MANAGEMENT'S DISCUSSION AND ANALYSIS

The management discussion and analysis section of the City of Redmond's annual financial report provides an overview of the City's financial activities for and financial position at the end of December 31, 2006. 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 $505,659,895 at the end of 2006. A total of 80% or $403,412,684 of total net assets is invested in capital assets such as streets, land, buildings, and utility pipes. Of the remaining net assets of $102,247,211, the majority are legally restricted, reserved by City policy for specific purposes, or are the net assets of business-type activities restricted for use by the City's utilities.

  The City's net assets increased by $38,579,812 in 2006. The overall increase was split between governmental activities and business-type activities at $22,380,363 and $16,199,449 respectively. The capital asset category of net assets increased $33,112,782 including $11 million contributed by developers. Net assets not invested in capital assets increased $5.4 million between 2005 and 2006.

  In the governmental activities category, net assets not invested in capital assets increased $11,107,691 or 16.3% in 2006. Net assets restricted for Debt Service and Special Revenue Funds increased $5,052,217 while net assets restricted for capital projects rose $830,421. Unrestricted net assets increased $5,225,053. Net assets not invested in capital assets in the business-type activities category declined $5,640,661 or 19.8% between 2005 and 2006.

- Governmental fund balances at year end were $74,545,242, an increase of $11,097,074 or 17.5% from the prior year. Of this amount, $9,058,520 is unreserved and available to fund ongoing activities. $1,550,360 is legally restricted for debt service and the remaining $63,936,362 is legally restricted or reserved by City policy for capital projects ($39,687,938) or Special Revenue Fund purposes ($24,248,424).

- Unreserved fund balance in the general fund was $9,035,080, an increase of $2,853,476 from the prior year. An additional fund balance of $5,073,832 is available in the operating reserve fund 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.

- Total City debt, excluding special assessment debt, decreased $1,403,258 from 2005 to 2006. Outstanding bonded debt, loans, and long term contracts at year end totaled $46,198,052.

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 while 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-five individual governmental funds. The City's three major governmental funds, the general fund, the advanced life support 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 other governmental funds. Individual fund data for each of the other governmental funds can be found in combining statements later on 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 and according to 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, 2005 and 2006 total $467,080,083 and $505,659,895, respectively. Following is a condensed version of the government-wide statement of net assets for 2006 compared to 2005.

City of Redmond's Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Current and other assets	$ 95,472,626	$ 85,495,488	$ 30,753,671	$ 32,681,116	$ 126,226,297	$ 118,176,604
Capital assets, net of accumulated depreciation	254,724,288	243,693,358	188,964,942	172,085,401	443,689,230	415,778,759
Total assets	$ 350,196,914	$ 329,188,846	$ 219,718,613	$ 204,766,517	$ 569,915,527	$ 533,955,363
Long-term liabilities	$ 48,714,497	$ 50,072,520	$ 1,116,952	$ 854,691	$ 49,831,449	$ 50,927,211
Other liabilities	12,095,342	12,109,614	2,328,841	3,838,455	14,424,183	15,948,069
Total liabilities	$ 60,809,839	$ 62,182,134	$ 3,445,793	$ 4,693,146	$ 64,255,632	$ 66,875,280
Net assets						
Invested in capital assets, net of related debt	$ 209,980,911	$ 198,708,239	$ 193,431,773	$ 171,591,663	$ 403,412,684	$ 370,299,902
Restricted	23,427,801	17,545,163	-	-	23,427,801	17,545,163
Unrestricted	55,978,363	50,753,310	22,841,047	28,481,708	78,819,410	79,235,018
Total net assets	$ 289,387,075	$ 267,006,712	$ 216,272,820	$ 200,073,371	$ 505,659,895	$ 467,080,083

As noted earlier, the statement of net assets can serve as one indicator of the City's overall financial health. The City of Redmond's assets exceeded liabilities by $505,659,895 as of December 31, 2006 and by $467,080,083 as of December 31, 2005.

