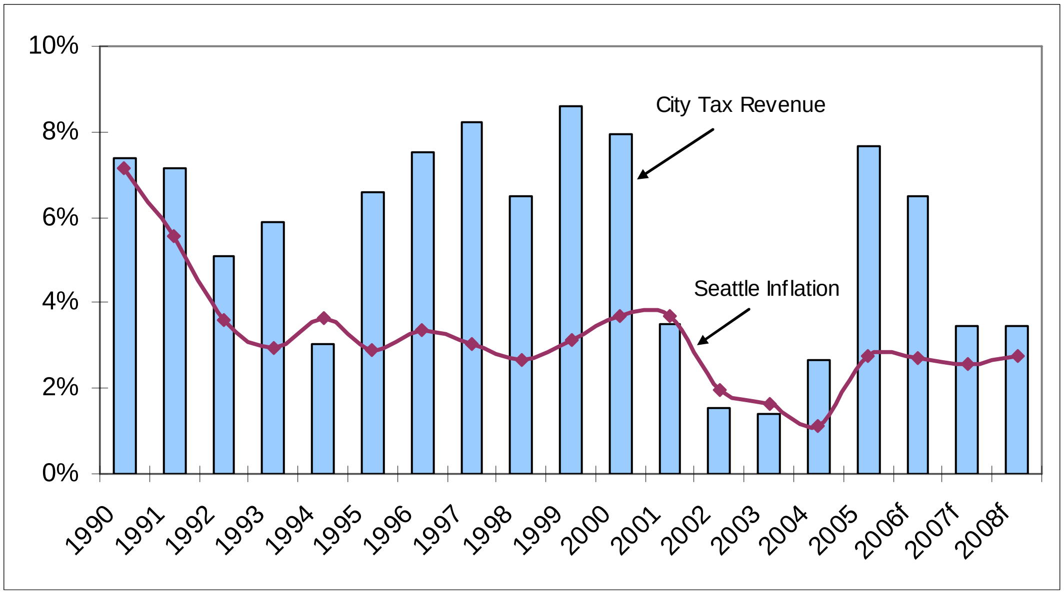
(4) New revenues to the General Subfund reflecting the change in debt service obligation for Key Arena from the Seattle Center Fund to the General Subfund.

A detailed listing of City General Subfund revenues is found in the Funds, Subfunds and Other section.

* Under the City Charter, 10% of certain revenues are deposited into the Park and Recreation Fund. These revenues are noted by the 90% figures above. This requirement also applies to certain license revenues.

Figure 7 shows how tax revenue growth outpaced inflation for most of the 1990s and 2000 before the local recession took hold. Slow growth posted in 2001 is also attributable to Initiative 747, which reduced the statutory annual growth limit for property tax revenues from 6.0% to 1.0% beginning in 2002. Economic growth starting in 2004 led to very strong revenue growth in 2005 and 2006, staying well above inflation. Growth is expected to slow over the next biennium, but continue to outpace inflation through 2008.

**Figure 7. City of Seattle Tax Revenue Growth, 1990-2008**




## Property Tax

Property tax is levied primarily on real property owned by individuals and businesses. Real property consists of land and permanent structures, such as houses, offices, and other buildings. In addition, property tax is levied on business machinery and equipment. In accordance with the Washington State Constitution and state law, property taxes paid by a property owner are determined by a taxing district's rate applied to the value of a given property. Figure 8 shows the different jurisdictions whose rates make up the total property tax rate imposed on Seattle property owners. The assessed value (AV) of a property is determined by the King County Assessor and is generally intended to be 100% of the property's market value.

In 2006, the total property tax rate from all jurisdictions paid by Seattle property owners is $9.63 per thousand dollars of AV. For an owner of a home with an assessed value of $400,000 (approximately the average AV for residences in Seattle), the 2006 tax obligation is approximately $3,850. The City of Seattle's 2006 tax rate is roughly one-third of the total rate at $3.16 -- an annual tax obligation of approximately $1,260 for the average valued home.

Figure 8 illustrates the components of the City's property tax: the non-voted General Purpose levy (63%); the five voter-approved levies for specific purposes (28%) – known as lid lifts because the voters authorize taxation above the statutory lid or limit; and the levy to pay debt service on voter-approved bonds (9%). There were no proposed property tax measures (lid lifts or bonds) for Seattle in 2005 that added to the property tax in 2006.

***Statutory growth limits and new construction.*** The annual growth in property tax revenue is restricted by state statute in two ways. First, state law limits growth in the *amount* of tax revenue a jurisdiction can collect. Beginning in 1973, state law limited the annual growth of the City's regular levy (i.e., General Purpose plus voted lid lifts) to 6%. However, in November 2001, voters statewide approved Initiative 747, which changed the 6% limit to the lesser of 1% or the Implicit Price Deflator, effective for the 2002 collection year. In addition to the

1% revenue growth limit, state law permits the City to increase its regular levy in the current year by an amount equivalent to the previous year's tax rate times the value of property constructed or remodeled within the last year.

The second limitation in state law caps the maximum tax rate that can be imposed. For the City of Seattle, this cap is $3.60 per $1,000 of assessed value and covers the City's general purpose levy and lid lifts. The City tax rate has been well below this cap for many years.

