

# Economic Update

Update on economic issues affecting Seattle's tax revenue performance

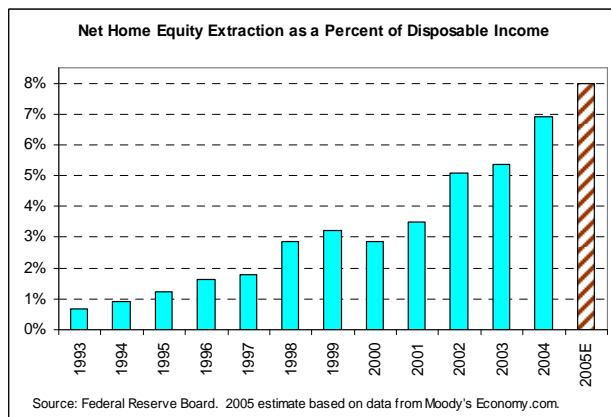
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## ECONOMY

**U.S. Economy:** The nation's recovery from the 2001 recession is now in its fifth year. Both employment and gross domestic product (GDP) have been growing at a healthy pace since mid-2003, and 5.3 million jobs have been added since August 2003. Wage growth has been weak during the recovery, and over the past year rising energy prices have pushed the inflation rate above the rate of growth in wages.

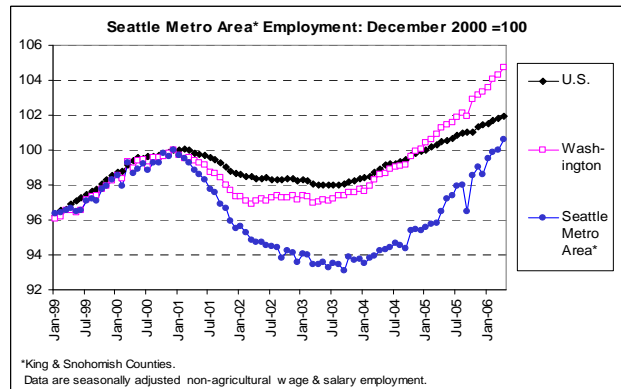
A key driver of the recovery has been the housing market, which has thrived on low interest rates in recent years. Not only has housing construction and real estate activity boosted the economy, but consumer spending has been supported by homeowners' ability to convert rising home equity to cash via refinancing and home equity loans (see graph below). However, with interest rates now rising and housing affordability declining, the housing market is in the process of slowing. In recent months, construction of new homes has fallen, the number of sales has dropped, inventories have been building, and price increases have moderated. In a few areas of the nation prices have fallen.

Higher interest rates and a slowing housing market are expected to slow the economy's rate of growth beginning in the second half of this year. At times of transition, such as this anticipated slowing in the pace of growth, uncertainty tends to be high and changes are often less smooth than expected. Other risk factors include high energy prices and inflation, which is showing signs of accelerating. The Federal Reserve is trying to raise interest rates to a level that slows the economy and



reduces inflationary pressures, while not raising rates so high that the economy stalls or falls into recession.

**Puget Sound Economy:** Following an extended downturn and period of weak growth that began in early 2001, the Puget Sound Region's economy has been growing at a healthy pace since the second quarter of 2005. Virtually all sectors of the economy are now expanding; led by construction, aerospace, business & professional services, and leisure & hospitality. Boeing, which secured orders for 1,002 airliners in 2005, has added over 11,000 employees in Washington since June 2004, and is expected to continue expanding its workforce through 2008.



The recent upswing in growth has finally pushed employment in the Seattle Metropolitan Area (King and Snohomish Counties) above the level reached in December 2000, the area's pre-recession peak (see graph above). The employment growth rate, which has been accelerating, reached 4.3% in the first four months of 2006. Comparable growth rates for the U.S. and the remainder of the state are significantly lower, at 1.5% and 2.5%, respectively.

The region is expected to continue to grow significantly faster than the nation over the next several years, in part due to expansion at Boeing. The major risk to this optimistic outlook is a downturn in the national economy; a sharp slowdown in the local housing market could also result in lower than expected growth.

# Cash Update

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

## CITY REVENUE

**Year-to-date through May:** The following describes how actual 2006 collections for general subfund revenues compared to the forecast reflected in the revised 2006 revenue forecast. Overall the collections exceed the forecast by \$3.6 million, a 1.6% difference. The bulk of this is due to better than expected B&O tax returns.

**Property Tax:** Year to date property taxes are in line with the forecast; revenues are down 10.6% from 2005 due to a timing adjustment. These revenues will be recovered in the coming months.

