# City Revenue Sources – September 2007

### City Revenue Sources and Fund Accounting System

The City of Seattle spends $3.55 billion annually on services and programs for Seattle residents. State law authorizes the City to raise revenues to support these expenditures. There are four main sources of revenues. 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 activities at the Seattle Center, recreational programs at community centers, 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.

The City accounts for all revenues and expenditures within a system of accounting entities called "funds" or "subfunds." The City maintains dozens of funds and subfunds. The use of multiple funds is necessary to ensure compliance with State budget and accounting rules, and promotes accountability for specific projects or activities. For example**,** the City of Seattle has a legal 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. For similar reasons expenditures of revenues from the City's Families and Education Property Tax Levy are accounted for in the Educational and Development Services Fund. As a matter of policy, several City departments have separate funds or subfunds. For example, the operating revenues and expenditures for the City's parks are accounted for in the Park and Recreation Fund. The City also maintains separate funds for debt service and capital projects, as well as 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.

The City's primary operating fund is the General Fund. The majority of resources for services typically associated with the City, such as police and fire or libraries and parks are received into and spent from one of two subfunds of the City's General Fund: the General Subfund for operating resources (comparable to the "General Fund" in budgets prior to 1996) and the Cumulative Reserve Subfund for capital resources.

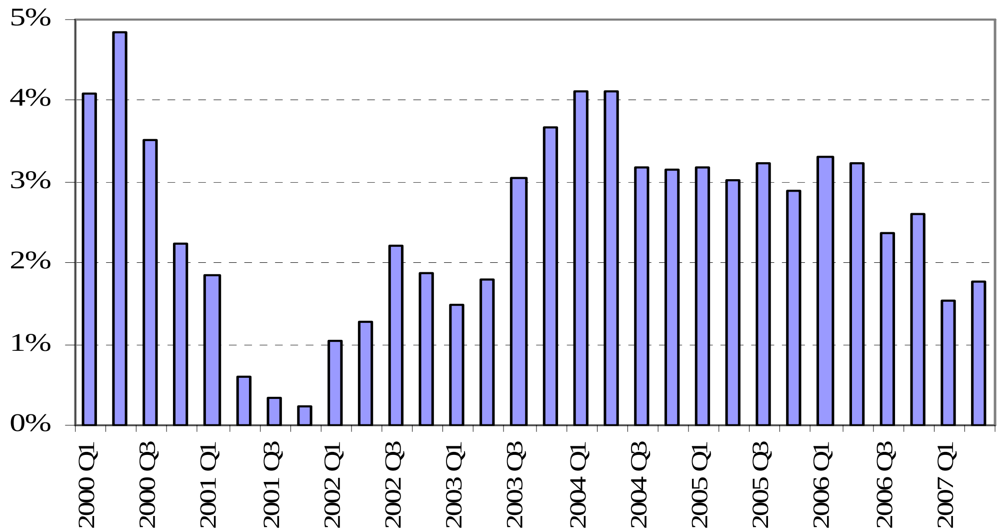
All City revenue sources are directly or indirectly affected by the performance of the local, regional, national and even international economies. For example, revenue collections from sales, business and occupation, and utility taxes, which together account for 56.8% of General Subfund revenue, fluctuate significantly as economic conditions affecting personal income, construction, wholesale and retail sales and other factors in the Puget Sound region change. The following sections describe the current outlook for the local and national economies, and present greater detail on forecasts for revenues supporting the General Subfund, Cumulative Reserve Subfund, and the Transportation Fund.

# The National and Local Economy

### National Economic Conditions and Outlook

***The national economy has slowed over the past year.*** Under the pressure of a downturn in the housing market and rising energy prices, the pace of economic growth has been slowing over the past year. Real gross domestic product (GDP), which had been growing at a 3% pace, slowed to a rate of less than 2% in the first half of 2007 (see Figure 1). Employment increased by an average of 189,000 jobs per month in 2006, but during the first seven months of 2007 the pace has fallen to 136,000 per month.

**Figure 1. Real U.S. GDP: Year-Over-Year Growth**




Source: U.S. Bureau of Economic Analysis.

Despite the slowdown, economic conditions were mixed in mid-2007. On the positive side, employment continues to grow at a healthy, though slower, pace, and income growth is healthy as well. The world economy is healthy, led by strong growth in much of Asia and an improving European economy. A healthy world economy increases the demand for U.S. exports, which have also been helped by a decline in the value of the dollar. Inflation, which has been above the Federal Reserve's comfort range of 1% - 2%, has been moderating in recent months. A final positive has been the decline in the cost of gasoline from its recent peak in May 2007.

On the negative side, the housing market continues to deteriorate, and most analysts don't anticipate a turnaround until mid-2008 or later. Problems in the sub-prime mortgage market are beginning to spread to the market for prime mortgages and to the financial markets more broadly. Consumer spending has been slowing, as consumers respond to the housing downturn and higher energy prices.

***Housing has played an outsized role in the economy since 2001.*** The Federal Reserve cut interest rates sharply during the 2001 recession and into 2002 to soften the downturn and spur a recovery, and to protect against the possibility of deflation. The very low interest rates set by the Federal Reserve 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 moved upward due to increased demand. Lenders further stimulated demand by introducing a variety of creative mortgage instruments which made it possible for many people to obtain home financing who previously would not have qualified for a loan due to poor credit histories or low incomes. Finally, 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, reaching an estimated 8% of disposable income in 2005 before peaking in the third quarter of 2006.

In June 2004, the Federal Reserve began increasing interest rates. The Fed raised the federal funds target rate by 0.25% at each of its meetings until it reached 5.25% in June 2006. Rising interest rates 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 been on the decline since then.

As of mid-2007, fewer new homes are being built, sales of both new and existing homes are declining, and home prices are falling in many - perhaps most - areas of the U.S. According to National Association of Realtors' data, as of June 2007 sales of existing homes had dropped 20.9% over the past two years. The Case-Schiller House Price Index for 20 large U.S. metropolitan areas registered year-over-year declines in housing prices in each of the first five months of 2007.

Mortgage credit problems are escalating rapidly as both delinquencies and defaults rise. Delinquency refers to a homeowner falling behind in his or her payments, while default is the first step in the foreclosure process. Most of the delinquencies and defaults are concentrated in the sub-prime mortgage market, in which loans were made to buyers with weak credit histories or high debt levels relative to their incomes. The number of homes facing foreclosure was up 58% in the first six months of 2007 compared to the first half of 2006.

In early August of 2007, there was growing evidence that sub-prime problems were spreading to the rest of the mortgage market. For example, Countrywide Financial, the nation's largest home lender, reported rising problems with prime loans, particularly on loans in which borrowers took out a second mortgage because they couldn't afford a large down payment.

In addition to spreading to the prime mortgage market, sub-prime problems are beginning to spread to the broader credit markets as investors reevaluate their tolerance for risk. Interest rate spreads between low-risk and high-risk debt have been widening, and a number of corporate debt offerings have been delayed or cancelled due to the inability of lenders to obtain financing on the terms they desire.

***The forecast anticipates slow growth through mid-2008.*** The slowdown in economic growth that the U.S. economy is currently experiencing is expected to continue through at least mid-2008, largely because the housing market is not expected to turn around for another year or more. Global Insight expects the growth rate of real U.S. GDP to average 2.3% in the second half of 2007 and first half of 2008 before moving up to the 3% - 3½% range. Employment growth is expected to slow and the unemployment rate is forecast to rise to 4.9%.

As always, there are numerous risk factors that could cause growth to deviate from expectations. The ongoing risks of inflation and high energy prices have been joined by a deteriorating housing market and the fallout from that deterioration. With housing values no longer rising in much of the nation, housing's positive wealth effect on consumer spending is diminishing and home equity withdrawal is declining, reducing the support that housing has provided to consumer spending in recent years.