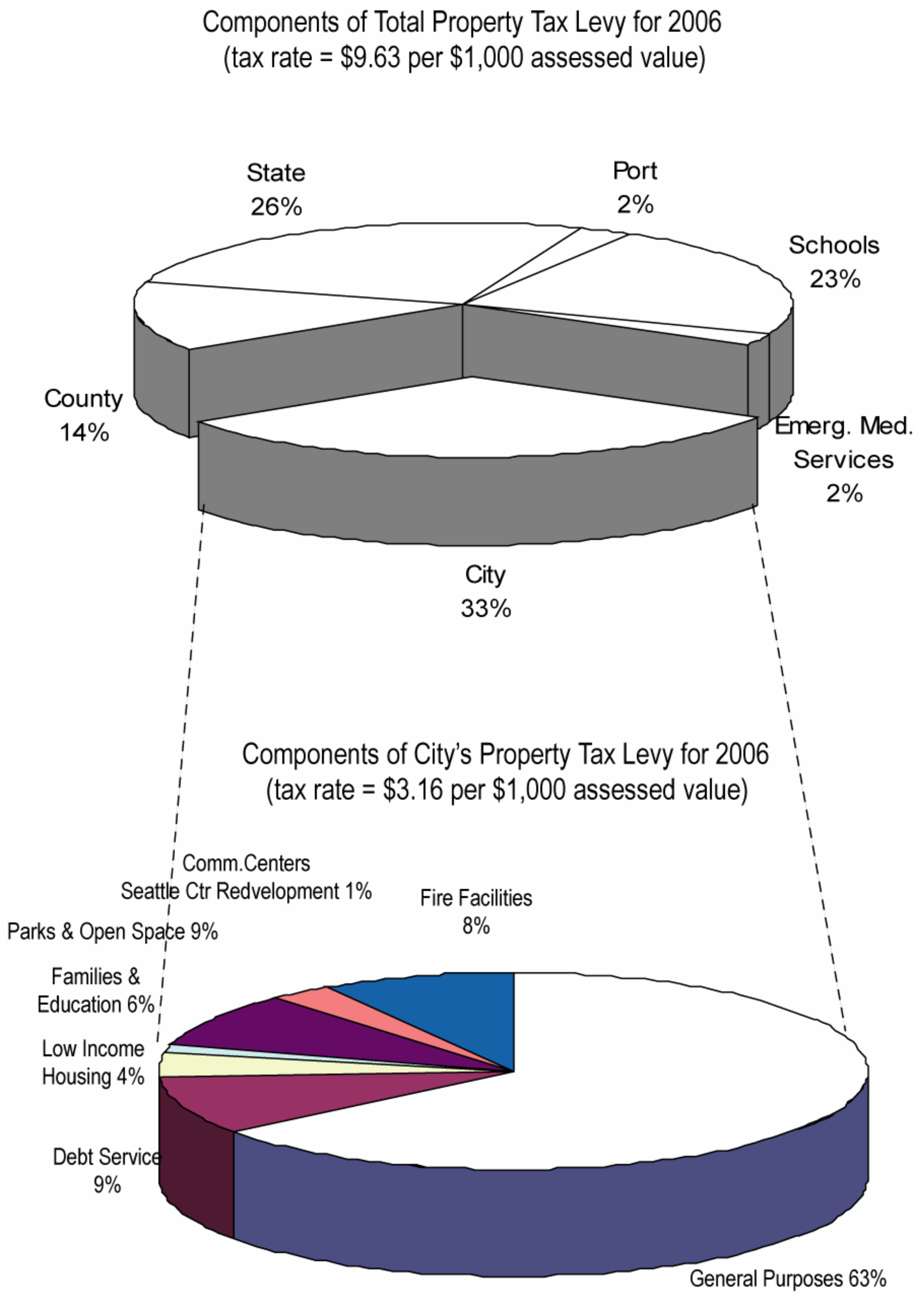
***The 2007 and 2008 Proposed Budgets implement 1% growth plus new construction.*** New construction revenues have exceeded $2 million since 1999, with a high of over $5 million in 2002. The forecast for 2007 and 2008 reflects continued strong construction activity. It is projected that approximately $3.8 million is added to the property tax base in both 2007 and 2008 due to new construction.

Additionally, a court settlement led to a multi-jurisdiction refund to Qwest in 2006. The City of Seattle's General Subfund share of this refund is approximately $1.2 million. State law allows the City to recoup this refund in the following year (2007), but then deducts it from the City's base levy in the subsequent year (2008).

The forecast for the General Subfund (General Purpose) portion of the City's property tax is $194.9 million in 2007 and $199.5 million in 2008.

***No Change Assumed for Medic 1/Emergency Medical Services Levy.*** The Medic 1/EMS levy, which generates approximately $20 million annually, is slated for a renewal vote in 2007. County and City officials are working on a proposal to put before the voters, but at this time no firm proposal regarding rates and levy amounts has been made. This forecast assumes that voters approve a new levy to generate the same amount of revenue that the current levy yields, as if the current levy were extended to 2008.

**Figure 8.**


Components of Total Property Tax Levy for 2006
(tax rate = $9.63 per $1,000 assessed value)
State 26%
Port 2%
Schools 23%
County 14%
Emerg. Med. Services 2%
City 33%
Components of City's Property Tax Levy for 2006
(tax rate = $3.16 per $1,000 assessed value)
Comm.Centers
Seattle Ctr Redvelopment 1%
Fire Facilities 8%
Parks & Open Space 9%
Families & Education 6%
Low Income Housing 4%
Debt Service 9%
General Purposes 63%

## Retail Sales and Use Tax

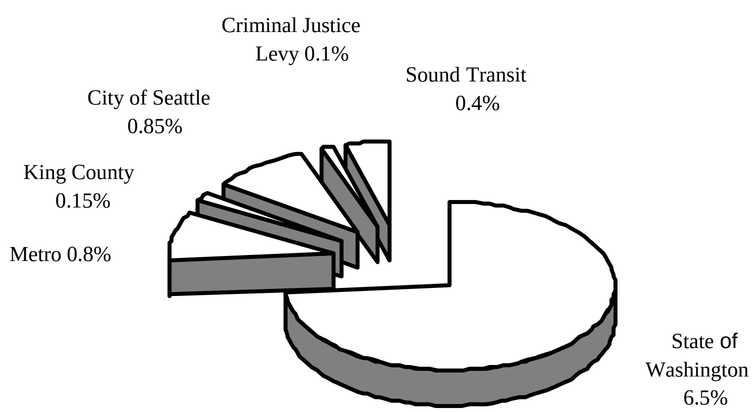
The retail sales and use tax (sales tax) is imposed on the sale of most goods and certain services in Seattle. The tax is collected from consumers by businesses that, in turn, remit the tax to the state. The state provides the City with its share of these revenues on a monthly basis.