The largest component of the City's net assets, 80% or $403,412,684, is its investment in capital assets less any related outstanding debt issued to acquire those assets. These capital assets such as streets, trails, water pipes, parks, fire and police vehicles, are used to provide services to the citizens. Consequently, these assets are not available to sell and convert to cash for future spending. The City has elected the GASB 34 reporting option to include all general infrastructure of the City acquired or substantially renovated since 1980.

The remaining $102,247,211 of net assets represents both restricted and unrestricted assets. Approximately 2.4% or $11,906,381 of the total net assets of the City are legally restricted for general government construction projects such as renovation and construction of sports fields in City parks, and street additions/improvements. The City attempts to fund its capital construction projects on a pay as you go basis, aggressively pursuing transportation grant funding and cost sharing with developers wishing to construct large projects in the City that impact the transportation system. A total of $1,550,360 (.3% of total net assets) is restricted for debt service payments. Net assets of $9,971,060 are restricted for special purposes and designated to fund activities such as advanced life support services, tourism activities, park maintenance and operation, and capital construction transfers.

A total of $78,819,410 represents the unrestricted net assets of the City. The business-type activities portion of $22,841,047 may only be spent on water/wastewater and stormwater utility activities. Maintenance of utility delivery systems (water lines, pump stations, wells), storm drain flushing, water meter reading, and capital construction projects such as well rehabilitation are examples of utility activities. Of the remaining $55,978,363 in funds not subject to legal restrictions, $46,943,283 is reserved for specific activities by City policy. Examples of the net assets reserved by City policy are funds earmarked for equipment replacement, rainy day funds, recreation activities, recycling, capital construction projects funded by general tax revenues, and transportation flow improvements. $9,035,080 of the City's net assets are unreserved.

At the end of the fiscal year, the City of Redmond reported positive balances in all three categories of net assets, for the government as a whole, as well as for the separate governmental and business-type activities.

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. The City of Redmond's net assets increased approximately $38.6 million in 2006. The increase was split between the government activities ($22.4 million) and the business-type activities ($16.2 million).

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 2005 and 2006. The graphs that follow compare program revenues to program expenses and illustrate the revenues by source separately for the governmental and business-type activities for 2006.

City of Redmond's Changes in Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues						
Charges for services	$ 26,734,394	$ 20,877,123	$ 31,914,057	$ 31,626,370	$ 58,648,451	$ 52,503,493
Operating grants and contributions	6,967,499	5,157,603	-	-	6,967,499	5,157,603
Capital grants and contributions	5,312,005	2,778,360	13,341,158	7,808,693	18,653,163	10,587,053
General revenues						
Property taxes	12,620,764	14,691,641	-	-	12,620,764	14,691,641
Sales taxes	20,070,662	18,647,890	-	-	20,070,662	18,647,890
Other taxes	22,174,191	18,705,429	-	-	22,174,191	18,705,429
Investment interest	3,664,879	1,927,511	1,298,037	785,340	4,962,916	2,712,851
Miscellanoues	588,763	623,081	149,333	63,368	738,096	686,449
Total revenues	$ 98,133,157	$ 83,408,638	$ 46,702,585	$ 40,283,771	$ 144,835,742	$ 123,692,409
Expenses:						
General government	$ 14,024,271	$ 14,497,527	$ -	$ -	$ 14,024,271	$ 14,497,527
Security	34,353,317	31,089,219	-	-	34,353,317	31,089,219
Physical environment	3,394,541	3,054,857	-	-	3,394,541	3,054,857
Economic environment	3,458,336	3,160,282	-	-	3,458,336	3,160,282
Transportation	9,533,011	9,150,474	-	-	9,533,011	9,150,474
Mental/physical health	98,479	94,300	-	-	98,479	94,300
Culture and recreation	8,907,741	8,121,462	-	-	8,907,741	8,121,462
Interest on long term debt	2,012,235	461,621	-	-	2,012,235	461,621
Water/wastewater	-	-	20,915,291	20,617,211	20,915,291	20,617,211
UPD water/wastewater	-	-	3,610,047	4,003,077	3,610,047	4,003,077
Stormwater	-	-	5,948,661	5,332,367	5,948,661	5,332,367
Total expenses	$ 75,781,931	$ 69,629,742	$ 30,473,999	$ 29,952,655	$ 106,255,930	$ 99,582,397
Increases in net assets before transfers and special items	$ 22,351,226	$ 13,778,896	$ 16,228,586	$ 10,331,116	$ 38,579,812	$ 24,110,012
Transfers	29,137	28,494	(29,137)	(28,494)	-	-
Increase in net assets	22,380,363	13,807,390	16,199,449	10,302,622	38,579,812	24,110,012
Net assets - beginning	267,006,712	253,199,322	200,073,371	189,770,749	467,080,083	442,970,071
Net assets - ending	$ 289,387,075	$ 267,006,712	$ 216,272,820	$ 200,073,371	$ 505,659,895	$ 467,080,083

