

Economic Update

Update on economic issues affecting Seattle's tax revenue performance

The newsletter of the City of Seattle's Economics Team/December 2004

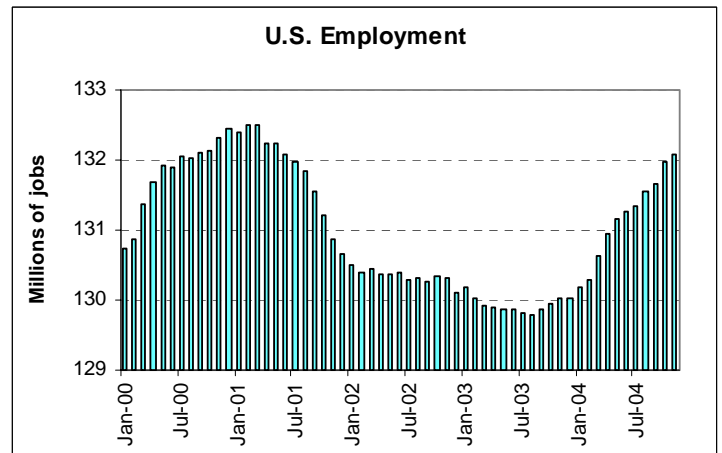
ECONOMY

U.S. Economy: After slowing in the 2nd quarter, U.S. economic growth picked up in the 3rd quarter led by an upswing in consumer spending and continued strong business investment. While employment has grown at a modest pace throughout 2004, it has not yet climbed back to its pre-recession peak - although it's been three years since the 2001 recession ended. High energy prices have been a drag on the economy for most of 2004, but energy prices have been declining since peaking in mid-October.

Economists are generally upbeat about the prospects for 2005, although growth of gross domestic product (GDP) is expected to slow a bit from 2004's pace. Reasons for this slowing include high energy prices, rising interest rates, and strained household finances. Employment growth, which has been unusually weak during the current recovery, is expected to accelerate next year.

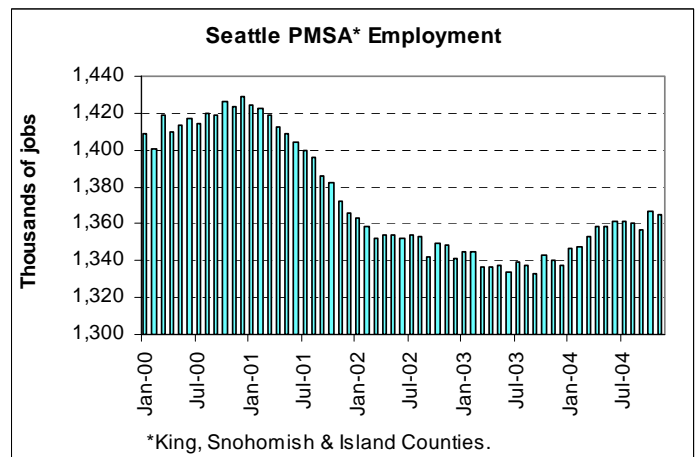
Among the various risks to the current economic expansion, global financial imbalances have taken center stage recently. The U.S. consumes much more than it produces and must borrow from foreigners to finance this consumption. Many nations have become dependent upon exports to the U.S. to support the growth of their economies, while the U.S. has become dependent upon those nations to lend it the money to support U.S. consumption. The financial imbalances have grown so large - the current account deficit has risen to 6% of GDP - that most economists consider them unsustainable. Reducing the imbalances without causing a disruption to the world and U.S. economies will be a major challenge.

Puget Sound Region Economy: The Puget Sound Region, which was hit particularly hard by the high tech downturn and cutbacks at Boeing caused by the plunge in air travel following the September 11 terrorist attacks, has endured a much deeper and longer recession than most of the country. However, the region has finally begun to recover in 2004, in part due to a turnaround at Boeing. Boeing, which reduced its Washington employment by 27,200 between Septem-



ber 2001 and June 2004, has added 2,400 jobs in the past six months.