The sales tax rate is 8.8% for most taxable transactions. The rate was increased from 8.6% in April 2001, following approval by King County voters of a proposal to raise the sales tax rate by 0.2% to provide additional funding for transit. County voters will be asked to increase the sales tax by an additional 0.1% in the November 2006 general election. Revenue from this increase would be used on additional transit services.

The exception to the 8.8% rate is a 9.3% rate that is applied to food and beverages sold in restaurants, taverns, and bars throughout King County. The extra 0.5% was imposed in January 1996 to help pay for the construction of a new professional baseball stadium in Seattle.

The basic sales tax rate of 8.8% is a composite of separate rates for several jurisdictions as shown in Figure 9. The City of Seattle's portion of the overall rate is 0.85%. In addition, Seattle receives a share of the revenue collected by the King County Criminal Justice Levy.

**Figure 9. Sales and Use Tax Rates in Seattle, 2006**

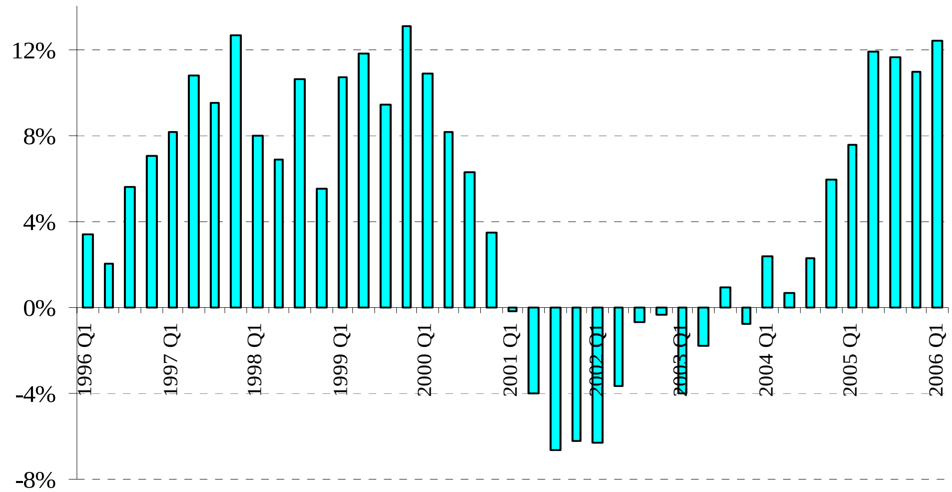



**Total Rate = 8.8%**

NOTE: Rate is 9.3% for food and beverages sold in restaurants and bars.

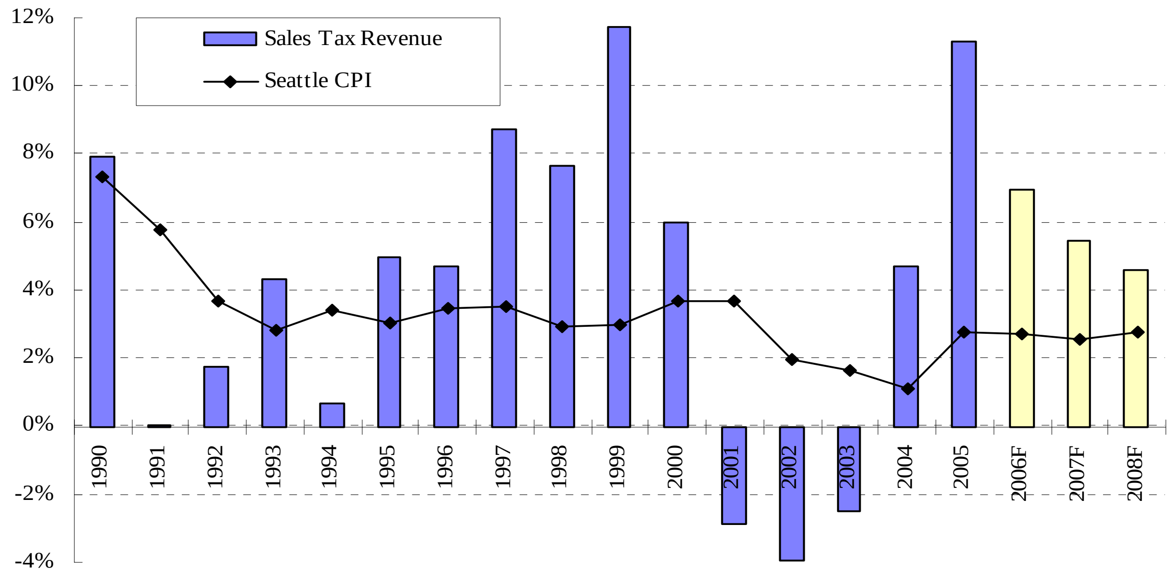
***Sales tax revenue has grown and contracted with the region's economy.*** The robust economy of the late 1990s resulted in very strong growth in taxable retail sales in Seattle. As illustrated in Figure 10, taxable sales growth accelerated rapidly in 1996-1997, driven by a strong economy led by aggressive expansion at Boeing, and surged again in 1999 when the stock market and technology booms reached their peaks. Growth began to slow in 2000, when the stock market bubble burst and technology firms began to falter. The slowdown continued into 2001 and 2002, with growth rates turning sharply negative beginning in early 2001. Year-over-year growth rates were negative for 10 consecutive quarters beginning in first quarter 2001, and revenue growth remained weak through third quarter 2004. Beginning in fourth quarter 2004, taxable sales growth accelerated rapidly, and has averaged a robust 11.7% over the most recent four quarters (2005 Q2 – 2006 Q1), led by construction which increased by 25.4%. Construction has maintained its rapid pace of growth thus far in 2006, but slower growth in other industries and a falloff in non-current revenue have reduced sales tax revenue growth to 8.3% for the first six months of the year.