Governmental activities contributed $22,380,363 of the total change in net assets of $38,579,812. The increase in net assets in 2006 was higher than the change in net assets for 2005 by $8.5 million. Key elements of the 2006 increase are as follows:

- The City's net investment in general government capital assets increased $11,272,672 while net assets legally restricted or reserved by City policy for capital expenses increased $830,421 from 2005 to 2006. These two capital asset categories accounted for 54.1% of the total increase in governmental activities net assets. Revenues to fund capital asset purchases and construction are recorded as program or general revenues in the Statement of Activities. These revenues primarily include impact fees, business transportation taxes, developer contributions, Local Improvement District assessments, and grants. The associated asset acquisition costs are not recorded as expenses in the year of acquisition but rather are included in the Statement of Net Assets as capital assets. The asset costs are allocated to expense over the lives of the assets through depreciation. The remaining components of net assets increased 18% or $10,277,270 from 2005 to 2006.

- Governmental revenues increased $14.7 million or 17.6% from 2005 to 2006. Approximately $6 million of this amount is available to fund increases in basic City operating costs. The remaining $8.7 million is legally restricted or reserved by City policy for specific purposes such as capital improvement projects and funding advanced life support services.

- Sales, property, and utility taxes are the primary sources of tax revenue available to fund general city operations. Retail sales and use tax increased $1,422,772 (7.6%) primarily from growth in the retail and telecommunications sectors. Property tax collections available for general use were flat, although total property taxes decreased just over $2 million as the final levy collection was made in 2005 to pay for a voted bond issue. Utility tax revenue was $1.4 million higher in 2006 than in 2005 due primarily to increases in Puget Sound Energy rates near the end of 2005.

- Development fees, including permits, inspections, and plan review services, increased by $1.84 million over 2005. Strong residential and commercial building activity contributed to this growth. Business license revenue available to fund general government activities increased just over $100,000 as the employee base increased. Redmond's business license fee is based on the number of employees working in the City.

- Increases in contract revenues of $900,000 from King County for advanced life support services and $450,000 from other governments for fire services provided by the City were used to pay for the higher costs of these services. The result was no net change to the net assets of the City's governmental activities. Investment interest increased 90% over 2005 due to several increases in interest rates and more cash available to invest. Of the $1.7 million increase in interest revenue, approximately $1 million may be used to fund basic services with the remainder earmarked for capital projects.

- Capital grants and contributions increased $2.5 million. Revenue in this category is restricted for specific purposes by the granting agency or the donor with the majority funding transportation projects.

- Overall, governmental activities expenses increased in 2006 over 2005 by 8.8% at $6,152,189. Personnel costs, which make up about 70% of the City's expenses, increased $1.8 million or 4.2% from 2005. Approximately $460,000 of this increase was due to a 50% increase in the rate charged to the City for retirement benefits by the State Department of Retirement Systems.

