

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management discussion and analysis section of the City of Redmond's Comprehensive Annual Financial Report provides an overview of the City's financial activities for the year ending December 31, 2008, and for the City's financial position at December 31, 2008. This information should be read in conjunction with the preceding letter of transmittal and the financial statements and notes to the financial statements that follow.

Financial Highlights

- Net assets, the amount by which total assets exceed total liabilities, equaled \$613,861,063 at the end of 2008. The City's net assets increased by \$41,891,313 or 7.32% in 2008. The overall increase was split between governmental activities and business-type activities at \$17,439,550 or 41.63% and \$24,451,763 or 58.37% respectively. The increase is predominantly due to an increase in investment in capital assets. In governmental activities, \$7,123,961 or 40.85% of the increase resulted from investments in capital assets while business-type activities had a \$15,628,073 or 63.91% increase in capital assets.

Of the remaining net assets, \$24,203,396 and \$77,758,280 are restricted and unrestricted respectively for Governmental Activities, while \$7,685,733 and \$37,125,665 are restricted and unrestricted respectively for Business-Type Activities. The major component of the legally restricted portion is for Capital Projects, which account for \$24,282,619 or 76.14% of total restricted net assets citywide.

- Governmental fund balances at year end were \$103,690,328, an increase of \$17,992,333 or 20.99% from the prior year. Of this amount, \$16,177,183 is unreserved in the general fund and available to fund ongoing activities. \$1,525,809 is legally restricted for debt service, and \$47,383,944 and \$38,603,392 is legally restricted or reserved by City policy for capital projects and Special Revenue Fund purposes respectively.
- The unreserved fund balance in the general fund, \$16,177,183, is an increase of \$1,492,401 from the prior year. A fund balance of \$6,545,560 is available in the operating reserve fund as well to provide the capacity to offset significant downturns and revisions in any general municipal purpose fund in accordance with the City's operating reserve policy. This is reported as a separate fund in the Special Revenue Fund totals.
- The City went through a re-evaluation of our bond rating for both general government bonds as well as a re-evaluation of the utility rating with Standard & Poors. This labor-intensive process yielded big results for the City – an AAA rating for both. This rating increase was well reflected in the bond offerings that the City had in 2008 with all three resulting in premiums totaling \$1,695,956.

The three offerings were one general obligation, one revenue and one refunding of existing general obligation bonds. The general obligation bonds were in the amount of \$33,935,000 for the Bear Creek Parkway expansion as well as other transportation projects. The revenue bonds were for the City's utility capital projects in the amount of \$11,755,000. The refunding bonds decreased the 1994 bonds by \$1,315,000.

Overview of the Financial Statements

The City's basic financial statements are presented in three parts: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. Other supplementary information in addition to the basic financial statements is also contained in this report. This section of the management's discussion and analysis is intended to introduce and explain the basic financial statements.

Government-wide financial statements

The government-wide financial statements are designed to give the reader a picture of the financial condition and activities of the City as a whole. This broad overview is similar to the financial reporting of private sector businesses. The government-wide financial statements have separate columns for governmental activities and business-type activities. Governmental activities of the City include general government (finance, executive, human resources), security (police and fire), physical environment, economic environment, transportation, mental/physical health, and culture and recreation. The City's business-type activities are limited to water/wastewater and stormwater utilities. Governmental activities are primarily supported by taxes, charges for services, and grants. Business-type activities are self-supporting through user fees and charges.

The **statement of net assets** presents information on all of the City of Redmond's assets and liabilities, highlighting the difference between the two as net assets. This statement is similar to the balance sheet of a private sector business. Over time, increases or decreases in net assets may be one indicator of improvement or deterioration in the City's overall financial health.

The **statement of activities** presents information designed to show how the City's net assets changed during the year. This statement distinguishes revenue generated by specific functions from revenue provided by taxes and other sources not related to a specific function. The revenue generated by the specific functions (charges for services, grants, and contributions) is compared to the expenses for those functions to show how much each function either supports itself or relies on taxes and other general funding sources for support. All activity on this statement is reported on the accrual basis of accounting, requiring that revenues are reported when they are earned and expenses are reported when they are incurred, regardless of when cash is received or disbursed. Items such as uncollected taxes, unpaid vendor invoices for goods or services received during the year, and earned but unused vacation leave are included in the statement of activities as revenue and expenses even though no cash has changed hands.