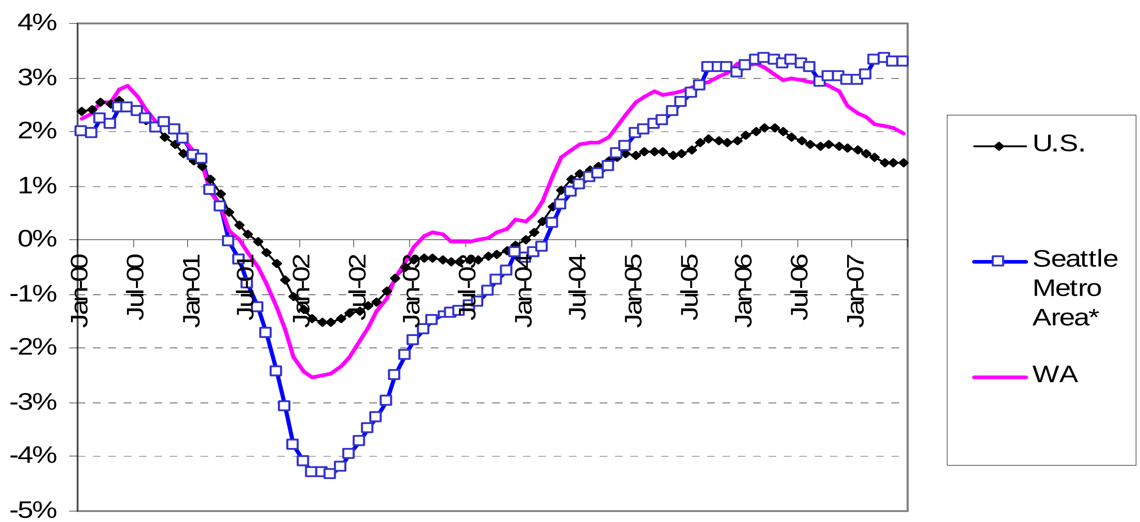
The fallout from the housing market includes investor losses on housing securities, and the more general impacts that the housing market is having on the financial markets. The consensus view is that the financial markets are in the midst of a correction in which the pricing of risk is returning to more normal levels, and that a serious credit crunch is unlikely. Nevertheless, economists have recently raised their forecasts of the likelihood of a recession. An August Wall Street Journal survey of 54 economists found that they had raised their estimate of the probability of a recession occurring during the next 12 months to 28% from 23% in June.

### Puget Sound Region Economic Conditions and Outlook

***The region is growing significantly 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. The economy improved steadily in 2004 and 2005, and has been growing at a brisk pace for the past two years. Regional employment, which has been growing at more than a 3% pace for nearly two years, is now growing at more than twice the rate of U.S. employment and significantly faster than the state (see Figure 2).

**Figure 2. Employment: Year-Over-Year Growth**

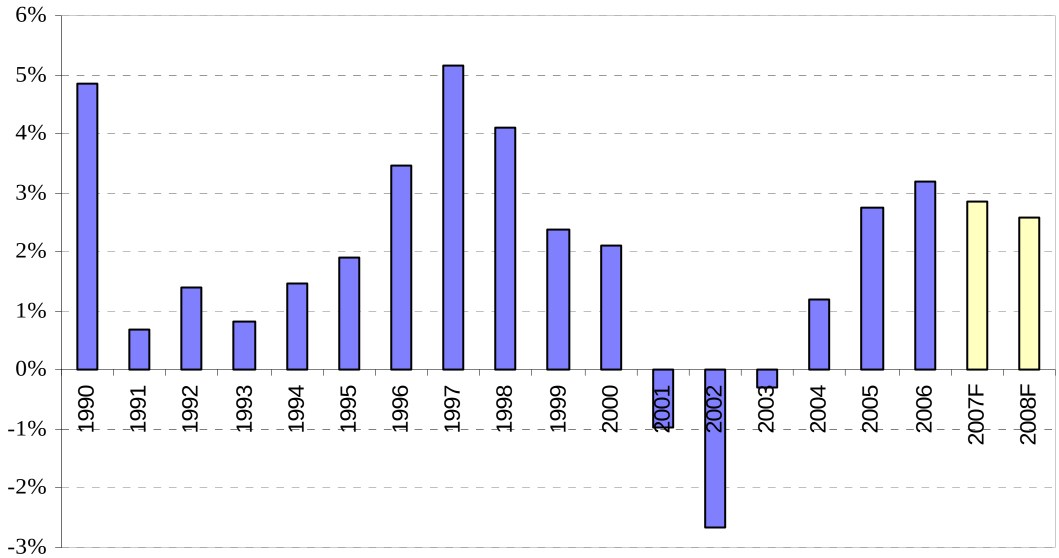



*King & Snohomish Co. Data are 3 month moving average of seasonally adjusted non-agricultural wage & salary employment. Data adjusted for Sep-05 Boeing strike.

Contributing to the region's healthy growth has been an upturn at Boeing and continued growth at Microsoft. With air travel growing and Airbus struggling, Boeing booked over 1,000 orders for new planes in both 2005 and 2006, and has booked over 600 orders thus far in 2007. Boeing has added 19,000 jobs since June 2004 to support increased production rates for existing models and to conduct research and development activity for, and begin production of, its popular new 787 model. Microsoft has added an average of 2,000 employees per year in the region over the past five years. To house its expanding workforce, Microsoft is expanding its Redmond campus, has leased 1.3 million square feet of office space in downtown Bellevue, and has just announced it is leasing space in the South Lake Union neighborhood. 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 gradually slow from its post-recession high of 3.2% in 2006 to 2.9% in 2007 and 2.6% in 2008. Aerospace employment is forecast to continue increasing through 2008.

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




Note: 2007-08 forecasts are from Puget Sound Economic Forecaster.
Puget Sound Region is King, Kitsap, Pierce, and Snohomish Counties.

## Consumer Price Inflation

***Consumer price inflation has moved up and down with energy prices in recent years.*** 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 rose gradually to reach 3.4% in 2005, after which it dropped to 3.2% in 2006 and 2.5% during the first seven months of 2007. Much of the rise in inflation has been 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 been growing more slowly than the overall CPI. Core inflation accelerated in mid-2006 reaching a peak of 2.9% in September, but it has fallen since then, to 2.2% for the most recent three-month period (May – July).

Due to the severity of the local recession in 2001-03, 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. However, inflation has picked up as the regional economy has improved, and since June 2006 local inflation has been running higher than national inflation. Looking to the future, local economists expect Seattle-area inflation to continue 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 2009. 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**

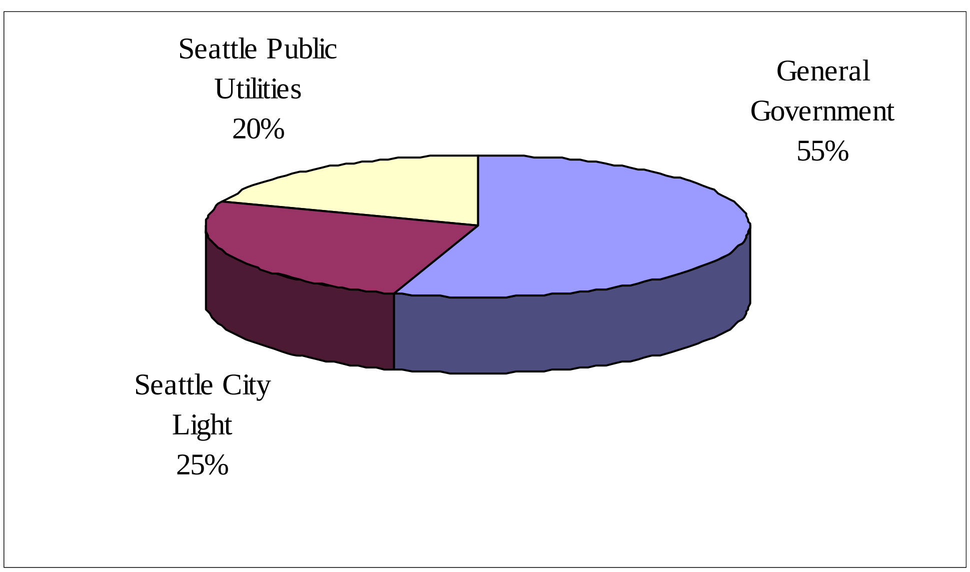
| | U.S. CPI-W (June-June growth rate) | Seattle CPI-W (June-June growth rate) | Seattle CPI-W (growth rate for 12 months ending in June) |
|---|---|---|---|
| 2006 (actual) | 4.5% | 4.6% | 3.4% |
| 2007 (actual) | 2.7% | 3.3% | 3.8% |
| 2008 | 2.3% | 2.9% | 3.4% |
| 2009 | 2.3% | 2.6% | 2.7% |

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.

## City Revenues

The City of Seattle will have approximately $3.6 billion in resources to spend on its programs and services in 2008. Approximately $240 million of these resources were collected in prior years and have been held in fund balances. Of the remaining $3.4 billion, approximately 45% are associated with the City's utility services, Seattle City Light and Seattle Public Utilities' Water, Wastewater and Solid Waste divisions. The remaining 55% are associated with general government services, such as police and fire, parks and libraries. Proceeds from bond issuances are included in these amounts (see Figure 5).