- Expenses in the general government function decreased $473,256 in total. A one-time expense in 2005 for furniture in the new City Hall resulted in reduction of expenses between 2005 and 2006 of approximately $1.4 million. This was offset by increased personnel costs, legal fee increases of just over $570,000 due to labor negotiation costs and litigation, and $178,602 in election costs in 2006.

- Other functions with notable increases for 2006 were security, encompassing police, fire, and inspections; transportation; and culture and recreation. Operating expenses for advanced life

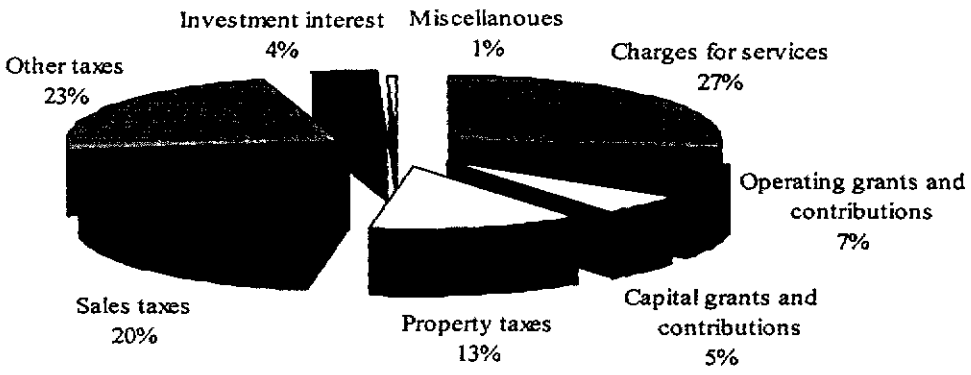
support services in the Fire Department increased approximately $470,000 in 2006. These expenses were funded by additional revenue from King County per contract. Jail costs increased by $330,000 between 2005 and 2006 due to increases in the cost of contracts for jail beds and more arrests by Redmond police. Included in security expenses for the first time in 2006 due to implementation of a new accounting standard is an expense of $437,092 for future medical costs for uniformed personnel accorded full lifetime medical coverage by State law. Other expenses contributing to the increase in security expenses were personnel costs, primarily due to retirement rate increases and vacancies in the Police Department being filled for a full year, start up costs for a new fire station, purchases of emergency response equipment, and higher fuel and energy costs.