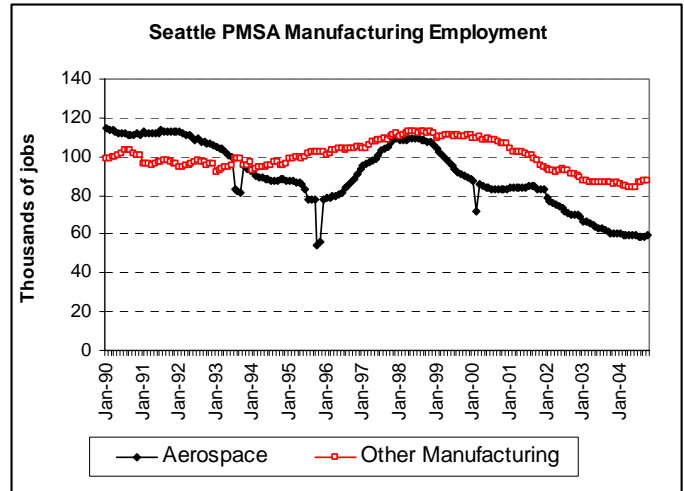
The Seattle PMSA (King, Snohomish, and Island Counties) lost 96,600 jobs, or 6.8% of its employment, during the 2¾ year period beginning in December 2000 and ending September 2003. The manufacturing sector, with 10.7% of Seattle PMSA employment, accounted for 41,900 (43.4%) of the lost jobs. Since September 2003, the region has added 32,500 jobs, recouping one-third of its loss. Employment has rebounded in construction, wholesale trade, and a number of service industries, including professional, scien-



tific and technical services, administrative and support services, education and health services, and leisure and hospitality services. The latter category includes arts, entertainment and recreation, hotels and motels, restaurants, and drinking places.

While manufacturing suffered greatly during the recession, it has actually been in decline for the past six years. Both aerospace and the rest of the manufacturing sector (other manufacturing) have been losing jobs since reaching peak employment in June of 1998. From June 1998 through mid-2004, aerospace lost 51,300 jobs, a 46.9% drop, and other manufacturing lost 29,200 jobs, a 25.8% decline. There has been a modest turnaround in recent months, with both aerospace and other manufacturing adding jobs in recent months. The decline in manufacturing employment is a national phenomenon; the U.S. has lost 2.9 million manufacturing jobs, 17.2% of its total, since mid-2000.

Local economists are generally upbeat about the prospects for the region's economy now that the national expansion has strengthened and Boeing has begun to hire. In addition, the state's software sector is expected to expand its employment by 5% per year according to the Washington Office of the Forecast Council, and the weaker dollar will boost exports and help to attract foreign tourists.



The Puget Sound Economic Forecaster expects the region's employment to increase by 2.6% in 2005, which would make it the strongest year since 1998. Personal income is forecast to grow at a healthy pace, and inflation is expected to accelerate but remain under control. One component of the economy that is expected to slow is the housing market, which will face rising mortgage rates in the coming years. If the national economy remains on track the region's expansion should be assured.

Monthly Cash Update

Comparing year-to-date revenues for general fund taxes and other major revenues with latest forecast

December 2004

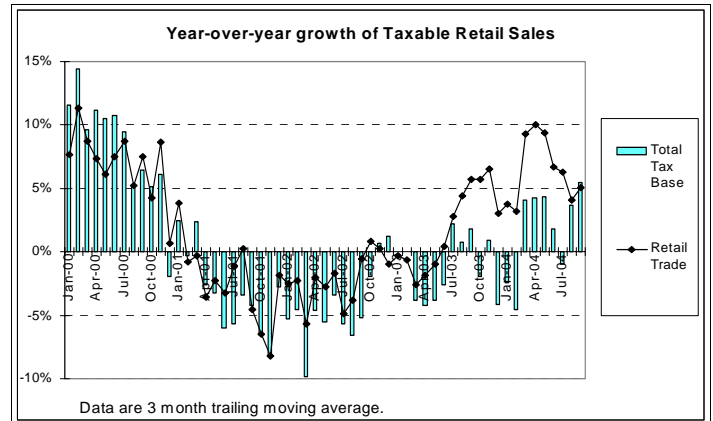
CITY REVENUE

The following table illustrates how actual 2004 collections for the most important general subfund revenues, through November, compare to the forecast that was prepared in August. Revenues exceeded expectations in several major revenues, most notably sales and B&O taxes.