**Figure 10. Quarterly Taxable Retail Sales: Year-Over-Year Growth**




***Retail sales tax revenue is forecast to increase by 7.0% in 2006 and then grow more slowly in 2007-08.*** The forecast of sales tax revenue reflects the expectation that the national and regional economies will grow more slowly in the second half of 2006 and in 2007-2008. Sales tax revenue is expected to increase by 7.0% in 2006, then drop to 5.5% and 4.6% in 2007 and 2008, respectively.

**Figure 11. Annual Growth of Retail Sales Tax Revenue**




Note: All revenue figures reflect current accrual methods. 2006-08 are forecasts.

### Business and Occupation Tax

The Business and Occupation (B&O) tax is levied by the City on the gross receipts of most business activity occurring in Seattle. Under some conditions, gross receipts of Seattle businesses are excluded from the tax if the receipts are earned from providing products or services outside of Seattle.

The City levies the B&O tax at different rates on different types of business activity, as indicated in Figure 13 at the end of this section. Most business activity, including manufacturing, retailing, wholesaling, and printing and publishing, is subject to a tax of 0.215% on gross receipts. Activities taxed at the 0.415% rate include services and transporting freight for hire. Included in the forecast of B&O tax revenue are projections of tax refund and audit payments and estimates of tax penalty and interest payments for past-due tax obligations.

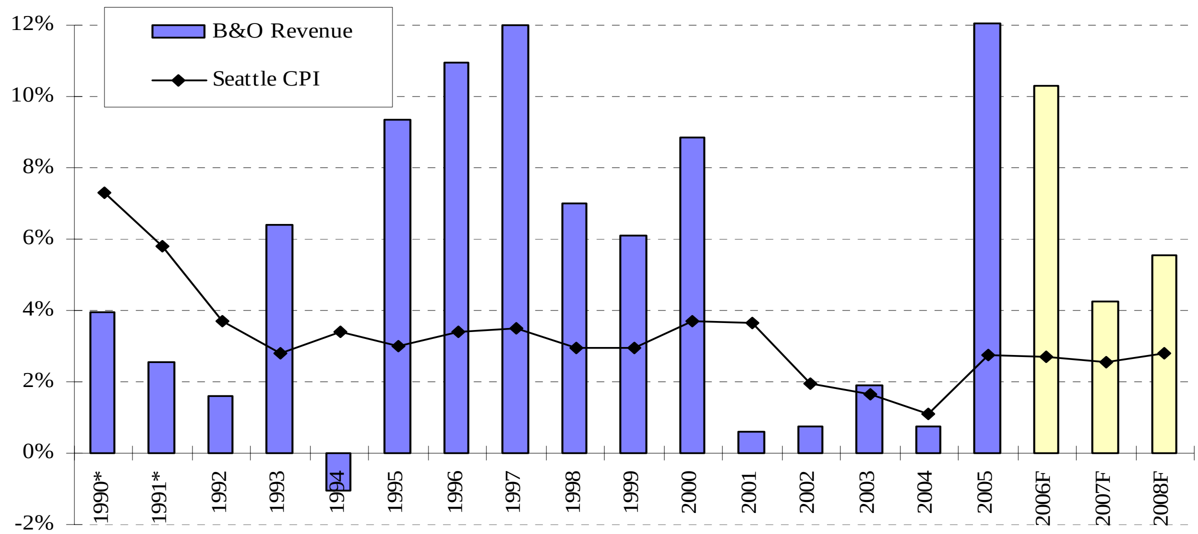
Other things being equal, the B&O tax base is more stable than the retail sales tax base. The B&O base is broader than the sales tax base, is less reliant on the construction and retail trade sectors, and is more dependent upon the service sector (most services are not subject to the sales tax).

***After rising strongly in the second half of the 1990s, B&O revenue growth stalled from 2001 to 2004.*** Beginning in 1995, the City made a concerted effort to administer the B&O tax more efficiently, educate taxpayers, and enforce tax regulations. As a result of these efforts, unlicensed businesses were added to the tax rolls, businesses began reporting their taxable income more accurately, and audit and delinquency collections increased significantly – all of which resulted in very strong B&O revenue growth during the period 1995-1997. Growth slowed somewhat in 1998, as these efforts began to yield diminishing returns once the most obvious and productive techniques for identifying unlicensed or under-reporting businesses had been put into practice. In 2000, B&O revenue was boosted by changes the State of Washington made in the way it taxes financial institutions. These changes affected the local tax liabilities of financial institutions.