Fund Financial Statements

The annual financial report includes fund financial statements in addition to the government-wide financial statements. While the government-wide statements present the City's finances based on the type of activity, general government versus business-type, the fund financial statements are presented by fund type such as the general fund, special revenue funds, and proprietary funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts used to account for specific activities or meet certain objectives. Funds are often set up in accordance with special regulations, restrictions or limitations. The City of Redmond, like other state and local governments, uses fund accounting to ensure and show compliance with finance-related legal requirements. The City's funds are divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds are used to account for essentially the same functions as are reported as governmental activities in the government-wide financial statements. The basis of accounting is different between the governmental fund statements and the government-wide financial statements. The governmental fund statements focus on near-term revenues/financial resources and expenditures while the government-wide financial statements include both near-term and long-term revenues/financial resources and expenses. The information in the governmental fund statements can be used to evaluate the City's near-term financing requirements and immediate fiscal health. Comparing the governmental fund statements with the government-wide statements can help the reader better understand the long-term impact of the City's current year financing decisions. To assist in this comparison, reconciliations between the governmental fund statements and the government-wide financial statements are included with the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances.

The City of Redmond maintains twenty-nine individual governmental funds. The City's two major governmental funds – the general fund and the capital improvements program fund – are presented separately in the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances. The remaining governmental funds are combined into a single column labeled

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other governmental funds. Individual fund data for each of the other governmental funds can be found in combining statements later in this report.

The City maintains budgetary control over its operating funds through the adoption of a biennial budget. Budgets are adopted at the fund level for all funds in accordance with state law. A budgetary comparison statement is presented for the general fund and the advanced life support fund as basic financial statements. Other budgetary comparison schedules are included following the other governmental funds' combining statements in this report.

Proprietary funds are used by governments to account for their business-type activities. Business-type activities provide specific goods or services to a group of customers that are paid for by fees charged to those customers. There is a direct relationship between the fees paid and the services received.

The City of Redmond has two types of proprietary funds, enterprise funds and internal service funds. Enterprise funds are used to account for goods and services provided to citizens. Internal service funds are used to account for goods and services provided internally to various City departments.

Enterprise funds of the City are used to report the same functions presented as business-type activities in the government-wide statements with the fund statements providing more detail than is reported in the government-wide statements. The enterprise fund statements provide separate information for the City's water/wastewater utility, an Urban Planned Development (UPD) water/wastewater utility outside the city limits, and the City's stormwater utility.

Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its fleet of vehicles, insurance premiums and claims, medical self-insurance, workmen's compensation self-insurance program, information technology, and one blended component unit, Redmond Community Properties. Internal service funds benefit both governmental and business-type activities and are allocated accordingly in the government-wide statement of activities. Internal service fund assets and liabilities are predominantly governmental and have been included in the governmental activities column of the government-wide statement of net assets.

Fiduciary funds account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governments, or other funds. Fiduciary funds are not included in the government-wide financial statements because their assets are not available to support the City of Redmond's activities.

The City has two types of fiduciary funds, a pension fund and agency funds. The accounting for the pension fund is on the accrual basis. Agency funds are custodial in nature and do not include revenues and expenses as they do not measure the results of operations.

Notes to the financial statements

The notes to the financial statements provide additional information that is important to a full understanding of the data in the government-wide and fund financial statements. The notes are located immediately following the basic financial statements.

Other information

In addition to the basic financial statements and accompanying notes, this report also presents certain **required supplementary information** concerning the City's progress in funding its obligation to provide pension benefits to certain retired firefighters and lifetime medical benefits to uniformed personnel hired before October 1, 1977. Required supplementary information may be found immediately following the notes to the financial statements.

The combining statements for other governmental funds, internal service funds, and agency-type fiduciary funds are presented immediately following the required supplementary information.

Government-wide Financial Analysis**Statement of net assets**

The statement of net assets can serve as a useful indicator of the City's financial position. The City of Redmond's net assets at December 31, 2007 and 2008 total \$571,969,750 and \$613,861,063, respectively. Following is a condensed version of the government-wide statement of net assets for 2008 compared to 2007.