Retail sales tax. November retail sales tax revenue was \$11.2 million, which exceeded DOF's forecast by \$1.04 million, or 10.2%. Sales tax revenue received in November come from sales transacted during the month of September. There are a number of reasons for the strong September performance:

- Taxable sales by auto dealers increased by 25.8% from the previous September, driven by auto industry incentives.
- Taxable sales for construction, which declined during the first half of 2004, grew by 8.7% in September. The forecast had not anticipated a turnaround in construction until 4th quarter of 2004.
- Other industries with strong retail sales growth in September include manufacturing, apparel stores, building materials and hardware stores, hotels and motels, and auto repair services.

Technical tax processing issues also appear to have boosted September sales tax receipts. As a result of a strong September, sales tax receipts are \$1.1 million, or 1.3%, above forecast for the year to date.



B&O tax: B&O revenue is \$445,000 over forecast year-to-date, reflecting the improving local economy. However, revenue through November is down \$2.0 million, or 2.3%, from the same period in 2003. This decline is a result of a steep falloff in revenue from audits and penalty and interest payments (on the order of \$3 million) and the impact of state legislation prohibiting the taxation of intellectual property creating activity. These efforts were anticipated when the 2004 revenue forecast was adopted.

2004 CASH UPDATE THROUGH NOVEMBER

	YEAR TO DATE				COMPARISON TO 2003		
	Cumulative Forecast	Actual	Difference	Percent	Cumulative 2003	Yr/Yr Difference	Yr/Yr Cumulative
PROPERTY TAXES							
General + EMS	196,157,000	196,156,000	-1,000	0.0%	192,319,000	3,837,000	2.0%
Leasehold Excise Tax	3,007,000	2,925,000	-82,000	-2.7%	2,932,000	-7,000	-0.2%
RETAIL SALES TAX							
General	84,889,000	85,969,000	1,080,000	1.3%	82,823,000	3,146,000	3.8%
Criminal Justice	8,212,000	8,342,000	130,000	1.6%	7,963,000	379,000	4.8%
BUSINESS TAXES AND OTHER							
Business and Occupation	84,893,000	85,338,000	445,000	0.5%	87,365,000	-2,027,000	-2.3%
Utilities - City Light	25,976,000	26,050,000	74,000	0.3%	24,889,000	1,161,000	4.7%
Utilities - City Water	7,794,000	7,699,000	-95,000	-1.2%	6,976,000	723,000	10.4%
Utilities - City Drainage/Waste Water	11,647,000	11,881,000	234,000	2.0%	11,096,000	785,000	7.1%
Utilities - City Solid Waste & Garbage	6,429,000	6,450,000	21,000	0.3%	6,482,000	-32,000	-0.5%
Utilities - Cable Television	7,625,000	7,599,000	-26,000	-0.3%	6,739,000	860,000	12.8%
Utilities - Telephone	22,936,000	23,307,000	371,000	1.6%	25,158,000	-1,851,000	-7.4%
Utilities - Private Energy	8,084,000	7,784,000	-300,000	-3.7%	6,595,000	1,189,000	18.0%
Admission Tax	5,299,000	5,397,000	98,000	1.8%	5,488,000	-91,000	-1.7%
Court Fines and Forfeitures	16,629,000	16,415,000	-214,000	-1.3%	14,556,000	1,859,000	12.8%
Interest Income	1,341,000	1,514,000	173,000	12.9%	1,462,000	52,000	3.6%
Parking Meters	10,095,000	10,004,000	-91,000	-0.9%	8,905,000	1,099,000	12.3%
Misc. Revenues	4,852,000	5,832,000	980,000	20.2%	5,185,000	647,000	12.5%
TOTAL	505,865,000	508,662,000	2,797,000	0.6%	496,933,000	11,729,000	2.4%
Real estate excise tax	29,811,000	32,680,000	2,869,000	9.6%	25,856,000	6,824,000	26.4%

Forecast for 2004-2006

Compared to 2003 actuals (in thousands of dollars)

The following table summarizes the forecast that was prepared in August and revised in November. The notable revenue changes are described below:

Retail sales and B&O taxes: With the local economy expected to continue its expansion into 2005 and 2006, revenue from retail sales and B&O taxes is forecast to grow at a healthy pace.