When the region's economy slipped into recession in early 2001, B&O revenue growth slowed abruptly (see Figure 12). Revenue from current year tax obligations declined by 2.5% in 2001 and 2.1% in 2002. However, in both years the declines were more than offset by large gains in non-current revenue, which includes revenue from audits and other enforcement activity, refunds, and penalty and interest payments. As a result, both 2001 and 2002 saw very small increases in B&O receipts. The strong growth in non-current revenue reversed in 2003 and

2004, but overall revenue growth remained positive because revenue from current tax year obligations increased by 4.0% in 2003 and 5.4% in 2004. Following four years growth below 2%, in 2005 revenue growth jumped to 12.0%, led by growth in construction, services, finance, insurance, and real estate.

**Figure 12. Annual Growth of B&O Tax Revenue**




*1990 and 1991 figures have been adjusted to remove the effects of tax rate increases.
Note: Revenue figures reflect current accrual methods; 2006-08 are forecasts.

***B&O revenue is forecast to grow rapidly in 2006, then slow to moderate growth in 2007 and 2008*.** B&O revenue is forecast to post a strong 10.3% growth rate in 2006, due to a healthy economy and an unusually large increase in penalty and interest payments during the first half of the year. Growth is expected to fall to 4.3% in 2007 as penalty and interest payments return to normal levels, and an increase in the small business threshold from $50,000 to $75,000 reduces B&O receipts by $573,000 (90% figure). The forecast anticipates a modest rebound in 2008 to 5.6% growth.

The forecast for 2008 does not incorporate any loss of revenue due to Section 13 of the State of Washington's House Bill 2030, subsequently codified as RCW 35.102.130, which becomes effective on January 1, 2008. It is assumed that any loss from the implementation of Section 13 of HB 2030 is fully mitigated.

Also not included in the B&O revenue forecast is revenue from proposed increases in B&O tax rates. In order to mitigate an estimated $21.3 million revenue loss in 2008 that will result from Section 13 of HB 2030 taking effect, the Mayor proposes increasing the retail B&O tax rate from 0.215% to 0.219% effective July 1, 2007, and from 0.219% to 0.223% effective July 1, 2008. The proposal raises the service rate from 0.415% to 0.423% effective July 1, 2007 and from 0.423% to 0.428% effective July 1, 2008. These tax rate increases add an estimated $1.6 million in 2007 and $4.1 million in 2008 to B&O receipts (at the 100% level). The Mayor's proposed tax rate increases only take effect if State House Bill 2030 is not fully mitigated by the state.

The B&O revenue forecast incorporates revisions the City Council made to the Executive's B&O forecast in November 2002 and November 2004 to provide additional funding for auditing.

### Utility Business Tax - Private Utilities

The City levies a tax on the gross income derived from sales of utility services by privately owned utilities within Seattle. These services include telephone, steam, cable communications, natural gas, and refuse collection for businesses.

***Natural gas utility tax forecast is revised upward.*** The City levies a 6% utility business tax on gross sales of natural gas. The bulk of revenue from this tax is received from Puget Sound Energy (PSE). PSE's natural gas rates are approved by the Washington Utilities and Transportation Commission.

While natural gas prices were fairly stable for 2004 and the early part of 2005, PSE was granted permission to increase their rates effective October 1, 2005 to mitigate the impact of significant wholesale price increases in the spring and summer of 2005. However, PSE's request for rate increases was made prior to the major hurricanes in the Gulf of Mexico that severely affected the natural gas market. PSE is expected to request another set of rate increases to mitigate the impact of the hurricane-related price spikes which occurred in the late summer and early fall of 2005. This request would be in addition to another PSE request made in February of 2006 to recover higher delivery costs. Together, these rate requests should raise natural gas rates by roughly 10% in January 2007. Revenue forecasts for City utility tax in 2007 and 2008 reflect these rate increases.

***Telephone utility tax forecast is overshadowed by federal legislation.*** The utility business tax is levied on the gross income of telecommunication firms at a rate of 6%. After extraordinary growth over several consecutive years in the late 1990s, telecommunication tax revenue growth halted completely in 2002, and began declining in the fourth quarter of that year. A variety of forces – the lackluster economy, industry restructuring, and heightened competition – all served to force prices downward and reduce gross revenues. Additionally, recent technological changes, particularly Voice-over Internet Protocol (VoIP), which enables local and long-distance calling through broadband Internet connections, contribute to the uncertainties in this revenue stream.

The technological risks are magnified due to a strong interest by U.S. legislators to keep access to Internet connections and many forms of Internet communication free from regulation and taxation. Current federal legislation, which expires in November 2007, permits state and local jurisdictions like Seattle to levy taxes on internet access if the tax existed prior to October 1998.

Although the economic outlook is currently optimistic, revenue from telecommunication utility taxes are not expected to increase through 2008. There are two principle reasons for a modest forecast. First, wireless services (tax revenue from which have grown dramatically) have shown little growth since their heyday in the late 1990s. Second, providers of broadband internet and telecommunications services are gaining market share from traditional network providers, and the ability of the City to levy its telecommunication tax is being disputed in court. Adverse legal findings may result in a reduction of the City's tax base as broadband telecommunication providers continue to grow.

***Cable revenue tax growth should be stable.*** The City has franchise agreements with cable television companies operating in Seattle. Under the current agreements, the City levies a 10% utility tax on the gross subscriber revenues of cable TV operators, which accounts for about 90% of the operators' total revenue. The City also collects B&O taxes on miscellaneous revenues not subject to the utility tax. The imposition of a 4.2% franchise fee makes funds available for cable-related public access purposes. This franchise fee, which does not go to the General Subfund, increased from 3.5% in June 2006.

There have been ongoing efforts in Congress to limit the authority local governments have over cable franchising. Current bills before the House and Senate do not necessarily alter a city's ability to impose a utility tax, but would limit the revenue base to which franchise fees are applied.