**Figure 5. Total City Revenue by Use – 2008 Proposed $3.39 Billion**

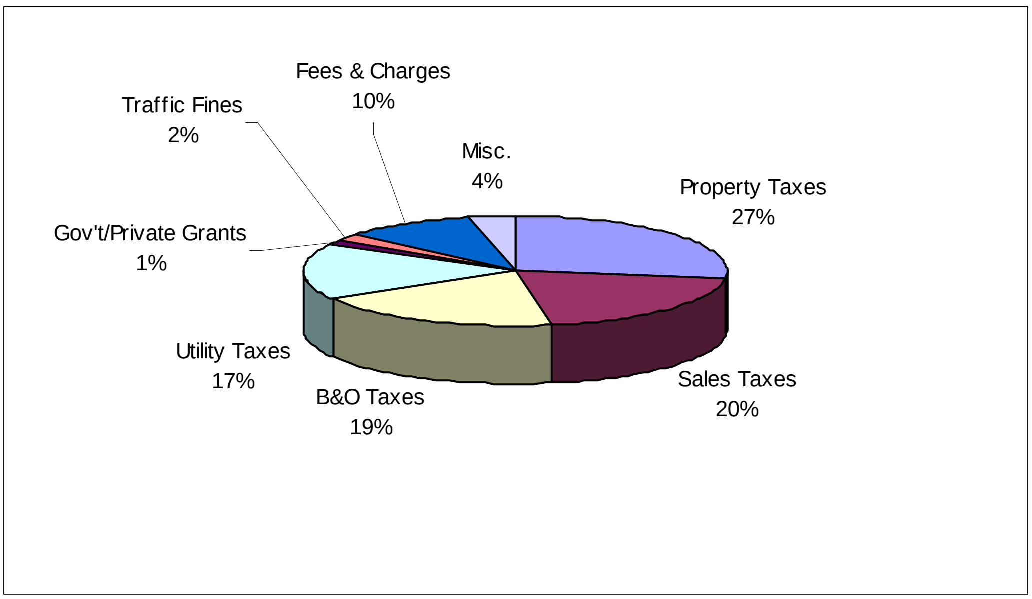


The following sections describe forecasts for revenue supporting the City's primary operating fund, the General Subfund, its primary capital fund, the Cumulative Reserve Subfund, as well as specific revenues supporting the City's Bridging the Gap Transportation program in the Transportation Fund.

## General Subfund Revenue Forecasts

Expenses assigned to the General Subfund are supported primarily by taxes. As Figure 6 illustrates, the most significant revenue source is the property tax, which accounts for 26.9%, followed by sales taxes and the Business and Occupation (B&O) tax.

**Figure 6. 2007-Revised General Subfund Revenue Forecast by Source - $809.8M**




### Revenue Overview

In 2006, general government revenue into the General Subfund totaled approximately $769.5 million. General Subfund revenue is projected to total $809.8 million in 2007 and $841.6 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.

Figure 7 shows General Subfund actual revenues for 2006, adopted and revised revenues for 2007 as well as the endorsed and proposed revenues for 2008. Tax revenues grew by a robust 7.5% in 2006 and are forecast to grow by 4.9% in 2007 and 4.5% in 2008. The main drivers of these growth rates are the B&O and sales taxes. Revenues from the B&O tax for 2006 were 13.1% higher than 2005, with expected growth slowing to 5.6% in 2007. The proposed 2008 forecast includes the effect of changes in State law that will reduce City B&O tax revenues by $22 million in 2008, but includes the proposed business tax on floor area use that partially mitigates this loss. These changes, along with an increase in the small business exemption threshold, result in a 3.6% growth rate for 2008. Sales tax revenues, led by construction, hotels and retail sales, experienced 6.4% growth in 2006, and are expected to show 7.7% and 5.2% growth for 2007 and 2008 respectively.

Other factors contributing to strong tax growth are sizable increases in drainage and 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. SPU's retail water sales are doing better than originally forecast. Water tax revenues are expected to grow by 6.3% for 2007 with negligible change in 2008. Natural gas revenues continue to perform well largely due to increased rates charged by Puget Sound Energy, even though PSE has requested a significant rate decrease beginning fall 2007.

Parking pay stations have seen strong growth in revenues and this trend is expected to continue. The City will install more pay stations over the next few years, particularly in the South Lake Union area where pay stations are becoming operational in late summer 2007. As a result, City revenue from parking fees will continue to grow. The City has also recently installed six red light cameras and has plans to install 24 more throughout the City. The 2007 forecast for this revenue stream is $1.13 million and due to the installation of more cameras, $3.4 million in 2008.

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.

The overall picture for the City's revenue sources is a positive one. Economic activity has been growing at a steady pace and the local real estate market has so far been spared the housing troubles plaguing the national market. Jobs are being continually added to the area and the population has been growing as a result. The local economy has continued to diversify, removing many of the risks associated with a contraction in the aerospace, international trade or software industries. Consumer and business confidence levels nationally have remained above the level needed to be considered expansionary, but just above. If the housing, job, or retail markets in the Seattle area start to slip, it could result in a cascade effect that would begin to chip away at the City's revenue sources and the broader health of the local economy.

**Figure 7. General Subfund Revenue, 2006 – 2008***
(in thousands of dollars)

| Revenue Source | 2006 Actual | 2007 Adopted | 2007 Revised | 2008 Endorsed | 2008 Proposed |
|---|---|---|---|---|---|
| General Property Tax (1) | 188,884 | 194,918 | 196,035 | 199,452 | 200,685 |
| Property Tax - Medic One Levy (2) | 20,814 | 21,185 | 21,508 | 21,856 | 33,793 |
| Retail Sales Tax | 139,391 | 147,805 | 150,105 | 154,558 | 157,951 |
| Retail Sales Tax - Criminal Justice Levy | 13,121 | 13,856 | 14,130 | 14,490 | 14,868 |
| B&O Tax (90%) (3) | 147,593 | 150,582 | 155,868 | 158,932 | 161,471 |
| Utilities Business Tax - Telephone (90%) | 28,746 | 26,035 | 29,010 | 25,733 | 27,590 |
| Utilities Business Tax - City Light (90%) | 31,404 | 29,617 | 31,203 | 30,188 | 30,231 |
| Utilities Business Tax - SWU & priv.garb. (90%) | 8,696 | 9,493 | 9,154 | 10,073 | 9,880 |
| Utilities Business Tax - City Water (90%) | 16,117 | 15,514 | 17,124 | 16,346 | 17,103 |
| Utilities Business Tax - DWU (90%) | 19,727 | 21,291 | 21,349 | 22,031 | 23,352 |
| Utilities Business Tax - Natural Gas (90%) | 13,853 | 14,980 | 14,748 | 14,339 | 14,068 |
| Utilities Business Tax - Other Private (90%) | 12,834 | 11,952 | 13,266 | 12,231 | 13,184 |
| Other Tax | 7,003 | 7,201 | 7,183 | 7,399 | 7,097 |
| Admission Tax | 4,957 | 4,995 | 4,748 | 4,995 | 4,740 |
| **Total Taxes** | **653,138** | **669,425** | **685,430** | **692,624** | **716,013** |
| Licenses and Permits | 12,671 | 12,684 | 14,491 | 12,400 | 12,455 |
| Parking Meters/Meter Hoods | 17,101 | 18,288 | 18,388 | 19,596 | 19,666 |
| Court Fines (90%) | 16,750 | 16,981 | 16,765 | 16,261 | 19,238 |
| Interest Income | 6,004 | 4,598 | 9,673 | 4,051 | 10,764 |
| Revenue from Other Public Entities (4) | 20,797 | 9,728 | 9,729 | 9,512 | 10,402 |
| Service Charges & Reimbursements | 41,174 | 45,915 | 47,007 | 46,182 | 47,169 |
| **Total: Revenue and Other Financing Sources** | **767,635** | **777,618** | **801,482** | **800,626** | **835,706** |
| All Else | 1,198 | 1,168 | 1,166 | 1,253 | 1,321 |
| Interfund Transfers | 637 | 2,739 | 3,379 | 937 | 937 |
| Key Arena Revenues (5) | 0 | 3,743 | 3,744 | 3,618 | 3,617 |
| **Total, General Subfund** | **769,470** | **785,269** | **809,771** | **806,434** | **841,582** |

**NOTES:**

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

(2) The 2008 Proposed figure for the Medic One Levy includes the rates to be on the November 2007 ballot.

