

The City of Seattle **Washington**

Comprehensive Annual Financial Report **For the Fiscal Year Ended December 31, 2006**

Department of Executive Administration



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Comprehensive Annual Financial Report

For Year Ended December 31, 2006

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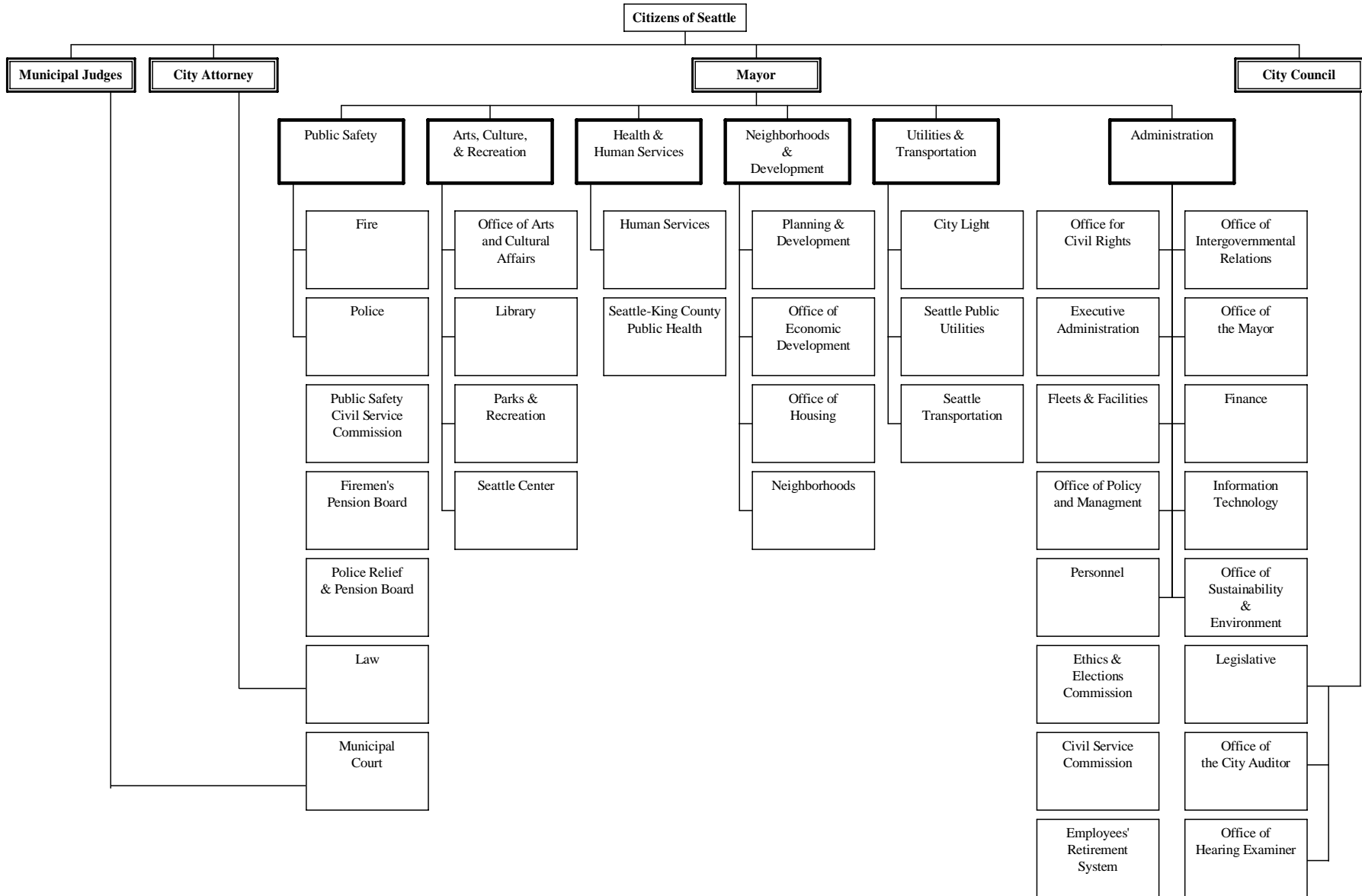
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CITY ORGANIZATION CHART