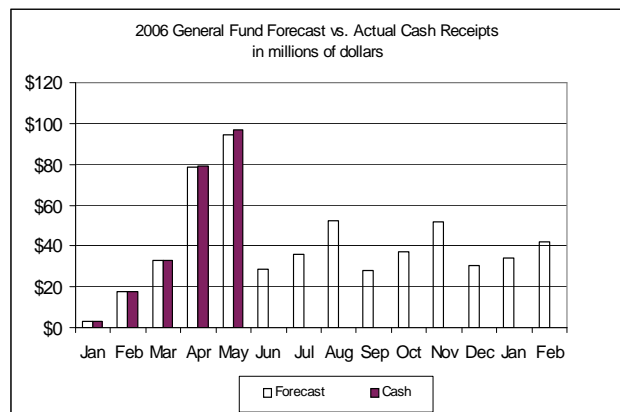
**B&O tax:** Receipts for the B&O are \$2.6 million over forecast, or 7.8%. This increase may be due to early cash receipts as opposed to a real gain in the tax base.

**Private Energy taxes:** Natural gas taxes are up 8% over forecast. This is largely to increases in rates that will continue through the year. PSE has requested a cost increase rate adjustment as well as an increased rate adjustment for higher delivery and infrastructure costs.

**REET:** Real Estate Excise taxes remain difficult to forecast. They are proving to be stronger than anticipated again this year. This is believed to be a sustained increase and expected to continue, thanks to a largely robust real estate market in Seattle.

**City Water:** The difference of 107% over last year is due to an increase in water rates, a \$600k accounting correction in 2005 and a late payment in 2006.

**Interest Earnings:** Interest income is up \$434k over forecast, or 27.2%. This can be attributed to both higher cash balances as well as significantly higher interest rates.



### 2006 Year to date through May

|  | YEAR TO DATE        |                    |                  |             | COMPARISON TO 2005 |                  |                  |
|--|---------------------|--------------------|------------------|-------------|--------------------|------------------|------------------|
|  | Cumulative Forecast | Actual             | Difference       | Percent     | Cumulative 2005    | Yr/Yr Difference | Yr/Yr Cumulative |
| <b>PROPERTY TAXES</b>                  |                     |                    |                  |             |                    |                  |                  |
| General + EMS                          | 94,064,000          | 94,064,000         | 0                | 0.0%        | 105,211,000        | -11,147,000      | -10.6%           |
| Leasehold Excise Tax                   | 951,000             | 956,000            | 5,000            | 0.5%        | 861,000            | 95,000           | 11.0%            |
| <b>RETAIL SALES TAX</b>                |                     |                    |                  |             |                    |                  |                  |
| General                                | 31,908,000          | 31,710,000         | -198,000         | -0.6%       | 29,398,000         | 2,312,000        | 7.9%             |
| Criminal Justice                       | 2,986,000           | 2,945,000          | -41,000          | -1.4%       | 2,737,000          | 208,000          | 7.6%             |
| <b>BUSINESS TAXES AND OTHER</b>        |                     |                    |                  |             |                    |                  |                  |
| Business and Occupation                | 33,499,000          | 36,109,000         | 2,610,000        | 7.8%        | 30,943,000         | 5,166,000        | 16.7%            |
| Utilities - City Light                 | 11,715,000          | 11,819,000         | 104,000          | 0.9%        | 11,260,000         | 559,000          | 5.0%             |
| Utilities - City Water                 | 3,937,000           | 4,044,000          | 107,000          | 2.7%        | 1,953,000          | 2,091,000        | 107.1%           |
| Utilities - City Drainage/Waste Water  | 6,667,000           | 6,413,000          | -254,000         | -3.8%       | 5,556,000          | 857,000          | 15.4%            |
| Utilities - City Solid Waste & Garbage | 2,897,000           | 2,790,000          | -107,000         | -3.7%       | 2,665,000          | 125,000          | 4.7%             |
| Utilities - Cable Television           | 3,720,000           | 3,591,000          | -129,000         | -3.5%       | 4,030,000          | -439,000         | -10.9%           |
| Utilities - Telephone                  | 8,697,000           | 9,030,000          | 333,000          | 3.8%        | 9,427,000          | -397,000         | -4.2%            |
| Utilities - Private Energy             | 6,975,000           | 7,531,000          | 556,000          | 8.0%        | 6,394,000          | 1,137,000        | 17.8%            |
| Admission Tax                          | 2,595,000           | 2,426,000          | -169,000         | -6.5%       | 2,407,000          | 19,000           | 0.8%             |
| Court Fines and Forfeitures            | 5,973,000           | 6,063,000          | 90,000           | 1.5%        | 6,843,000          | -780,000         | -11.4%           |
| Interest Income                        | 1,593,000           | 2,027,000          | 434,000          | 27.2%       | 686,000            | 1,341,000        | 195.5%           |
| Parking Meters                         | 6,006,000           | 6,214,000          | 208,000          | 3.5%        | 5,354,000          | 860,000          | 16.1%            |
| Misc. Revenues                         | 1,772,000           | 1,818,000          | 46,000           | 2.6%        | 2,029,000          | -211,000         | -10.4%           |
| <b>TOTAL</b>                           | <b>225,955,000</b>  | <b>229,550,000</b> | <b>3,595,000</b> | <b>1.6%</b> | <b>227,754,000</b> | <b>1,796,000</b> | <b>0.8%</b>      |
| Real estate excise tax                 | 19,084,000          | 20,154,000         | 1,070,000        | 5.6%        | 17,518,000         | 2,636,000        | 15.0%            |