(3) The 2008 Proposed figure for B&O tax assumes implementation of the Business Tax on Square Footage.

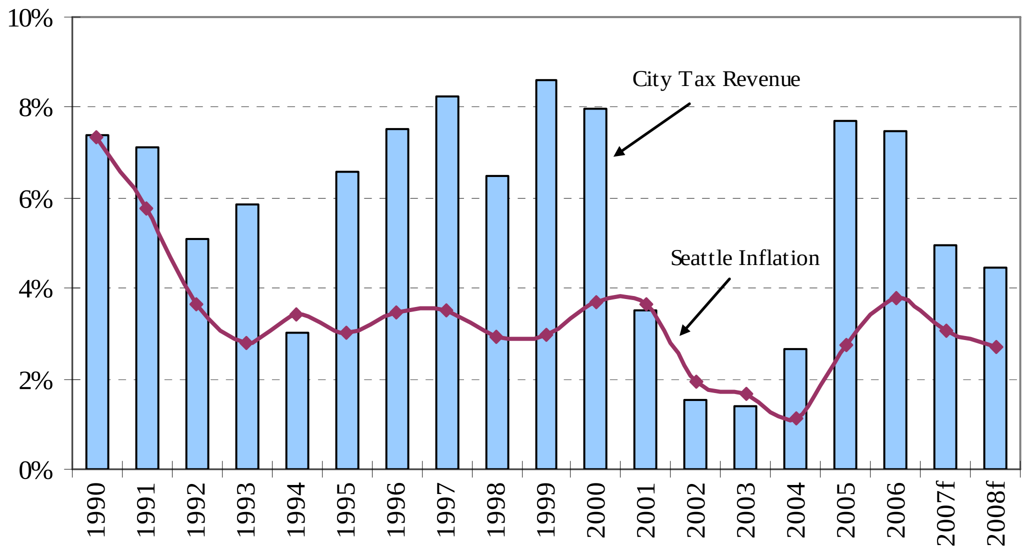
(4) Included in 2006 Actual figures are the pass-through revenues that are not appropriated in the 2006 Adopted Budget.

(5) 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.

* 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 8 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. The tax revenue growth rate has been slowing, and is expected to drop to 4.9% in 2007 and 4.5% in 2008.

**Figure 8. City of Seattle Tax Revenue Growth, 1990-2008**




## Property Tax

The 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 9 shows the different jurisdictions whose rates make up the total property tax rate imposed on Seattle property owners. The King County Assessor determines the value of properties, which is intended to generally reflect 100% of the property's market value.

In 2007, the total property tax rate from all jurisdictions paid by Seattle property owners is $9.28 per thousand dollars of Assessed Value (AV). For an owner of a home with an AV of $435,000 (approximately the average AV for residences in Seattle), the 2007 tax obligation is approximately $4,036. The City of Seattle's total 2007 tax rate is roughly one-third of the total rate at $3.22 -- an annual tax obligation of approximately $1,400 for the average valued home.

Figure 9 illustrates the components of the City's property tax: the non-voted General Purpose levy (58%); the five voter-approved levies for specific purposes (34%) – 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 (8%). In November 2006, voters approved a transportation lid lift that will generate approximately $36.2 million in 2007 and $37.1 million in 2008. These revenues will be accounted for in the Transportation Fund and are discussed later in this section. There are no City of Seattle proposed property tax measures (lid lifts or bonds) in 2007 that would add to the property tax in 2008.

***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.

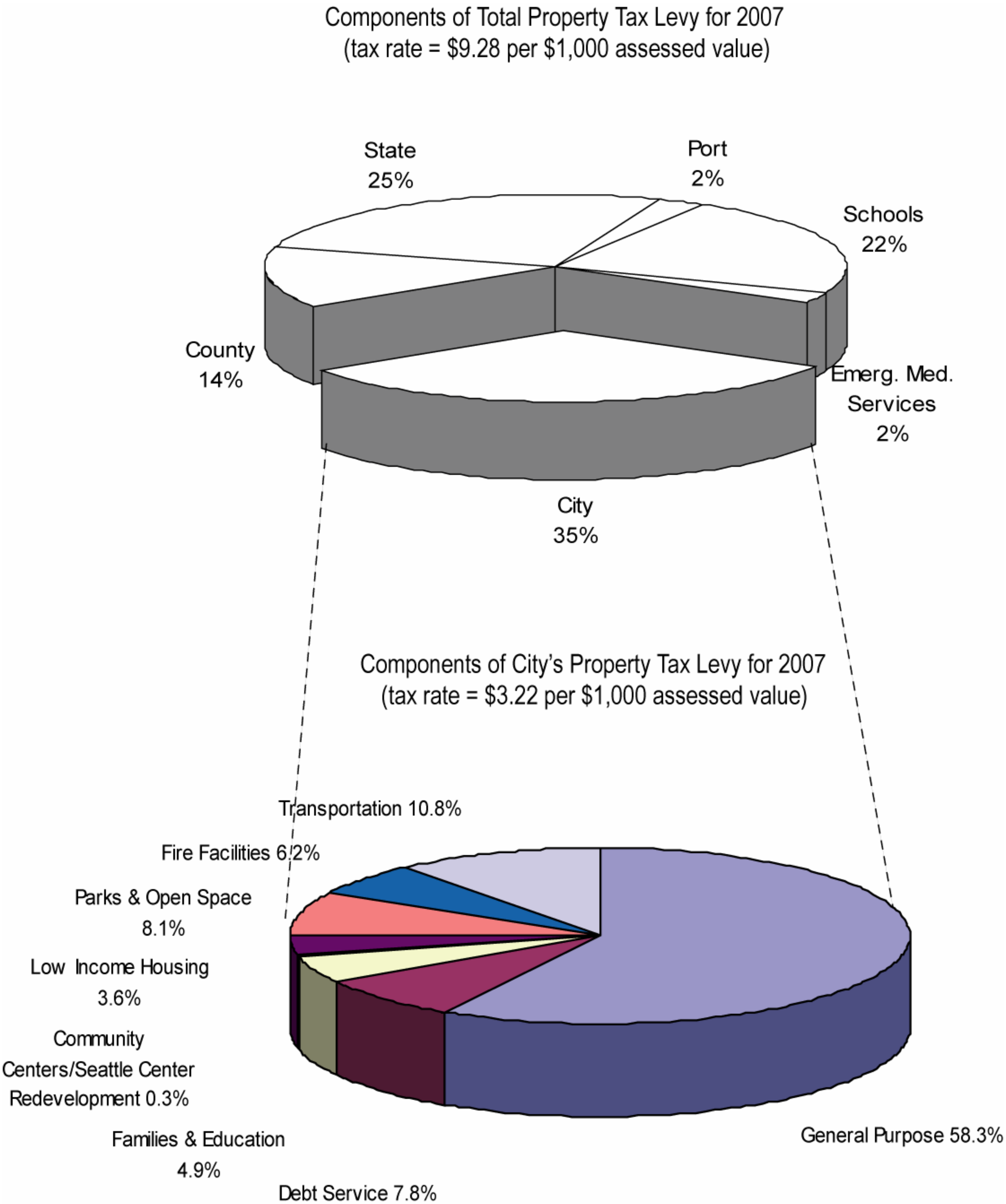
***The 2007 Adopted and 2008 Proposed Budgets implement 1% growth plus new construction.*** New construction revenues have exceeded $2 million since 1999, with a high of over $5 million in 2002. For the 2007 collection year, new construction revenues are $4.46 million. The forecast for 2008 reflects continued strong construction activity. It is projected that approximately $4.1 million is added to the property tax base in 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 $196 million in 2007 and $200.7 million in 2008.

***Medic 1/Emergency Medical Services Levy assumed at a rate of $0.30.*** The Medic 1/EMS levy is slated for a renewal vote in November 2007. After almost two years of assessment and deliberation among stakeholders and elected officials, King County and City officials will place on the ballot a 6-year renewal levy (2008-2013) at a starting rate of $0.30 per thousand dollars of assessed value. This forecast assumes that voters approve this measure, which would generate approximately $33.8 million for Seattle Medic 1/EMS services in 2008.