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City of Seattle Department of Finance

Dwight Dively, Director
Gregory J. Nickels, Mayor

June 26, 2007

The Honorable Mayor and
Members of the City Council:

I am pleased to submit to you the 2006 Comprehensive Annual Financial Report (CAFR) of the City of Seattle, Washington. The Department of Executive Administration has prepared this report to present the financial position of the City of Seattle on December 31, 2006, and the results of its operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds for the year then ended. The financial statements and supporting schedules have been prepared in accordance with generally accepted accounting principles and meet the requirements of the State Auditor and the City Charter.

Washington State law requires an annual audit of the City's financial statements by the independently elected State Auditor. The State Auditor conducts his examination in accordance with generally accepted auditing standards and provides an independent assessment that helps assure fair presentation of the City's financial position and results of operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds. In addition to the opinion on the City's financial statements included in this report, the State Auditor also issues separate reports on internal control and compliance with laws and regulations that meet the requirements of the Single Audit Act and related OMB Circular A-133. These reports are available in the City's separately issued Single Audit Report.

The accuracy of the City's financial statements and the completeness and fairness of their presentation is the responsibility of City management. The City maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that financial records can be relied upon to produce financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of maintaining the system of internal accounting controls should not exceed benefits likely to be derived. Comprehensive written policies support the system and the Office of City Auditor reviews internal accounting controls based upon request or observed need.

Management's discussion and analysis (MD&A) immediately follows the State Auditor's report. It provides a narrative introduction, overview, and analysis to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it.

Profile of the Government

The City of Seattle was incorporated on December 2, 1869. The City operates under a City Charter adopted on March 12, 1946, providing for a nonpartisan Mayor-Council form of government. The City Council is composed of

nine members elected at large to four-year terms. The City provides the full range of municipal services authorized by its charter and operates four rate-funded utilities.

The City of Seattle is a primary government for financial reporting purposes. Its governing body is elected by the citizens in a general, popular election. This report includes all organizations and activities for which elected City officials exercise financial accountability. Certain organizations created by or related to the City, for which the City is not financially accountable, have been excluded from this report. Joint ventures, component units, and contingent liabilities, which exist from relationships with organizations created by the City, are included in this report. The notes to the financial statements further discuss the City as a financial reporting entity.

The City provides a full range of services, including the City's infrastructure services. The City builds and repairs roads; maintains electric, water, solid waste, sewer and drainage services; provides police and fire protection as well as judicial services; administers land use policy; and takes an active role in commercial and industrial development and environmental protection. The City designs and maintains many parks and golf courses, coordinates recreation activities, maintains libraries, fosters neighborhood livability, and works to preserve a satisfactory living environment for both the community and individuals.

Budgets and Budgetary Accounting

The City Council approves the City's operating budget. In addition, the City Council annually approves two separate but related financial planning documents: the Capital Improvement Program (CIP) plan and the Community Development Block Grant (CDBG) program allocation.

The operating budget is proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The budget is designed to allocate available resources on a biennial basis among the City's public services and programs and provides for associated financing decisions. On a biennial basis, the annual budget is adopted and the following year's budget is endorsed. The budget appropriates fiscal year expenditures and establishes employee positions by department and fund except for project-oriented, multi-year appropriations made for capital projects, grants, or endowments.

The CIP plan is also proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The CIP is a six-year plan for capital project expenditures and anticipated financing by fund source. It is revised and extended annually. The City Council adopts the CIP as a planning document but does not appropriate the multi-year expenditures identified in the CIP. These expenditures are legally authorized through the adoption of the annual budget. The CIP is consistent with the City's Comprehensive Plan and includes information required by the State's Growth Management Act.

The CDBG planning process allocates the annual grant awarded by the federal government. Allocations are made to City departments and non-City organizations. Although this federally funded program has unique timetables and requirements, the City coordinates it with the annual budget and CIP processes to improve preparation and budget allocation decisions and streamline budget execution.