City of Redmond's Net Assets (in thousands)

	Governmental Activities		Business-Type Activities		Total	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Current and other assets	\$ 136,176	\$ 115,455	\$ 55,287	\$ 39,725	\$ 191,463	\$ 155,180
Capital assets, net of accumulated depreciation	<u>305,784</u>	<u>274,169</u>	<u>233,883</u>	<u>213,066</u>	<u>539,667</u>	<u>487,235</u>
Total assets	<u>\$ 441,960</u>	<u>\$ 389,624</u>	<u>\$ 289,170</u>	<u>\$ 252,791</u>	<u>\$ 731,130</u>	<u>\$ 642,415</u>
Long-term liabilities	\$ 80,288	\$ 46,893	\$ 12,678	\$ 749	\$ 92,966	\$ 47,642
Other liabilities	<u>20,815</u>	<u>19,314</u>	<u>3,487</u>	<u>3,488</u>	<u>24,302</u>	<u>22,802</u>
Total liabilities	<u>\$ 101,103</u>	<u>\$ 66,207</u>	<u>\$ 16,165</u>	<u>\$ 4,237</u>	<u>\$ 117,268</u>	<u>\$ 70,444</u>
Net assets						
Invested in capital assets, net of related debt	\$ 238,895	\$ 231,771	\$ 228,193	\$ 212,565	\$ 467,088	\$ 444,336
Restricted	<u>24,203</u>	<u>24,320</u>	<u>7,686</u>	<u>-</u>	<u>31,889</u>	<u>24,320</u>
Unrestricted	<u>77,758</u>	<u>67,326</u>	<u>37,126</u>	<u>35,988</u>	<u>114,884</u>	<u>103,314</u>
Total net assets	<u><u>\$ 340,856</u></u>	<u><u>\$ 323,417</u></u>	<u><u>\$ 273,005</u></u>	<u><u>\$ 248,553</u></u>	<u><u>\$ 613,861</u></u>	<u><u>\$ 571,970</u></u>

Changes in net assets

The changes in net assets table illustrates the increases or decreases in net assets of the City resulting from its operating activities. Following is a condensed version of the City's changes in net assets. The table shows the revenues, expenses, and related changes in net assets in tabular form for the governmental activities separate from the business-type activities for 2007 and 2008.

City of Redmond's Changes in Net Assets (in thousands)

	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
Revenues:						
Program revenues						
Charges for services	\$ 33,807	\$ 32,681	\$ 40,772	\$ 42,968	\$ 74,579	\$ 75,649
Operating grants and contributions	7,383	5,903	19	523	7,402	6,426
Capital grants and contributions	5,240	5,227	20,735	21,160	25,975	26,387
General revenues					-	
Property taxes	18,589	13,039	-	-	18,589	13,039
Sales taxes	20,675	24,420	-	-	20,675	24,420
Other taxes	19,578	27,404	-	-	19,578	27,404
Investment interest	4,087	5,135	1,740	1,668	5,827	6,803
Miscellaneous	1,242	3,819	140	143	1,382	3,962
Total revenues	\$ 110,601	\$ 117,628	\$ 63,406	\$ 66,462	\$ 174,007	\$ 184,090
Expenses:						
General government	\$ 14,823	\$ 13,390	\$ -	\$ -	\$ 14,823	\$ 13,390
Security	40,940	41,105	-	-	40,940	41,105
Physical environment	3,962	3,360	-	-	3,962	3,360
Economic environment	3,689	3,488	-	-	3,689	3,488
Transportation	16,501	10,616	-	-	16,501	10,616
Mental/physical health	97	98	-	-	97	98
Culture and recreation	11,104	9,551	-	-	11,104	9,551
Interest on long term debt	2,045	1,990	-	-	2,045	1,990
Water/wastewater	-	-	26,467	22,528	26,467	22,528
UPD water/wastewater	-	-	5,908	5,466	5,908	5,466
Stormwater	-	-	6,580	6,188	6,580	6,188
Total expenses	\$ 93,161	\$ 83,598	\$ 38,955	\$ 34,182	\$ 132,116	\$ 117,780
Increases in net assets						
before transfers	\$ 17,440	\$ 34,030	\$ 24,451	\$ 32,280	\$ 41,891	\$ 66,310
Transfers	-	-	-	-	-	-
Increase in net assets	17,440	34,030	24,451	32,280	41,891	66,310
Net assets - beginning	323,417	289,387	248,553	216,273	571,970	505,660
Net assets - ending	\$ 340,857	\$ 323,417	\$ 273,004	\$ 248,553	\$ 613,861	\$ 571,970