**Figure 9.**


Components of Total Property Tax Levy for 2007
(tax rate = $9.28 per $1,000 assessed value)
State 25%
Port 2%
Schools 22%
County 14%
Emerg. Med. Services 2%
City 35%
Components of City's Property Tax Levy for 2007
(tax rate = $3.22 per $1,000 assessed value)
Transportation 10.8%
Fire Facilities 6.2%
Parks & Open Space 8.1%
Low Income Housing 3.6%
Community Centers/Seattle Center Redevelopment 0.3%
Families & Education 4.9%
Debt Service 7.8%
General Purpose 58.3%

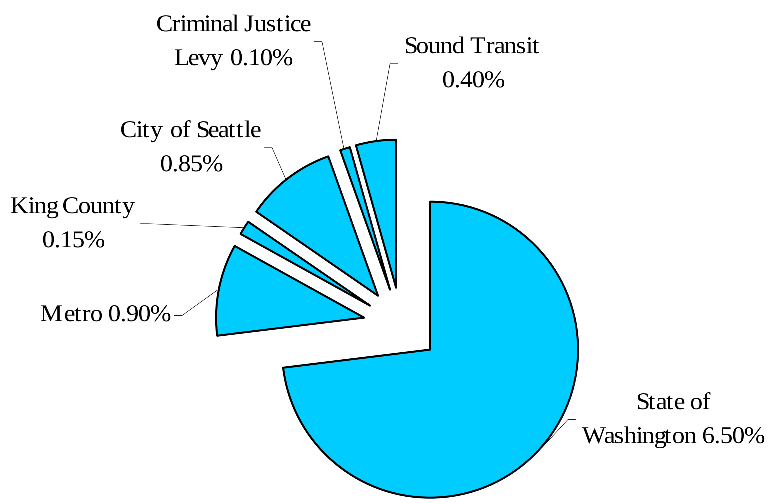
### Retail Sales and Use Tax

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 8.9% for most taxable transactions. The rate was increased from 8.8% on April 1, 2007, following the approval by King County voters in November 2006 of a proposal to raise the sales tax rate by 0.1% to provide additional funding for transit. The exception to the 8.9% rate is a 9.4% 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 8.9% is a composite of separate rates for several jurisdictions as shown in Figure 10. 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 10. Sales and Use Tax Rates in Seattle, April 1 – December 31, 2007**



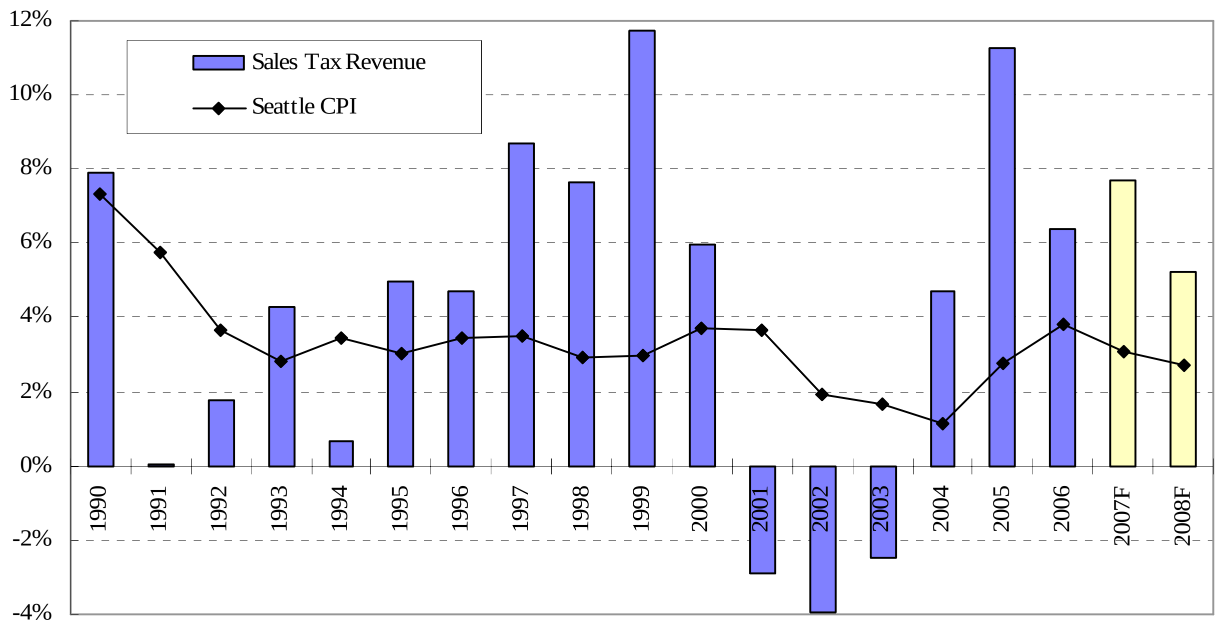

**Total Rate = 8.9%**

NOTE: Rate is 9.4% 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 caused very strong growth in taxable retail sales in Seattle. Taxable sales growth accelerated rapidly in 1996 and 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 did not rise above 2.4% for another five quarters.

However, beginning in fourth quarter 2004 taxable sales growth accelerated rapidly and has averaged a robust 9.6% over the most recent ten quarters (2004 Q4 – 2007 Q1), led by construction which posted an average growth rate of 19.7%. The rate of growth of taxable sales slowed during 2006, falling to 6.1% in the fourth quarter, but it rebounded to 9.8% in first quarter 2007, led by construction's 17.1% rate. Despite the strong growth of taxable sales, revenue increased by only 6.4% in 2006 due to a sharp decline in non-current revenue. Non-current revenue includes audit payments and refunds associated with economic activity that occurred in prior years.

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




Note: All revenue figures reflect current accrual methods. 2007-08 are forecasts.

***Retail sales tax revenue is forecast to increase by 7.7% in 2007 and then slow to 5.2% in 2008.*** The forecast of sales tax revenue reflects the expectation that the national and regional economies will continue to slow over the second half of 2007 and into 2008. Sales tax revenue is expected to increase by 7.7% in 2007, then slow to 5.2% and 3.7% in 2008 and 2009, respectively (see Figure 11).

## 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).

***B&O revenue was flat from 2001 to 2004, but has grown at a healthy pace since 2005.*** 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 helped to increase B&O revenue beginning in 1996. 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 of growth below 2%, B&O revenue growth jumped to 12.0% in 2005 and 13.1% in 2006, led by upswings in construction, services, finance, insurance, and real estate. 2006 revenue was boosted by a large gain in non-current revenue; the growth rate of current year tax obligations was 9.5% in 2006.

***Small business threshold is increased to $80,000 in 2008.*** Currently the City provides an exemption from the B&O tax for businesses whose annual taxable gross revenue (gross receipts less allowable deductions) is less than $50,000. The threshold has been $50,000 since 1994, when it was increased from $25,000. In 2008, the threshold will be raised to $80,000 to take account of inflation that has occurred since 1994. Thereafter, the threshold will be adjusted annually for inflation.

***New procedures for the allocation and apportionment of B&O income take effect January 1, 2008.*** In 2003 the Washington legislature passed Engrossed House Bill 2030 (HB 2030), with the stated intent of enhancing municipal business and occupation tax uniformity and fairness. The bill required cities imposing gross receipts business taxes to develop a model ordinance for local B&O taxes and to adopt the mandatory provisions of the model ordinance. The bill also required those cities to adopt State B&O tax provisions for a number of administrative functions such as interest calculation and payment due dates. These changes, which were mandated to be implemented in 2003, have not had a significant impact on Seattle's B&O revenue.

However, HB 2030 also established new procedures for the allocation and apportionment of business income which take effect on January 1, 2008. Allocation and apportionment of income is necessary when elements of a taxable transaction take place in more than one jurisdiction. This can occur when an item is delivered from a business in one taxing jurisdiction to a customer in a different taxing jurisdiction, or when staff from multiple offices of a business work together on a project and the offices involved are located in more than one jurisdiction. In such instances income must either be allocated fully to one of the jurisdictions (allocation) or split between the jurisdictions (apportionment). HB 2030 significantly changes the rules for allocating and apportioning income for both the sale of tangible personal property and the delivery of "service" activity.

For sales of tangible personal property, HB 2030 requires that income be allocated to the location at which delivery to the customer occurs. This allows a Seattle business to deduct any sales delivered to a point outside of Seattle for tax purposes. Current practices allow Seattle to tax all Seattle sales delivered within Washington unless the goods are delivered into another city with a gross receipts B&O tax which can tax the sale if a nexus exists. As a result of the changes, Seattle loses its ability to tax sales of tangible personal property when delivery takes place in a Washington location that does not have a gross receipts B&O tax. The City's ability to tax sales of tangible personal property delivered into Seattle is unaffected.