The adopted budget generally makes appropriations for operating expenses at the budget control level within the departments unless the expenditure is from one of the General Fund reserve accounts or is for a specific project or activity budgeted in the General Subfund category called Finance General. These projects and activities are budgeted individually. Capital projects programmed in the CIP are appropriated in the budget at the program or project level. Grant-funded activities are controlled as prescribed by law and federal or state regulations.

National and Local Economy

The current national economic expansion is now in its sixth year. The recovery, which began in December 2001, has been relatively weak by historical standards. Wage growth has been particularly weak, and over the course of the recovery the growth rate of employee compensation, which includes salaries and benefits, has barely exceeded the rate of inflation.

Housing has led the recovery. The very low interest rates set by the Federal Reserve to soften the 2001 downturn and spur a recovery stimulated the housing 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 by creating an opportunity for home owners to extract some of their home equity.

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

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

The national economy has been slowing since mid-2006, as the housing market has shifted from a source of growth to a drag on the economy. The annualized growth rate of real Gross Domestic Product (GDP) fell to 1.3 percent in first quarter 2007, its slowest pace in four years. Business investment has weakened and there has been a modest slowing of both job creation and retail spending. A sharp rise in energy prices in recent months has also contributed to the slowdown.

Most forecasters expect the economy to grow slowly for the rest of 2007 and then accelerate in 2008. As always, there are numerous risk factors that could cause growth to deviate from expectations. Inflation is an ongoing concern, though in recent months inflation has showed signs of easing. Other risks to the economy include the housing market continuing to contract and the potential for further energy price hikes or a supply disruption. With the economy slowing and the housing market contracting, the chances of a recession occurring are rising.

Puget Sound Region Economic Outlook

The Puget Sound area's economy has rebounded strongly from the 2001 recession. Job growth in the region now exceeds that in the rest of the state and the nation as a whole. A major construction boom now under way includes office buildings, research and manufacturing facilities, housing, and public projects, such as Sound Transit light rail. This economic growth has bolstered many City revenues, including sales tax, Business and Occupation (B&O) tax, Real Estate Excise Tax (REET), electricity sales, and construction permits.

It is important to put this recent revenue growth into a longer-term context. For example, when the effects of inflation are removed, Seattle's sales tax revenues did not return to 2000 levels until mid-2006. Similarly, the rapid growth in property values has not translated into large growth in property tax revenues. State law limits property tax revenue growth to 1 percent per year plus the value of new construction. Because new construction has seen strong growth, overall property tax revenue has been growing by 2 percent to 3 percent per year, or about the rate of inflation.

During the recession the region lost 97,800 jobs, a 6.9 percent decline, between December 2000 and September 2003. The recovery started out slowly but growth has picked up steadily over time. Contributing to the region's healthy growth over the past couple of years has been an upturn at Boeing, which added 17,100 jobs between June 2004 and April 2007, and continued growth at Microsoft. Other sources of growth in the local economy include construction and professional & business services, an industry in which Seattle specializes.

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.

The strong recent economic performance gives the City the opportunity to add high-priority services. However, it has not yet been sufficient to fully offset the \$120 million in General Fund budget reductions made in the first four years of this decade.

MAJOR INITIATIVES

2007 Budget: Mayor Nickels established four major priorities when he took office five years ago: get Seattle moving, keep our neighborhoods safe, create jobs and opportunity for all, and build strong families and healthy communities. The City's 2007 Adopted and 2008 Endorsed Budget include significant investment in each of these areas. The budget was developed during a period of strong regional economic growth but with several looming issues that may affect the City's finances during the biennium. Thus, the budget focuses resources on a combination of the Mayor's high-priority programs plus some one-time investments, such as improvements to the City's technological capabilities, nonrecurring funding for several community facilities, and investments in "green" equipment.

Get Seattle Moving: Transportation systems are a critical feature of an urban area. The City has lost several revenue sources devoted to transportation maintenance over the last decade as a result of court decisions or statewide initiatives. The City has expanded its support of transportation from the General Fund over the last five years but still has a substantial backlog. The adopted budget continues current transportation maintenance efforts and adds significant funding in two programs.