Cable revenues have been growing and are expected to continue to do so through 2008. Revenues for 2006 have been augmented by a late payment from 2005, yielding a total of $11.6 million. The forecasts for 2007 and 2008 are $10.9 and $11.2 million respectively. Amid growing competition from satellite TV, the cable industry has increased its services, including additional channels, pay-per-view options, and digital reception in order to remain competitive.

### Utility Business Tax - Public Utilities

The City levies a tax on most revenue collected by City-owned utilities (Seattle City Light and Seattle Public Utilities). In 2004, tax rates were 6.0% for electricity and 10.0% for the other public utility services (see Figure 13). Tax rate increases on various public utilities were passed by the Council in November 2004. These rate increases led to sizable increases in revenues to the General Subfund. As of now there are no planned tax rate increases, therefore the revenues from the utilities are projected to remain fairly stable with the exception of those utilities with changes in rate structure.

***Less tax revenue from City Light due to rate proposal.*** Following the west coast energy crisis of 2000, City Light was granted the right to charge significantly higher rates to customers to make up for the severe shortfall in cash flow that affected the utility at the time. In July 2006, the Mayor proposed to lower electric rates. This reduction is expected to result in a 2.3% decrease in utility tax revenues for 2007, and grow slightly in 2008 to reflect greater electricity load demand.

***Modest growth from water tax revenue***. The utility tax rate on water service increased to 14.04% in January 2005, and 15.54% on May 15, 2005. As a result, water tax revenues rose sharply in 2005. Revenues are expected to grow modestly between 2006 and 2008.

***Higher Drainage and Wastewater rates mean higher tax revenue growth.*** Effective January 2005, the utility tax rate increased to 12.0% for wastewater service and 11.5% for drainage service. Largely as a result of these tax rate increases, revenue from drainage and wastewater service increased dramatically in 2005. The drainage and wastewater utility is expected to implement increased rates for 2007 resulting in a tax revenue increase of 8.2% over 2006.

***Higher Solid Waste rates mean higher tax revenue growth.*** The utility tax rate on both City of Seattle and commercial solid waste service increased to 11.5% on April 1, 2005. Largely as a result of these tax rate increases, revenue from solid waste service increased in 2005. Increases in commercial collection rates result in an increase in tax collection of 8.5% for 2007 compared to 2006.

### Admission Tax

The City imposes a 5% tax on admission charges to most Seattle entertainment events, the maximum allowed by state statute. This revenue source is highly sensitive to unanticipated swings in attendance at athletic events. It is also dependent on economic conditions, as people’s ability and desire to spend money on entertainment is influenced by the general prosperity in the region.

By City ordinance, 20% of admissions tax revenues, excluding men’s professional basketball, are dedicated to programs supported by the Office of Arts and Cultural Affairs. This set-aside had been reduced to 10% for 2003 and 2004 and 15% for 2005 in response to the recession. The forecasts in Figure 6 for admission taxes reflect the full amount of tax revenue. The Office of Arts and Cultural Affairs budget provides detail on the Office’s use of Arts Account revenue from the admission tax.

### Licenses and Permits

The City requires individuals and companies conducting business in Seattle to obtain a City business license. In addition, some business activities, such as taxi cabs and security systems, require additional licenses referred to as professional and occupational licenses. The City also assesses fees for public-safety purposes (e.g., pet ownership and fire hazard inspection) and charges a variety of fees for the use of public facilities and rights-of-way.

The City instituted a two-tier business license fee structure beginning with licenses for 2005. The cost of a license, which had been $80 per year for all businesses, was raised to $90 for businesses with worldwide revenues of more than $20,000 per year and lowered to $45 for businesses with worldwide revenues less than $20,000 per year. The shift to the two-tier structure was expected to result in a small decline in revenue, of approximately $90,000 per year.

The transition to the two-tier business license, which occurred in late 2004, caused a delay in the mailing of license renewals for 2005. As a result, business license fee revenue fell 14.9% short of forecast in 2004 as payments that would normally have been received in 2004 slipped into 2005, boosting 2005 revenue.

As part of the City's Bridging the Gap transportation funding initiative, effective July 1, 2007 the Commercial Parking License fee paid by commercial parking operators is reduced from $90 per 1,000 square feet of floor space to $6 per 1,000 square feet. As a result of this change, license revenues decline by $760,000 in 2007 and $1.025 million in 2008.

### Parking Meters/Meter Hoods

In spring 2004, the City of Seattle began removing traditional parking meters and replacing them with pay stations in various areas throughout the city. Pay stations are parking payment devices offering the public a more convenient array of payment options, including credit cards and debit cards, to pay for hourly street parking. Along with this switch, the City increased parking rates from $1 to $1.50 per hour. Finally, as part of the pay station program, Seattle Department of Transportation (SDOT) increased the total number of parking spaces in the street right-of-way which are subject to fees.

In 2007 SDOT plans to extend pay station control over 2,160 previously non-paid spaces in the South Lake Union area. Under an experimental approach, the rates for these spaces will vary as frequently as quarterly to achieve a desired occupancy rate for the area. Revenues for this area are estimated to be approximately $710,000 in 2007 and $1.5 million in 2008. Total parking revenues are anticipated to be $17.3 million in 2007 and $18.6 million in 2008. More information about the pay station technology program is provided in the SDOT section of this document.

Meter Hood Service revenues are anticipated to remain stable at approximately $1.0 million in both 2007 and 2008.