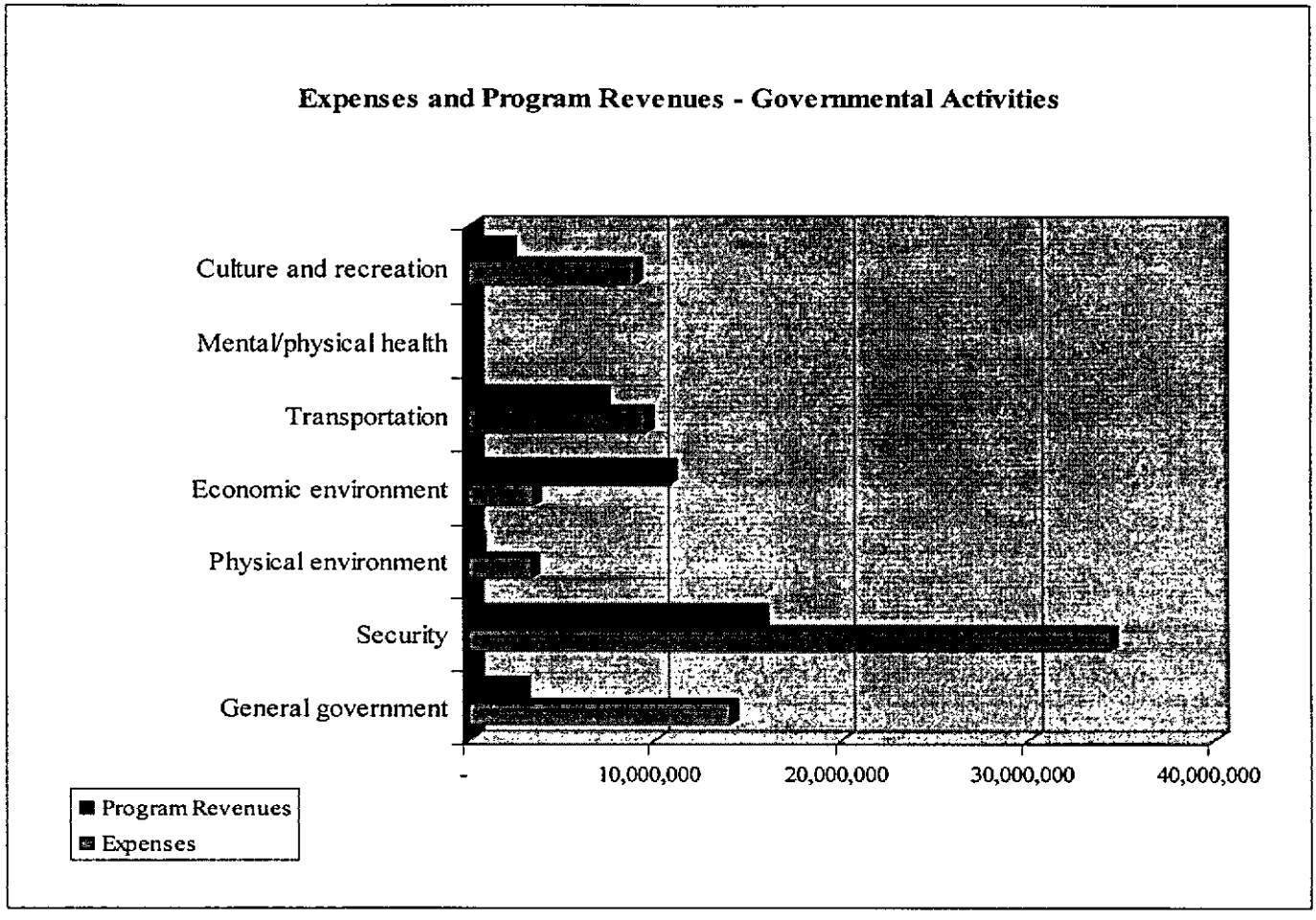
- Transportation function expenses were up $382,537 or about 4.2% in 2006. Personnel costs make up about two-thirds of this increase as salary and benefit costs rise throughout the City. Other contributing factors are depreciation as the City's transportation infrastructure grows and fluctuations from year to year in the cost of street maintenance activities such as repaving and road striping.

- Culture and recreation expenses increased 9.7% or $786,269 in 2006. Popular recreation classes required additional supplemental staff to lead the classes resulting in increased supplemental staff personnel costs. These costs are offset by an increase in recreation class fees. Maintenance and depreciation expenses for City parks increased more than $300,000 over 2005 as the number of amenities and popularity of the parks continued to grow. The remaining two functional areas, physical environment and mental/physical health, experienced increases of less than 5%, primarily for personnel costs, as their activities remain relatively stable.

- The City updates its revenue forecasts during the year and closely monitors incoming revenues to ensure sufficient funding will be available to maintain basic City functions. Should revenues fall short of expectations, immediate steps are taken to limit expenses to maintain the City's fiscal health. The City's fiscal prudence for the past several years enabled Redmond to end 2006 on a positive financial note.

Revenues by Source - Governmental Activities





Business-type activities of the City's utilities increased the City of Redmond's net assets by $16,199,449, accounting for 42% of the total growth in the government's net assets.