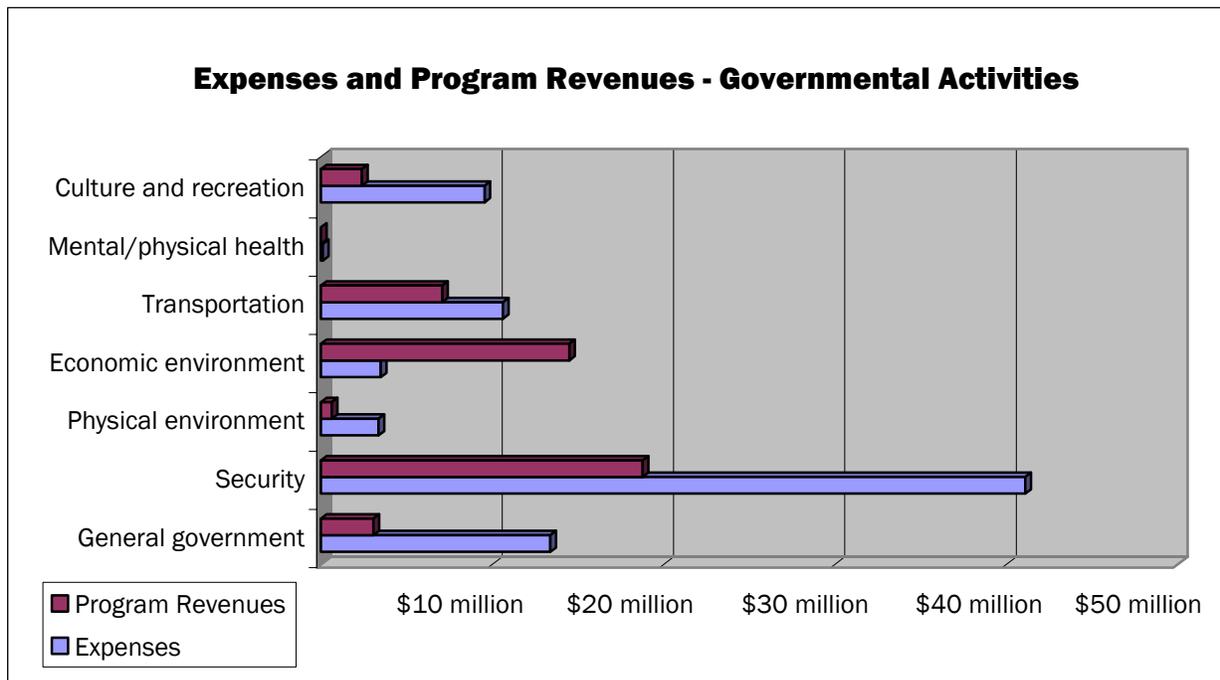
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Governmental activities contributed \$17,439,550 of the total change in net assets of \$41,891,313. The increase in net assets in 2008 was lower than the change in net assets for 2007 by \$24,047,705.

Key elements of the 2008 increase are as follows:

- The City's cash and investments increased by \$19,793,373 due primarily to the new bond offering to finance the Bear Creek Parkway expansion project. The cash received was \$35,063,583 of which \$15,528,958 was expended for the purchase of land for the expansion.
- The Bear Creek bond offering was also the reason for the \$33,560,083 or 70.96% increase in governmental debt. The City's government debt related to bonds, excluding special assessment debt, increased \$45,352,222 from 2007 to 2008. Total outstanding bonded debt, loans, compensated absences and long-term contracts at year end totaled \$92,938,530. This is a 94% increase from 2007.
- Equipment increased by \$2,107,953 from 2007 to 2008. This increase was primarily due to fire department purchases of a new triple pumper truck. The cost of the truck was \$1,550,037.
- The total revenue decreased between 2007 and 2008 by \$5,575,048. The decrease was due primarily to a decrease in tax revenue of \$6,014,737 as well as a decrease in permits and licenses of \$1,623,399. The increase of \$3,067,123 in charges for services helped reduce the decline in the other areas. A significant factor in the decline in tax revenues during 2008 as compared to 2007 was a "one-time" audit recovery of sales tax revenues during 2007 of just over \$4 million. Notwithstanding this audit recovery, sales taxes grew slightly in 2008.
- Total expenditures showed an increase of \$19,562,599. The biggest contributor to this increase was the \$15,967,140 in capital outlay. This includes land purchases and other capital outlay related to the Bear Creek Parkway expansion which is scheduled for completion in 2009.