### Court Fines

Historically, between 70% and 85% of fine and forfeiture revenues collected by the Seattle Municipal Court are from parking citations and fines resulting from enforcement efforts by Seattle Police Department parking enforcement and traffic officers. An additional 8% to 10% comes from traffic tickets. Overall trends indicate decreases in citation volume in the 2006 through 2008 forecast period. This is in part due to enforcement and compliance changes stemming from the parking pay station technology. Despite this trend, revenues are anticipated to increase in 2006 due to increased collections revenues and administrative changes in the Municipal Court related to filing unpaid citation information with the State Department of Licensing.

The downward trend in parking citations are offset in part beginning later in 2007 when, as part of the South Lake Union parking pay station extension (described above in the Parking Meter section), three additional Parking Enforcement Officers are added. In 2007 the City anticipates receiving $17.0 million in court fines and forfeitures and $16.3 million in 2008.

### Interest Income

Through investment of the City’s cash pool in accordance with state law and the City’s own financial policies, the General Subfund receives interest earnings on cash balances attributable to several of the City’s funds or subfunds that are affiliated with general government activities. Many other City funds are independent, retaining their own interest earnings. Interest income to the General Subfund varies widely, subject to significant fluctuations in cash balances and changes in interest rates dictated by economic and financial market conditions.

Positive growth in interest rates combined with improved cash balances through 2005 and 2006 resulted in increased interest earnings over this period: $1.9 million in 2004, $3.2 million in 2005, and an estimated $4.3 million in 2006. Current estimates for General Subfund interest earnings anticipate lower cash balances but slightly higher interest rates in 2007, producing earnings of $4.3 million. In 2008, cash balances are anticipated to decline further along with marginal decreases in interest rates, producing interest earnings of $3.6 million.

## Revenue from Other Public Entities

***Washington state shares revenues with Seattle.*** The State of Washington distributes a portion of tax and fee revenue directly to cities. Specifically, portions of revenues from the State General Fund, liquor receipts (both profits and excise taxes), and motor vehicle fuel excise taxes are allocated directly to cities. Revenues from motor fuel excise taxes are dedicated to street maintenance expenditures and are deposited into the City's Transportation Fund. Revenues from the other taxes are deposited into the City's General Subfund.

***Little Change in Criminal Justice revenues.*** The City receives funding from the state for criminal justice programs. The state provides these distributions out of its general fund. These revenues are allocated on the basis of population and crime rates relative to statewide averages. The City should receive approximately $2.3 million in 2007 and 2008.

***Liquor Board profits and excise tax revenue declining.*** The City's share of Liquor Board profits increased dramatically from $3.1 million in 2002 to $4.1 million in 2004. There were $4.1 million in revenues for 2005 as well. 2006 revenues have been revised downwards to $3.6 million. This drop is the result of new initiatives and programs the Liquor Board has undertaken in the aim of increasing revenues, decreasing costs and therefore increasing profits later on. Some of these benefits are anticipated to be seen in Liquor Board revenues beginning in 2007, with a forecast of $3.8 million. Liquor excise taxes, which are levied on the sale of liquor, have been growing consistently and this trend is expected to continue. The 2007 and 2008 forecasts for the liquor excise taxes are $2.45 million and $2.50 million respectively.

***City General Subfund receives additional resources from Sound Transit.*** The construction of Link Light Rail by Sound Transit will continue to require City services. Sound Transit reimburses the City for these additional services. The General Subfund will receive money in both 2007 and 2008 for police and fire support services. City revenues will decline in 2008 as the work on the Metro Tunnel nears completion. Revenue from Sound Transit for these services is expected to be $1.1 million in 2007 and $237,000 in 2008.

## Service Charges and Reimbursements

***Internal service charges reflect current administrative structure.*** In 1993, the City Council adopted a resolution directing the City to allocate a portion of central service expenses of the General Subfund to City utilities and certain other departments not supported by the General Subfund. The intent of this allocation is to allocate a fair share of the costs of centralized general government services to the budgets of departments supported by revenues that are largely self-determined. These allocations are executed in the form of payments to the General Subfund from these independently supported departments.

Central Service departments have seen their budgets change significantly for the 2007-2008 biennium due to a large increase in the allocation of space rent charges from the Fleets and Facilities Department. This increase has led to increases in central service allocations charged to the revenue-generating funds, and therefore significantly higher revenues from internal service charges to the General Subfund. More details about these cost allocations and methods are in the back of the budget book under the cost allocation tab.

## Interfund Transfers

***Interfund transfers increase significantly.*** Interfund transfers are payments from the balances of department-specific funds and capital project funds to the General Subfund. For 2006, the Parks Department will transfer $155,000 to the General Subfund because of larger-than-forecasted charter revenues. In 2007 approximately $1.1 million of fund balance from the Department of Information Technology (DoIT) is transferred to the General Subfund in order for the Department of Executive Administration (DEA) to develop a cash receipting system and an employee self-service module, both of which are described in more detail in DEA's section of the budget.

A detailed list of these transfers is included in the General Subfund revenue table found in the Funds, Subfunds, and Other section. In ratifying the 2007 Proposed Budget, it is the intent of the Council and Mayor to authorize the transfer of unencumbered, unreserved fund balances from the funds listed in the General Subfund revenue table to the General Subfund.