- **Bridging the Gap.** In November the City's voters approved a transportation maintenance and development program to be supported by a combination of a property tax levy lid lift, a commercial parking tax, and a business transportation tax calculated on employee hours worked. These new revenue sources will generate approximately \$39.9 million and \$51.5 million in 2007 and 2008, respectively. The funds will be used to significantly expand maintenance programs, such as street paving and bridge rehabilitation; to add new and expanded programs to build sidewalks and bicycle lanes; to support transit operations and related capital improvements; and to cover the City's share of the cost of four major facilities – the Spokane Street Viaduct, the Mercer Corridor, the Lander Street Overcrossing, and King Street Station.
- **Alaskan Way Viaduct and Seawall Replacement.** The Alaskan Way Viaduct is approximately 50 years old. Many parts of the structure are seismically unsafe and it sits on unstable soils. The neighboring Seawall was mostly built in the 1930s and has deteriorated under attack by marine organisms. The City has been working with the Washington State Department of Transportation (WSDOT) to develop plans for replacing these structures.

Keep Our Neighborhoods Safe: Public safety is the principal responsibility of local government. In the last three years the City has made major new investments in public safety, including the addition of about 33 police officers and significant investments in police technology and equipment. The City is in the process of adding firefighters so each engine has a four-person crew, which will improve safety and provide faster response times. The Fire Facilities Levy is providing funds to replace or renovate neighborhood fire stations, build a new Fire Alarm Center and Emergency Operations Center (EOC), and purchase two new fireboats. The City has also stepped up its efforts to prepare for emergencies, including disaster caches, emergency generators, emergency water supplies, and equipment and supplies needed to respond to terrorist events or natural disasters. Two major new efforts are:

- **Emergency Preparedness.** Staff are being added to the Fire Department and the Fleets and Facilities Department to coordinate their departments' emergency work. The Emergency Preparedness Bureau in the Police Department plans to study the City's needs to respond to a medical emergency, such as pandemic flu. The 2008 Endorsed Budget includes funding to purchase equipment or supplies identified by this study. It also includes funding to build a backup 911 dispatch center in the new EOC. In addition, it provides funds to conduct a study of unreinforced masonry buildings in Seattle.
- **New Officers, Technology, and Vehicles.** The City has received grant funding from Sound Transit to provide additional traffic control during construction of light rail in the Downtown Bus Tunnel. Some of this funding expires in 2007. The 2007 budget continues current staffing levels by adding six positions. In addition, funding is set aside for 10 additional officers in 2007 and 20 more in 2008. Funding is also provided for four civilian support positions. The budget includes technology funding to facilitate dispatching, recordkeeping, and accountability that will improve efficiency and support the neighborhood policing effort to assign officers to areas with the greatest need. Finally, the budget provides funds to

purchase 10 new patrol cars, which will provide more coverage through one-person rather than two-person vehicles.

Create Jobs and Opportunity for All: Economic development was a major focus of the City in the first part of this decade. The deep recession led the City to undertake major efforts to attract and retain employers, including lifting the development lid in the University District, changing development regulations and making public investments in the Northgate neighborhood, building infrastructure and supporting redevelopment in South Lake Union, and changing development regulations to support construction and housing downtown. The City also made a series of targeted investments in job training, business outreach, and neighborhood business districts. These efforts will continue and expand in 2007. In addition, the 2007 budget includes two new economic development efforts:

Permit Processing Times. The recent boom in construction has led to delays in processing building-related permits, despite staff expansions and new systems that improve interdepartmental coordination. The budget adds staff to ensure that permit processing time goals are met.

Apprenticeship. Apprenticeship programs are one of the best ways to provide access to well-paying jobs in building trades, automotive professions, and other jobs. These programs are especially valuable for women and people of color. The City has been a leader in providing apprenticeship opportunities and a substantial expansion of these opportunities is planned for 2007.