The graph that follows compares program revenues to program expenses and illustrate the revenues by source separately for the governmental activities for 2008.



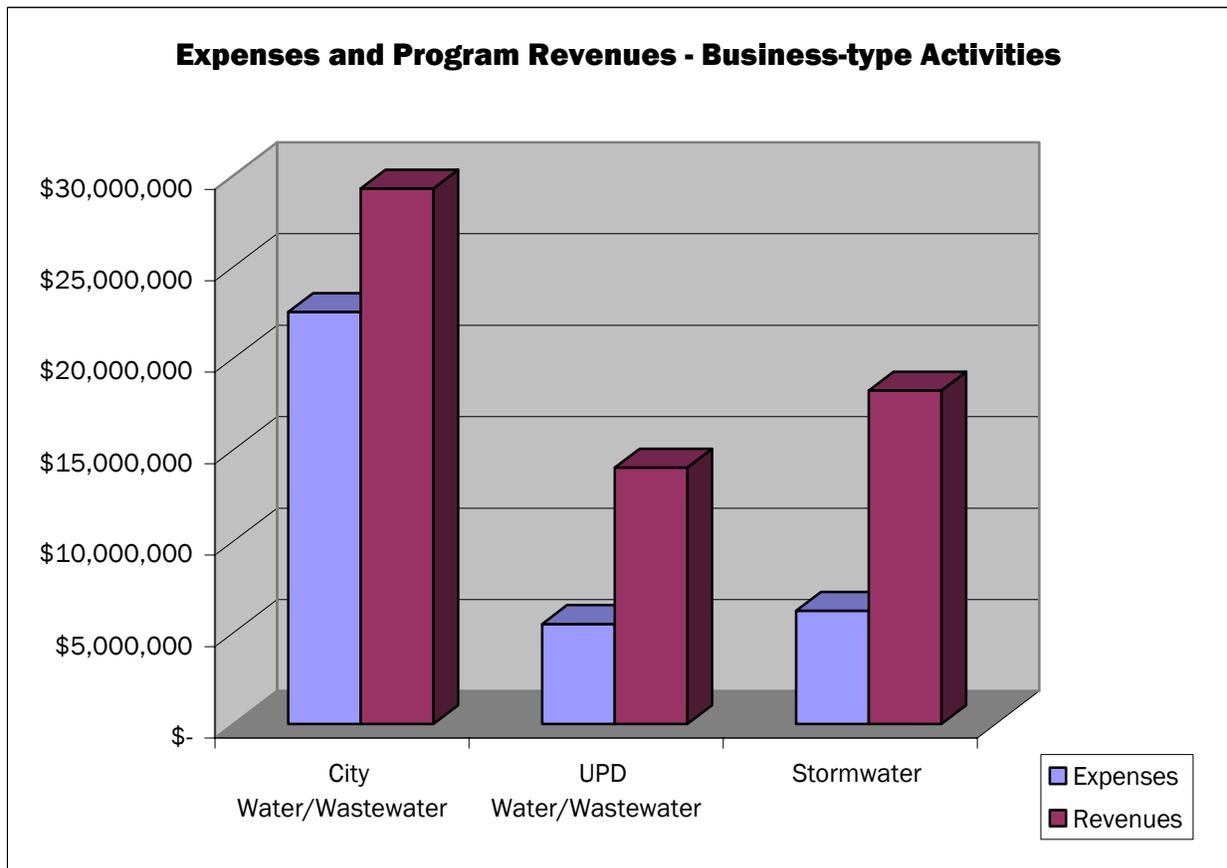
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Business-type activities of the City's utilities increased the City of Redmond's net assets by \$24,451,763 or 58.37% of the total change of net assets of \$41,891,313. Business-type activities accounts for 44.47% of the City's net assets.