Changes to allocation and apportionment procedures for service income are more complex. The following discussion provides a general overview of how current procedures will be changed by HB 2030. Under current practices, service income is taxable as follows:

- Businesses with an office or place of business in Seattle but not elsewhere are taxed on gross income derived from services generated from or attributable to their Seattle business location unless another gross receipts B & O city taxes the income.
- Businesses with an office or place of business outside of Seattle but within Washington that conduct business within Seattle are subject to tax on gross income for services provided to customers in Seattle.
- Businesses with offices or places of business both within and outside of Seattle are required to apportion income to the place of business which generated the income. If this is not practical, income may be apportioned to individual offices on the basis of the cost of doing business within Seattle versus the total cost of doing business in all the business locations.

HB 2030 takes a very different approach to service apportionment. HB 2030 uses a two-factor formula to determine what share of a business' gross service income is subject to tax by a city with a gross receipts B&O tax. The two factors, the payroll factor and the service income factor, are each given a weight of 50%. The formula for computing the amount of service income that is subject to tax by a city multiplies the service income of a business by a fraction, the numerator of which is the payroll factor plus the service income factor and the denominator of which is two. The payroll and service income factors apportion a firm's payroll and service income, respectively, among the firm's places of business and the locations of its customers.

The payroll factor measures a firm's total payroll paid within a city as a share of it total payroll paid everywhere. Payroll is assigned to specific places of business based upon where individual employees are primarily assigned. If an employee is not primarily assigned to any place of business, payroll is assigned to the location at which the employee performs more than 50% of his or her service activity.

The service income factor measures a firm's service income within a city as a share of its total service income everywhere. Service income is in the city if:

- The customer location is in the city; or
- The greater proportion of the service income producing activity is performed in the city than in any other location, based on the cost of performance, and the taxpayer is not taxable at the customer location; or
- The service income producing activity is performed in the city and the taxpayer is not taxable at the customer location.

Taxable at the customer location means that the government where the customer is located either imposes a gross receipts B&O tax or has the authority to do so, a definition which encompasses all Washington cities. Customer location is defined by HB 2030 as the location at which the majority of contacts between the taxpayer and the customer take place.

The complexity of the changes to the service allocation and apportionment procedures makes it difficult to summarize their impacts. However, it is possible to identify two changes which have a significant impact on Seattle's taxing authority:

- Under current procedures, Seattle is able to tax service income generated by a Seattle business unless it is subject to tax by another Washington city with a B&O tax. The new HB 2030 apportionment rules allow Seattle businesses to allocate at least 50% of their income to a non-Seattle location if the customer is located in another Washington city, whether or not the city has a B&O tax and regardless of where the service activity takes place.
- Under current procedures, Seattle is able to tax the income from services delivered to customers in Seattle by non-Seattle businesses located within Washington. Under the new procedures, up to 50% of that income can be allocated to non-Seattle locations.

The new approach also requires significantly more recordkeeping by affected business.

***HB 2030's new apportionment and allocation procedures will result in a $21.9 million revenue loss in 2008.*** The HB 2030 allocation and apportionment procedures that take effect on January 1, 2008 will result in an estimated revenue loss for the city of Seattle of $21.9 million in 2008. The loss will be split on a 90% - 10% basis between the General Subfund and the Park and Recreation Fund, which makes the General Fund's loss $19.7 million.

The HB 2030 loss estimate is based on a study conducted by the Washington Department of Revenue (DOR) at the request of the State Legislature. Using 2004 tax information, DOR estimated that Washington cities would lose $23.3 million, of which Seattle's loss would be $15.6 million. Independent estimates by the Seattle Department of Finance yielded loss estimates of a similar magnitude, though there are a wide range of possible outcomes depending upon how businesses respond to the new requirements. DOR estimated that the losses would be distributed as follows:

| | |
|---|---|
| $3,424,000 | Construction industry |
| $8,100,000 | Wholesaling tax class |
| $4,040,000 | Service tax class |
| $1,000 | Retailing tax class |

The estimate of $21.9 million for 2008 was developed by updating DOR's 2004 estimate to 2008 by accounting for the growth of the tax base and inflation.

***Seattle will implement a square footage business tax beginning January 1, 2008.*** In response to the expected loss of $21.9 million in B&O tax revenue resulting from the imposition of HB 2030's apportionment and allocation procedures, the Mayor has proposed a new business tax that will be implemented on January 1, 2008. The only businesses that will pay the new tax are those that receive a tax reduction as a result of the new allocation and apportionment procedures. The tax will be levied on the amount of area (measured by square feet occupied) a firm occupies in Seattle. The tax is structured so that no business will pay more tax on its activities than would have been the case under existing (2007) tax law. Some business will pay the same tax as they would under current law, others will pay less, but none will pay more.

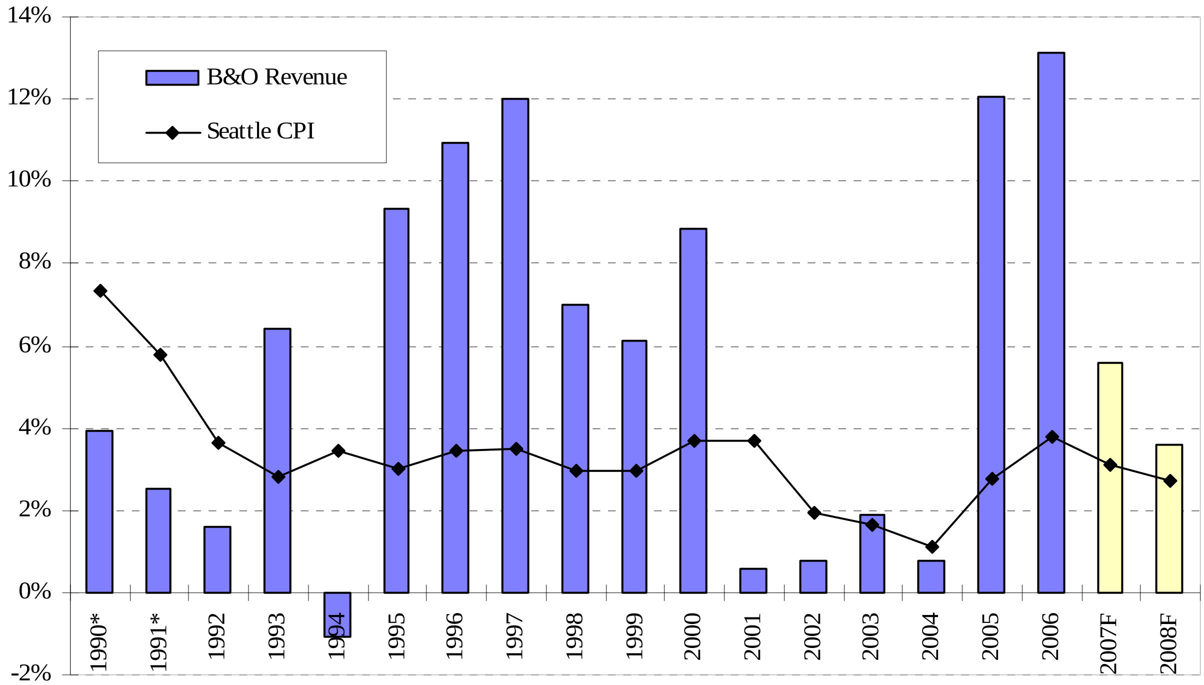
Floor area will be taxed at two different rates. Business floor space, which includes office, retail, and production space, will be taxed at 39 cents per square foot per quarter. Other floor space, such as warehouse, dining, and exercise space, will be taxed at 13 cents per square foot per quarter. The different tax rates are intended to reflect the revenue-producing value to a business of various types of space. The tax rates will be adjusted annually for inflation.

To determine the tax rate, an estimate of the city's taxable floor area was developed using commercial building data from the King County Assessor along with floor area, employment, and tax revenue data from other sources. The tax rate was set at a level to recover the $21.9 million revenue loss estimated by the Department of Revenue. However, the provision that no business will pay more in tax under the new law than under current law results in a reduction in revenue to a level below full recovery.

Any business which pays both the gross receipts B&O tax and the new square footage tax may take a credit against the square footage tax for the amount of gross receipts tax paid. To use the credit, a business first computes the square footage tax it would owe on 100% of its floor area, and then multiplies that figure by the credit. The credit is determined by computing the total gross income derived from the Seattle business locations less the gross income derived from the Seattle business locations that is exempted from taxation by HB 2030, and then dividing that figure by the total gross income derived from the Seattle business locations. In simple terms, if a Seattle business receives a 20% reduction in its gross receipts tax from HB 2030, 20% of its floor area will be subject to the square footage business tax.