Key elements of this increase are as follows:

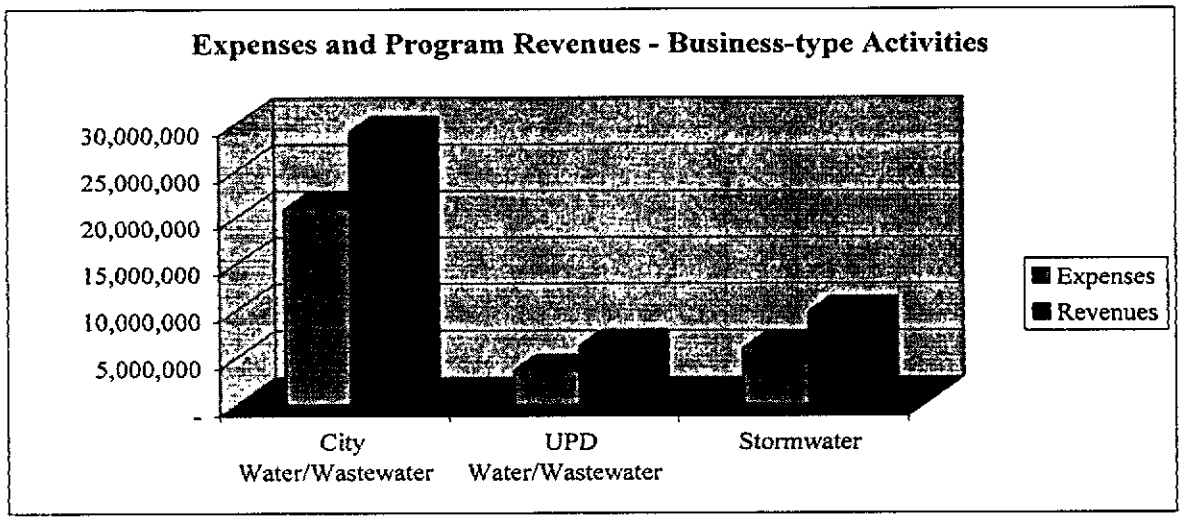
- Capital contributions were a major revenue source for the utilities again this year, producing over $13.3 million in revenue. Capital assets totaling $9.3 million were contributed to the utilities, consisting of $4.6 million in assets to the City water/wastewater utility, $2.9 million to the Redmond Ridge Urban Planned Development (UPD) and $1.8 million to the stormwater utility. The remaining $4 million is attributable to connection fees and capital facility charges.

- Water/wastewater operating revenues for 2006 were $21,085,081, a 2% increase over 2005. This increase was due to growth and increased water consumption of 8%.

- UPD water/wastewater operating revenues for 2006 were $3,363,008, an 11.6% decline from 2005. While water sales increased 17% due to growth in the UPD development, regional capital facility charges and depreciation reserve surcharge fees declined due to a delay in new construction at Redmond Ridge East.

- Stormwater operating revenues for 2006 were $7,465,968, a 4% increase over 2005 due to a 1% growth in stormwater service, a $90,571 increase in engineering fees, and $122,242 from King County for assuming the West Lake Sammamish Flood Control Zone District.

- Investment earnings for the business-type activities increased $512,697, a 65% increase over 2005 due to higher interest rates.



Financial Analysis of the Government's Funds

As discussed earlier, the City of Redmond uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds

The purpose of the City's governmental funds is to report on near term revenues/financial resources and expenditures. This information helps determine the City's financial requirements in the near future. In particular, fund balance is a good indicator of the City's resources available at the end of the year.

At the end of the current year the City's combined ending governmental fund balance was $74,545,242. This was an increase of $11,097,074 or 17.5% from the ending fund balance of the prior year. Of the $74,545,242, a total of $1,550,360 is reserved for debt service, $39,687,938 is earmarked for capital construction projects and $24,248,424 resides with special revenue funds. Significant special revenue fund balances include $5,073,832 in the operating reserve fund, including general reserves and development reserves, $4,058,243 in equipment reserve funds, $8,554,095 in the real estate excise tax fund, and $1,070,634 in the business license surcharge fund for future transportation projects. Special revenue fund balances are either legally restricted or reserved by City policy for particular purposes.