Build Strong Families and Healthy Communities: The City of Seattle provides a wide range of services to its residents and to people from the surrounding region. The 2007 budget includes significant expansion of effort in many areas:

- **Environmental Action Agenda.** The Mayor has proposed a three-part Environmental Action Agenda. “Green Seattle” focuses on expanding the City’s tree cover and ensuring that City-owned trees are maintained appropriately. The “Climate Protection Initiative” focuses on reducing greenhouse gas emissions and having Seattle achieve the goals of the Kyoto protocol by 2012. “Restore Our Waters” focuses on improving the City’s streams and shorelines and reducing adverse impacts caused by City facilities. Some of the most significant investments in the 2007 budget include:
 - Adding new tree crews to the Seattle Department of Transportation to maintain City-owned trees;
 - Purchasing “green” vehicles and equipment, including hybrid cars for police nonpatrol uses and electric equipment for maintenance in parks, as well as further expansion of the City’s use of biodiesel;
 - Reducing wastewater discharges from City facilities by covering material storage areas and changing systems at fire stations;
 - Adding and maintaining sidewalks and bike lanes;
 - Investing in transit operations and making capital investments that improve transit reliability; and
 - Adding staff and capital funds to reduce energy and water use by City facilities.
- **Ten-Year Plan to End Homelessness and the Housing First Strategy.** Seattle is one of the participants in the Ten-Year Plan, which calls for investments in affordable housing to move homeless individuals and families out of shelters and into supported housing. One aspect of this is “Housing First,” a strategy that offers immediate long-term housing with support services for homeless individuals with the most significant challenges, including drug or alcohol abuse and mental health issues. The budget provides funding to continue and expand support services for Housing First and to pay for the City’s share of construction of about 40 units of supported housing. The Mayor is calling on King County, suburban cities, and nonprofit organizations to match Seattle’s efforts in the Ten-Year Plan.
- **Neighborhood Investments.** The budget expands City programs in neighborhoods facing economic uncertainty and social challenges. Three neighborhoods receiving special attention are South Park, Broadway, and Southeast Seattle.
- **Race and Social Justice.** The Mayor started his Race and Social Justice Initiative (RSJI) four years ago to ensure that City services are available to everyone and that the City works to eliminate the effects of racism within City government and the broader community. Many aspects of the 2007-2008 budget were

developed with an explicit focus on social justice issues, including the Ten-Year Plan, South Park, and apprenticeship investments previously described. Other initiatives in this area include continued City support for the Contractor Development and Competitiveness Center, which helps small businesses develop skills to obtain public contracts, and funding for a position to monitor compliance with wage laws by housing contractors. This responds to recent concerns that many workers on these projects, who are often immigrants and people of color, have not been paid appropriately.

- **Community Facilities.** The City has provided financial support for several development projects by nonprofit cultural or human services organizations in the last few years, including the Museum of History and Industry, the Seattle Children's Museum, the Wing Luke Museum, the Colman School project, and the Asian Counseling and Referral Services project. The 2007 budget continues this practice by providing support to organizations such as the Rainier Vista Boys and Girls Club; the East Madison YMCA; the Chief Seattle Club, serving Native Americans; and the Nisei Veterans project.
- **Parks Improvements.** The 2007 budget includes several major initiatives in the Parks Department. In addition to the "green" investments mentioned above, the budget includes a downtown parks initiative of maintenance and program expansions. Funds are provided for partial payment for the Capehart property in Discovery Park. There are also plans for new artificial turf fields and replacement of lights with safer, more energy-efficient, and less obtrusive structures. Finally, the rapid growth of REET in recent years allows Parks to expand its major maintenance of existing facilities.
- **Library Collections and Technology.** The 2007 budget provides a \$500,000 annual increase in the Library collections budget. A recent patron survey found that users wanted more investment in collections rather than expansion of hours. The budget also includes ongoing funding to replace the Library's major information processing systems.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Seattle for its comprehensive annual financial report for the fiscal year ended December 31, 2005. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

I would like to express my appreciation to the entire staff of Accounting Services, other members of the Department of Executive Administration, and other City departments who contributed to the preparation of this report. Finally, I thank you for your interest and continuing support in planning and conducting the City's financial operations in a responsible manner.

Sincerely,

Dwight D. Dively, Director
Department of Finance

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SIGNATURE**

City of Seattle

DEPARTMENT OF EXECUTIVE ADMINISTRATION