To insure that no business faces a tax increase due to the implementation of the square footage tax, a maximum square footage tax credit is provided. To use this credit, a business computes its tax under both the new post-January 1, 2008 tax law and the old pre-January 1, 2008 tax law. If the tax due is higher under the new law, the business is allowed to take a credit for the difference between the tax computed under the new law and the tax computed under the old law.

**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; 2007-08 are forecasts.
2008 forecast includes both gross receipts and floor area tax revenue.

***The pace of B&O revenue growth is expected to slow in 2007 and 2008.*** The growth rate of B&O revenue is forecast to slow to 5.6% in 2007 and 3.6% in 2008. Most of the slowdown from the very high growth rates of 2005 and 2006 is due to the slowing of the region's economy and an expected return to a more normal growth rate for non-current revenue following two years of exceptional growth.

The 2008 forecast for B&O revenue combines revenue from the gross receipts tax with revenue from the new business tax on square footage occupied. The new HB 2030 allocation and apportionment procedures are expected to cause a $21.9 million drop in revenue from the gross receipts tax in 2008. The business square footage tax was designed to recoup that loss by taxing the floor area of businesses that receive a tax reduction due to HB 2030. The tax rate was set to recover 100% of the expected loss. However, the mechanism that insures that no business will pay more under the combined gross receipts and business square footage tax than it would under existing (2007) law reduces the floor area tax revenue somewhat. The forecast assumes that $18.6 million of the $21.9 million loss will be recovered.

Finally, raising the small business threshold from $50,000 to $80,000 in 2008 will result in an estimated revenue loss of $770,000 in 2008.

## 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 rates are lowered.*** 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.

Effective in January of 2007, PSE was granted permission to increase the rate it charges natural gas customers. This was in response to the high gas prices experienced as a result of the 2005 hurricane season when rates for 2006 had already been set. However, prevailing market prices for 2007 have been considerably lower due to relatively high inventories and light hurricane seasons in both 2006 and so far in 2007. As a result, PSE has requested a 13% rate decrease to be effective October 1, 2007. Approval of this request, which is all but certain, still gives a substantial rise in receipts over 2006 of 8.2% for 2007 but a 5.9% drop in 2008.

***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.

Certain sectors of the telecom industry are experiencing solid growth, while others are steadily declining. Wireless revenues have been on an upward trajectory and are forecast to remain robust for the next few years. Traditional telecom providers however are showing negligible growth and even contraction and this trend is expected to continue. As it stands now, growth in tax revenue from firms selling wireless telecom services is more than making up for any decline in other parts of this revenue stream. While VoIP and other technological improvements remain open questions and risks to revenues, telecommunications tax revenues should be significant for the foreseeable future.

***Cable tax revenue shows mild growth.*** 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 finished at $11.7 million. The forecasts for 2007 and 2008 are $11.9 and $12.0 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 revenue that affected the utility at the time. The Council reduced City Light rates in the fall of 2006 for 2007 and 2008. These lower rates reduced the General Subfund's forecast for revenue from City Light for 2007 and 2008. This reduction in tax revenues was partially offset by an additional utility payment from a large energy user for 2006 that accrued to the City in the beginning of 2007.

***Modest growth forecast for 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. Water fund revenues have been growing faster than expected and as a result water tax receipts have grown as well. 2007 water tax revenues are expected to be $17.1 million, a 6.3% increase over 2006. 2008 receipts are not forecast to materially change from 2007.

***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. Because of rate increases and a modest increase in usage tax revenues will increase by 8.2% in 2007 and 9.4% in 2008.

***Higher Solid Waste rates mean higher tax revenue growth.*** The utility tax rate on both City of Seattle and commercial solid waste service is currently 11.5%. Solid waste receipts are performing well, largely due to the City's solid waste collection, and show growth rates of 5.3% and 7.9% for 2007 and 2008 respectively.

### 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. The forecasts in Figure 7 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 was 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 revenue is expected to decline by $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 $1.1 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 parking 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.

The downward trend in parking citations may be countered 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 $16.7 million in court fines and forfeitures and $19.2 million in 2008. The 2008 revenue projection includes an estimated $1.8 million in additional revenue resulting from the anticipated expansion of the City's red light camera enforcement program from the existing 6 camera locations to a total of 30 locations. Additionally, in 2008 the City is aligning its fine for red light moving violations to the State's fine amount, which was increased from $101 to $124 over the last two State legislative sessions. This increase is estimated to generate an additional $673,000 in red light camera infraction revenues.

## 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 and investment 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 and investment income to the General Subfund varies widely, subject to significant fluctuations in cash balances and changes in earnings rates dictated by economic and financial market conditions.

Rapid positive growth in earnings rates and cash balances through 2005 and 2006 resulted in increased interest and investment earnings over this period: $1.9 million in 2004, $3.2 million in 2005, and $6.0 million in 2006. Current estimates for General Subfund interest and investment earnings anticipate continued growth in cash balances and earnings rates in 2007, producing earnings of $9.7 million. In 2008, cash balance growth is anticipated to slow, and earnings rates are expected to flatten out, producing interest earnings of $10.7 million.

## Revenue from Other Public Entities

***State shares revenues with Seattle.*** The State 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 $2.0 million in 2007 and 2008.

***Liquor Board profits and excise tax revenues are picking up.*** 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 liquor board profits were $3.7 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. These benefits have begun to show for 2007 and will be fully realized by 2008 with $3.9 million and $4.1 million in revenues respectively. 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 $2.6 million and $2.7 million respectively.

***Sound Transit work on the Metro Tunnel comes to a close.*** The construction of Link Light Rail by Sound Transit will no longer require City services for the Metro Tunnel. Sound Transit has been reimbursing the City for police and fire support services while work on the Metro Tunnel has been underway. The work on the Metro tunnel has been completed and so no revenue will accrue to the City for police work in 2008. 2007 revenues are $350,000. The Fire Department will continue to provide support for other Sound Transit work, including work on the university link for light rail.

## 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 for 2007, drop in 2008.*** Interfund transfers are payments from the balances of department-specific funds and capital project funds to the General Subfund. For 2007, the Parks Department will transfer $640,000 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 Proposed 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 2008 Adopted 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.

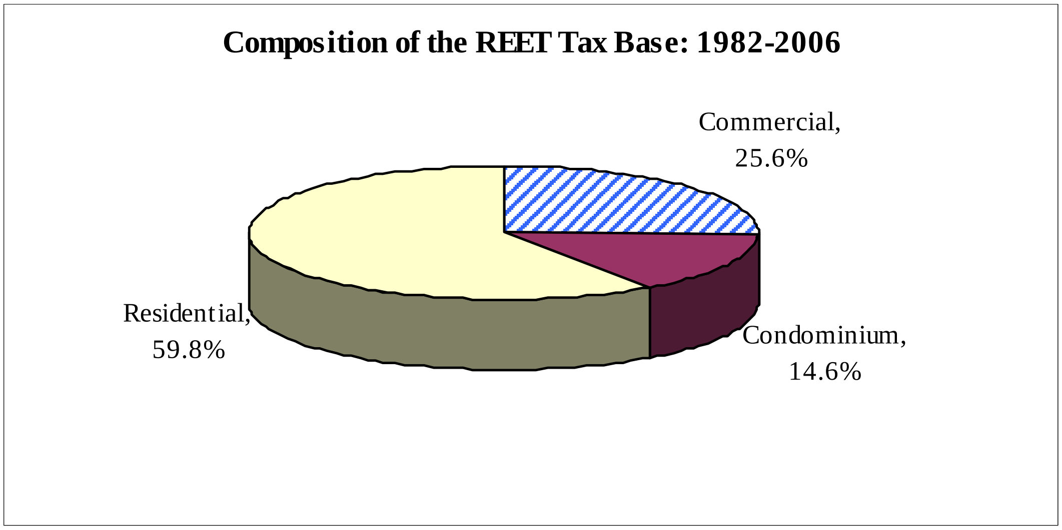
## Cumulative Reserve Subfund – Real Estate Excise Tax

The Cumulative Reserve Subfund resources are used primarily for the maintenance and development of City capital facilities. These purposes are supported mainly by revenues from the Real Estate Excise Tax (REET), but also, to a lesser degree, by the proceeds from certain property sales and rents, a portion of street vacation revenues, General Subfund transfers, and interest earnings on subfund balances. Total revenues to the subfund are projected at approximately $78.1 million in 2007 and $60.0 million in 2008. Of these total amounts approximately $14.9 million in 2007 and $9.0 million in 2008 are derived from non-Real Estate Excise Tax sources.