The general fund is the primary operating fund of the City through which all receipts and payments of ordinary City operations are processed, unless they are required to be accounted for in another fund. Taxes are the major revenue source. At the end of 2006 the fund balance of the general fund was $9,058,520. As a measure of the fund's liquidity, the ending fund balance is 17% of the fund's 2006 expenditures. This meets the City's goal to have a balance sufficient to cover daily financial needs without carrying an excessive balance forward at year end.

The general fund balance increased $2,853,496 from the prior year. Revenues rose faster than expenditures from 2005 to 2006, increasing 13.2% and 9.1% respectively. Expenditure increases were small in 2006 in part due to unsettled union contracts. The Police and Fire contracts expired at the end of 2004 and the City continues negotiations with the two unions. Revenues exceeded expenditures in the general fund by $8,750,776 in 2006. In keeping with the City's policy to fund capital projects on a pay as you go basis, net transfers out of the general fund totaled $5,899,080, primarily for capital activities.

Taxes are the primary source of revenue in the General Fund, at 67% of the fund's 2006 revenues. Sales tax revenues, the City's largest single revenue source, increased $1,387,555 from 2005 to 2006 or 8%, up from an increase of 5.5% in 2005. After five years of slow growth sales tax collections in 2006 finally rose above collections for 2000.

Changes of note occurred in several other General Fund revenues. License and permit revenue was up

significantly, increasing by $2,090,476 over 2005 with building permit revenue leading the way at $1,800,000, primarily for commercial, electrical and heating building permits. An increase in the gas and electric rates by Puget Sound Energy brought in an additional $1,000,000 in utility taxes in 2006.

Prudent management dictates that the City closely monitor expenditures to not exceed revenues and that the impact of any service adjustments be fully evaluated in light of community and organizational goals. The City's largest General Fund expenditure category, at 52% of total expenditures, is security encompassing Police and Fire services. Expenditures in this category were up only 5.7%. Police vacancies filled during 2005 were included as expenditures for a full year in 2006, increasing personnel costs for the department. The Police Department also experienced a $330,000 increase in jail costs and invested in additional security equipment. A new fire station was opened in 2006, resulting in purchases of equipment and office furniture. The Police and Fire union contracts remained unsettled in 2006, leaving salaries for these two groups at their 2004 rates during all of 2005 and 2006. Funds will be set aside to cover cost increases resulting from future settlement of these contracts. General government expenditures increased 15.8% at $1,567,547 as legal costs jumped $570,000, election costs were up $178,000 and general personnel costs rose.

The Advanced Life Support (ALS) Fund's purpose is to account for the cost of providing advanced life support services to several eastside cities and areas of East King County. These services are funded by an Emergency Medical Services property tax levy collected by King County. As Redmond incurs the costs of providing these services, King County is billed for the services by Redmond. Therefore revenues and expenditures in this fund are relatively equal each year with little or no year ending fund balance. Expenditures for ALS services were approximately $880,200 higher than in 2005 due to an increase in service capacity.

The Capital Improvements Program Fund ending fund balance was $39,423,426, an increase of $6,176,732 from 2005. Several factors contributed to this increase as compared to 2005. Revenues and transfers in were up close to $5.5 million while expenditures and transfers out were down approximately $600,000. The City requires developers to directly contribute to some transportation capital projects if the developers will benefit from the project or their development will greatly impact the City's transportation system. Contributions from developers rose $3.2 million in 2006. Capital construction project expenditures were about the same in 2005 with several major road projects in the engineering or construction phase in 2006. Investment income was up $611,763 from 2005 due to increasing interest rates and cash available to invest.

Proprietary funds

The City of Redmond's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. Factors concerning the finances of the City's proprietary funds have already been addressed in the discussion of the City's business-type activities.

General Fund Budgetary Highlights

The City of Redmond budgets on a biennial basis with each budget beginning in an odd numbered year by state law. The difference between the 2005/2006 biennial budget adopted at the end of 2004 and the final 2005/2006 biennial budget at December 31, 2006 amounts to $3,818,943.