Key elements of this increase are as follows:

- The investments in capital assets increased \$15,628,073 or 7.35% between 2007 and 2008. This increase accounts for 63.91% of the total increase in capital assets.
- The increase of \$11,928,797 in liabilities is due to the bond offering for capital projects in the Water/Wastewater Utility. The utilities did not have long-term debt in the preceding several years (dating to 2002).
- Both the Water/Wastewater and the UPD Water/Wastewater utilities show operating losses of \$1,538,984 and \$810,071 respectively. This loss is attributed to a few factors. First is the decrease in revenue of \$1,697,962 which is teamed with an increase in the expense of purchasing water of \$2,306,105. However, when non-operating income and capital contributions are included, the net income is \$3,199,585 and \$7,703,600 for the Water/Wastewater and the UPD Water/Wastewater utilities respectively.
- Investment earnings for the business-type activities had a modest increase of \$72,683 over 2007. This increase is much lower than prior years due in part to the sluggish investment market in the latter part of 2008.

The graph that follows compares program revenues to program expenses and illustrate the revenues by source separately for the business-type activities for 2008.



City of Redmond's Capital Assets (net of depreciation)

The City continued to make large investments in capital assets in 2008 as reflected in the following table. The increase from 2007 to 2008 was \$52,431,540 or 10.76%.

Governmental activities increased \$31,614,447 partially made up of:

- Grasslawn Park Improvements totaled \$3,730,518 in 2008.
- RITS Phase 5 increased \$1,252,054 for a year-end closing total of \$1,531,319.
- Development Agreement with Microsoft for construction of the NE 36th Street overpass increased \$1,813,942 for a year-end closing total of \$3,368,797.
- Police Evidence Area increased \$1,178,064 for a year-end closing total of \$2,576,391.

Business-Type Activities reflected an increase of \$20,817,093 partially made up of:

- Completion of Well #3 with a capitalized cost of \$6,851,843.
- Completion of Education Hill Tank Upgrades with a capitalized cost of \$1,667,822.
- Wells 1 & 2 had a year-end closing balance of \$3,404,072.
- Well 3 had a year-end closing balance of \$3,676,692.

	Governmental Activities		Business-Type Activities		Total	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Land	\$ 69,567,875	\$ 53,841,445	\$ 7,393,355	\$ 7,292,365	\$ 76,961,230	\$ 61,133,810
Buildings/ Bldg. Improvements	54,432,657	55,810,300	24,063,241	18,746,910	78,495,898	74,557,210
Improvements other than buildings	18,754,915	16,401,787	189,864,840	176,610,985	208,619,755	193,012,772
Machinery and equipment	12,511,615	10,390,749	331,618	251,902	12,843,233	10,642,651
Construction in progress	20,702,608	19,826,014	12,230,046	10,163,845	32,932,654	29,989,859
Infrastructure	129,504,015	117,600,617	-	-	129,504,015	117,600,617
Art	309,981	298,307	-	-	309,981	298,307
Total	<u>\$ 305,783,666</u>	<u>\$ 274,169,219</u>	<u>\$ 233,883,100</u>	<u>\$ 213,066,007</u>	<u>\$ 539,666,766</u>	<u>\$ 487,235,226</u>

Additional information on the City of Redmond's capital assets can be found in Note 8 of this report.

Long-term debt

At the end of 2008, the City of Redmond had total bonded debt outstanding of \$84,740,000 which is an increase of \$43,623,616. Of this amount, \$72,455,000 is general obligation bonds (City Hall, Bear Creek Parkway, and 1994 Refunding Bonds); \$530,000 is special assessment debt with governmental commitment; and the balance of \$11,755,000 is revenue bonded debt for the water/wastewater utility.

	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
General obligation bonds	\$ 72,455,000	\$ 40,531,384	\$ -	\$ -	\$ 72,455,000	\$ 40,531,384
Special assessment debt with governmental commitment	530,000	585,000	-	-	530,000	585,000
Revenue bonds	-	-	11,755,000	-	11,755,000	-
Total	\$ 72,985,000	\$ 41,116,384	\$ 11,755,000	\$ -	\$ 84,740,000	\$ 41,116,384

For further details related to the outstanding debt please refer to Note 13 in the document.

Requests for Information

This financial report is designed to provide a general overview of the City of Redmond’s finances for readers with an interest in the government’s finances. Questions concerning any of the information provided in this report, or requests for additional information, may be addressed to the Finance Director, City of Redmond, PO Box 97010, Redmond, WA 98073-9710.