The REET is levied by the City at a rate of 0.5% on sales of real estate measured by the full selling price. 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, 59.8% 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 14.6% (see Figure 14).

**Figure 14. Value of Seattle Real Estate Transactions by Property Type, 1982 - 2006**




***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 12.9% between 1982 and 2006, a period when Seattle area inflation averaged only 3.2% per year. Growth has been particularly strong during the past five 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 through 2006 were exceptional years for commercial real estate activity only to be surpassed in 2007.

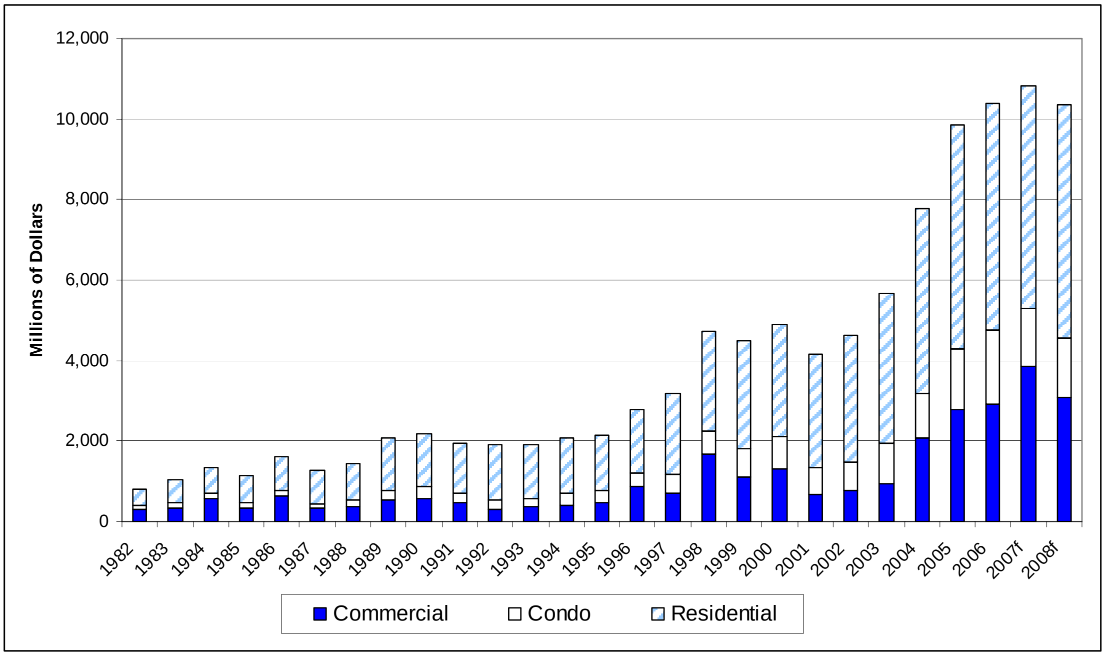
The volatility of REET is reflected by the fact that despite an 11.5% annual growth rate, the REET tax base declined in six years out of 24 during the period 1982 – 2006 (see Figure 15). The most recent decline was a drop of 15.6% in 2001. Volatility results largely from changes in sales volumes, which 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 rose to new high in 2007, will fall in 2008.*** The national real estate market has continued to dim with the states that saw the biggest growth over the last four years experiencing the worst of the fallout. The subprime market and its commensurate default and foreclosure rates has sent credit markets into turmoil and is sending fear into broader credit markets. Housing starts are down significantly as are home sales. The Seattle market has thus far been spared any ill effects from the national housing scene. Home prices have been maintaining positive growth, but they are not showing the double digit growth that has been the case for the past four or five years. The Seattle housing market is not highly exposed to subprime borrowers, and with a solid job market and positive net migration the real estate market is expected to perform well, or at least maintain position. There is some risk of a worsening credit market and the inability for prime borrowers to get mortgage rates on the terms they desire. This coupled with mortgage issuers' recent flight from loans too large to qualify for government guarantee could presage a dip in home sales that might lead to an eventual drop in prices, and therefore REET revenues.

2007 has set a new benchmark for REET receipts, especially in the commercial sector. A large group of Class A office space buildings were sold twice in the 2nd quarter leading to REET revenues of some $25 million in that quarter alone. The commercial sector, along with the residential and condo sectors, is performing well and while

2008 is not expected to approach 2007 activity it is still forecast to perform well. The revised 2007 forecast for REET is $63.2 million and for 2008, $51.0 million.

**Figure 15. Real Estate Excise Tax: Value of Sales**




## Transportation Fund -- Bridging the Gap revenue sources

The Transportation Fund is the primary operating fund whose resources support the management, maintenance, design, and construction of the City's transportation infrastructure. The fund receives revenues and resources from a variety of sources: General Subfund transfers, distributions from the State's Motor Vehicle Fuel tax, State and Federal Grants, service charges, use fees, bond proceeds and several other sources more fully presented in the Transportation Department section of this budget document. The Transportation Fund received approximately $159.2 million in operating revenues in 2006, and is projected to receive approximately $213.5 million in 2007 and $252.3 million in 2008. The large increases are due to the addition of three new revenue sources, described below, and projected increases in federal, state and interlocal grants. These grant opportunities are made possible because of the additional revenues available to provide matching support for the grants.

In September 2006, in order to fund the 9-year phase-one of the 20-year "Bridging the Gap" program of transportation maintenance and improvements, the City established three additional revenue sources dedicated to these purposes: a levy lid lift (Ordinance 122232), a commercial parking tax (Ordinance 122192) and a business transportation tax (Ordinance 122191)

The transportation lid lift is a 9-year levy authorized under RCW 84.55.050 to be collected from 2007 through 2015. The lid lift is forecast to raise $36.2 million in 2007 and $37.1 million in 2008.

The commercial parking tax is a tax on the act or privilege of parking a motor vehicle in a commercial parking lot within the City that is operated by a commercial parking business. Effective July 1, 2007 the tax rate is initially established at 5 percent. The rate will increase annually on July 1 to 7.5 percent in 2008 and 10 percent in 2009. Current forecast anticipates $3.7 million in 2007 (partial year effective July 1, 2007) and $8.9 million in 2008.

The business transportation tax or employee hours tax is a tax levied and collected from every person for the act or privilege of engaging in business activities within the City of Seattle. The amount of the tax can be calculated using hours worked or on a full time equivalent employee basis. The tax rate per hour is $0.01302, which is equivalent to $25 per full time employee working at least 1,920 hours annually. Several exemptions and deductions were provided in the authorizing ordinance. Most notably a deduction is offered for those employees who regularly commute to work by means other than driving a motor vehicle alone. This tax is effective July 1, 2007, but the City will not receive tax payments for 2007 liabilities until January 2008. Thus, no revenues are forecast in 2007 and $5.5 million in 2008.

### Figure 13. Seattle City Tax Rates

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Property Taxes (Dollars per $1,000 of Assessed Value)** | | | | |
| General Property Tax | $2.16 | $2.12 | $2.01 | $1.88 |
| Families & Education | 0.04 | 0.19 | 0.18 | 0.16 |
| Seattle Center/Parks Comm. Ctr. | 0.10 | 0.02 | 0.02 | 0.01 |
| Parks and Open Space | 0.30 | 0.30 | 0.28 | 0.26 |
| Low Income Housing | 0.04 | 0.04 | 0.04 | 0.04 |
| Fire Facilities | 0.30 | 0.28 | 0.26 | 0.20 |
| Emergency Medical Services | 0.24 | 0.23 | 0.22 | 0.21 |
| Low Income Housing (Special Levy) | 0.10 | 0.10 | 0.09 | 0.08 |
| City Excess GO Bond | 0.31 | 0.31 | 0.28 | 0.25 |
| **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% | 14.04-15.54%* | 15.54% | 15.54% |
| City Drainage | 10.00% | 11.50% | 11.50% | 11.50% |
| City Wastewater | 10.00% | 12.00% | 12.00% | 12.00% |
| City Solid Waste | 10.00% | 10-11.50%** | 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% | 10-11.5%** | 11.5% | 11.5% |
| **Franchise Fees** | | | | |
| Cable Franchise Fee | 2.5% | 2.5% | 3.5-4.2%*** | 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