## Figure 13. Seattle City Tax Rates

| | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| **Property Taxes (Dollars per $1,000 of Assessed Value)** | | | | |
| General Property Tax | $2.20 | $2.16 | $2.12 | $2.01 |
| Families & Education | 0.04 | 0.04 | 0.19 | 0.18 |
| Seattle Center/Parks Comm. Ctr. | 0.10 | 0.10 | 0.02 | 0.02 |
| Parks and Open Space | 0.31 | 0.30 | 0.30 | 0.28 |
| Low Income Housing | 0.05 | 0.04 | 0.04 | 0.04 |
| Fire Facilities | 0.00 | 0.30 | 0.28 | 0.26 |
| Emergency Medical Services | 0.24 | 0.24 | 0.23 | 0.22 |
| Low Income Housing (Special Levy) | 0.11 | 0.10 | 0.10 | 0.28 |
| City Excess GO Bond | 0.36 | 0.31 | 0.31 | 0.28 |
| **Retail Sales and Use Tax** | 0.85% | 0.85% | 0.85% | 0.85% |
| **Business and Occupation Tax** | | | | |
| Retail/Wholesale | 0.2150% | 0.2150% | 0.2150% | 0.2150% |
| Manufacturing/Extracting | 0.2150% | 0.2150% | 0.2150% | 0.2150% |
| Printing/Publishing | 0.2150% | 0.2150% | 0.2150% | 0.2150% |
| Service, other | 0.4150% | 0.4150% | 0.4150% | 0.4150% |
| **City of Seattle Public Utility Business Taxes** | | | | |
| City Light | 6.00% | 6.00% | 6.00% | 6.00% |
| City Water | 10.00% | 10.00% | 14.04-15.54%* | 15.54% |
| City Drainage | 10.00% | 10.00% | 11.50% | 11.50% |
| City Wastewater | 10.00% | 10.00% | 12.00% | 12.00% |
| City Solid Waste | 10.00% | 10.00% | 10-11.50%** | 11.50% |
| **City of Seattle Private Utility B&O Tax Rates** | | | | |
| Cable Communications (not franchise fee) | 10.0% | 10.0% | 10.0% | 10.0% |
| Telephone | 6.0% | 6.0% | 6.0% | 6.0% |
| Natural Gas | 6.0% | 6.0% | 6.0% | 6.0% |
| Steam | 6.0% | 6.0% | 6.0% | 6.0% |
| Commercial Solid Waste | 10.0% | 10.0% | 10-11.5%** | 11.5% |
| **Franchise Fees** | | | | |
| Cable Franchise Fee | 2.5% | 2.5% | 2.5% | 3.5-4.2%*** |
| **Admission and Gambling Taxes** | | | | |
| Admissions tax | 5.0% | 5.0% | 5.0% | 5.0% |
| Amusement Games (less prizes) | 2.0% | 2.0% | 2.0% | 2.0% |
| Bingo (less prizes) | 10.0% | 10.0% | 10.0% | 10.0% |
| Punchcards/Pulltabs | 5.0% | 5.0% | 5.0% | 5.0% |

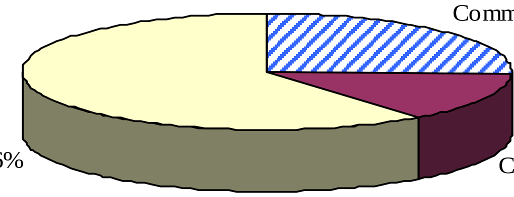
*The 15.54% rate was effective May 15, 2005
**The 11.5% rate was effective April 1, 2005
***The 4.2% rate was effective June 3, 2006

## Cumulative Reserve Subfund – Real Estate Excise Tax

The real estate excise tax (REET) is levied by the City at a rate of 0.5% on sales of real estate measured by the full selling price. Revenue from REET is deposited in the Cumulative Reserve Subfund, and is used primarily for the maintenance and development of capital facilities. Because the tax is levied on transactions, the amount of revenue that the City receives from REET is determined by both the volume and value of transactions.

Over time, 60.6% of the City's REET tax base has come from the sale of residential properties, which include single-family homes, duplexes, and triplexes. Commercial sales, which include apartments with four units or more, account for a quarter of the tax base, and condominiums constitute the remaining 13.8% (see Figure 14).

**Figure 14. Value of Seattle Real Estate Transactions by Property Type, 1982 - 2005**




***Historically REET revenue growth has been both strong and volatile.*** The value of Seattle real estate transactions (the REET tax base) increased at an average annual rate of 11.5% between 1982 and 2005, a period when Seattle area inflation averaged only 3.2% per year. Growth has been particularly strong during the past four years as the housing market has boomed in response to very low interest rates and the recent upturn in the region's economy. In addition, 2004 and 2005 were exceptional years for commercial real estate activity.

The volatility of REET is reflected by the fact that despite an 11.5% annual growth rate, the REET tax base declined in six years out of 23 during the period 1982 – 2005 (see Figure 15). The most recent decline was a drop of 15.6% in 2001. Volatility results largely from changes in sales volumes, which are sensitive to shifts in economic conditions and movements in interest rates; average prices tend to be more stable over time. Commercial activity is more volatile than residential, in part because the sale of a handful of expensive properties can result in significant swings in the value of commercial sales from one year to the next.

***REET revenue is forecast to fall in 2007.*** The real estate market is beginning to slow both nationally and locally, with the nation leading and the Puget Sound area lagging behind. Nationally, housing starts and home sales are down significantly from a year ago, the inventory of unsold homes is expanding, and in recent months sales prices for homes have been growing at less than the rate of inflation. Locally, home prices are still increasing at double digit rates, but sales volumes have been declining in recent months and the inventory of active listings is beginning to increase. Given how quickly the national real estate market has cooled and the fact that the region's economy has begun to slow, the local real estate market is expected to continue to cool.

The forecast expects REET revenue to peak in 2006, decline by 5.5% in 2007, and then grow slowly in 2008. The downturn in 2007 will be led by an anticipated drop in commercial activity and a modest decline in the value of condominium sales.

**Figure 15. REET: Value of Sales**