Public Utility Tax : In 2005, there will be large increases in utility tax revenue for all City utilities except City Light. These increases result from the City Council's decision to raise the utility tax rate from 10% to 11.5% for water, drainage, wastewater, the City's solid waste utility, and private garbage. In addition, the water utility tax rate will be increased by an additional four percent to pay for the cost of shifting fire hydrant services from utility revenues to General Fund revenues. Customers will not be affected because the tax rate increase will be offset by a decrease in water rates, which results because the water utility will no longer be paying for hydrant service costs. A similar change is being made in wastewater taxes to fund public toilets.

Telephone tax: The forecast for telephone utility tax revenue is flat amid speculation that U.S. legislation may reduce telephone tax base considerably, or even eliminate it.

Natural Gas: After a substantial gas rate hike in 2004, the forecast assumes rate stability in 2005-06.

Admission tax: The 2005-06 forecast reflects the dedication of admission tax revenue to the arts account as follows—15% in 2005 and 20% in 2006, excluding revenue from professional men's basketball.

Court fines and forfeitures: After extraordinary revenue gains in 2004, due mostly to one-time events, court fines are expected to stabilize at around \$16.5m for 2005-06.

Parking meters: After a slow start for the new parking pay stations, parking meter revenues are expected to come in strong for 2005-06.

2004-2006 General Subfund Revenue Forecast

Summary Name	2003				Year over Year Growth		
	Actuals	2004	2005	2006	2004	2005	2006
General Property Tax	173,429	178,630	182,453	186,801	3.0%	2.1%	2.4%
Property Tax - EMS Levy	19,044	19,752	20,273	20,731	3.7%	2.6%	2.3%
Retail Sales Tax	112,461	115,274	120,650	125,395	2.5%	4.7%	3.9%
Retail Sales Tax - Criminal Justice Levy	10,803	11,155	11,670	12,172	3.3%	4.6%	4.3%
B&O Tax (90%)	115,571	114,446	118,905	124,220	-1.0%	3.9%	4.5%
Utilities Business Tax - Telephone (90%)	30,384	28,170	28,700	28,700	-7.3%	1.9%	0.0%
Utilities Business Tax - City Light (90%)	30,191	30,957	30,767	31,138	2.5%	-0.6%	1.2%
Utilities Business Tax - SWU & priv.garb. (90%)	7,641	7,623	8,557	8,931	-0.2%	12.3%	4.4%
Utilities Business Tax - City Water (90%)	8,051	9,032	12,934	13,066	12.2%	43.2%	1.0%
Utilities Business Tax - DWU (90%)	13,254	13,967	18,463	19,095	5.4%	32.2%	3.4%
Utilities Business Tax - Natural Gas (90%)	7,814	9,785	9,923	9,123	25.2%	1.4%	-8.1%
Utilities Business Tax - Other Private (90%)	9,263	10,075	10,535	11,020	8.8%	4.6%	4.6%
Admission Tax	6,757	6,500	5,600	5,400	-3.8%	-13.8%	-3.6%
Other Tax	4,952	5,040	5,190	5,305	1.8%	3.0%	2.2%
subtotal, Taxes	549,615	560,407	584,620	601,098	2.0%	4.3%	2.8%
Other Revenue							
Licenses and Permits	12,397	11,533	12,455	12,460	-7.0%	8.0%	0.0%
Parking Meters/Meter Hoods	11,245	12,513	15,635	17,165	11.3%	25.0%	9.8%
Court Fines	15,978	18,049	16,500	16,500	13.0%	-8.6%	0.0%
Interest Income	2,102	1,595	1,291	1,591	-24.2%	-19.0%	23.2%
Revenue from Other Public Entities	8,419	9,302	10,178	10,058	10.5%	9.4%	-1.2%
Service Charges & Reimbursements	39,132	37,475	39,983	37,670	-4.2%	6.7%	-5.8%
All Else	967	1,005	898	940	3.9%	-10.6%	4.8%
Interfund Transfers	5,252	13,940	1,893	912	165.4%	-86.4%	-51.8%
Total, General Subfund	645,107	665,817	683,452	698,395	3.2%	2.6%	2.2%
Real estate excise tax (REET)	27,928	33,200	26,200	27,000	18.9%	-21.1%	3.1%

Shaded figure was reduced by one-time transfers and non-forecasted revenues to reduce year-over-year distortions.