Revenues increased in the following categories:

- Beginning fund balance increased $1,091,507 due to a higher than anticipated ending fund balance at December 31, 2004.
- Taxes $1,933,960
- Contributions $8,900
- Intergovernmental revenue $720,272
- Charges for services $6,047
- Miscellaneous $58,257

Expenditure increases in the following areas were funded by the $1,091,507 increase in beginning fund balances:

- Planning Department technology project expenditures increased $7,015 as a result of unspent technology surcharge funds from the previous biennium. Printing costs of $11,100 for the 5 year comprehensive plan and a specialized training program for the development review team at $30,000 round out the expenditure increases funded in the Planning Department.

- Public Works was allotted $8,850 in additional funding for transportation consulting services.

- The Fire Department received an additional $23,928 for rescue equipment, and $500,000 for firefighter overtime.

- A Parks bond study was funded at $78,000 and $261,467 was set aside as a salary and benefit contingency for future contract settlements.

- $171,147 was transferred to the Capital Improvement Program Fund for City Hall furniture purchases.

The $1,933,960 increase in taxes funded Fire Department overtime, salary and benefit contingencies for unsettled union contracts, and increased transfers to the Workman's Compensation Fund.

The $8,900 increase in contributions was budgeted for additional Public Works Department consultant services, police personnel costs, and Planning Department neighborhood meetings.

The $720,272 increase in intergovernmental revenue consisted of grants to fund a neighborhood master plan, police personnel costs for a DUI task force, forensics equipment, Hurricane Katrina fire personnel, emergency preparedness, $359,904 from Fire District 34 for overtime costs, and $174,862 to recognize fire insurance premium tax in the General Fund.

Increases in miscellaneous revenue of $58,257 and $6,047 in charges for services funded traffic flagging for developers and street light replacement and repair covered by private insurance.

Capital Asset and Debt Administration

Capital Assets

The City of Redmond's investment in capital assets for its governmental and business-type activities as of December 31, 2006 amounts to $443,689,230 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, art, construction in progress, utility transmission/distribution systems, roads, and bridges.

- General government capital investment street projects were completed at a cost of $6.2 million.

- General government capital investment projects currently under construction are valued at $14,526,409. These include road work at Redmond Way and Highway 202, extension of Bear Creek Parkway, and transportation projects in the Overlake area.

- Capital assets totaling $4.5 million were contributed to the City water/wastewater utility including the Lakeshore Estates Sewer Pump Station valued at $1,030,349.

- Quadrant Corporation contributed capital assets valued at $2.9 million to the UPD water/wastewater utility including Sewer Pump Station #55 valued at $1,012,832.

- The stormwater utility received capital assets totaling $1.8 million including the West Lake Sammamish Flood Control Zone District assets from King County valued at $227,678.

Major capital assets changes during 2006 included the following:

- 116th Street improvements were completed at a cost of $1.97 million.

- King County donated 1.16 acres of land on the Sammamish River to Redmond for open space valued at $1.8 million.

- Park land was purchased for the Bear Creek/Avondale trail and adjacent to Perrigo Park at a cost of $900,000.

- Hartman Park soccer fields were completed at a cost of $1.3 million.

- Several large play structures were installed at Grass Lawn Park.

- Renovation of water well 5 was completed for a cost of $4.7 million and will begin operation in early 2007.

- Land was purchased for $853,787 for the relocation of wells 1 and 2 and their related treatment facilities with construction scheduled to begin in the fall of 2007. Construction of well 3 is scheduled to begin in spring of 2007. Total cost to date for the design and new land for wells 1, 2, and 3 is $3.9 million.

- The Willows Stream daylighting project was completed, creating 680 feet of new open channel and abandoning the existing pipe for a cost of $800,139.
- Peters Creek culvert was replaced with a large box culvert under the street with upstream and downstream channel improvements for a total cost of $406,542.

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

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land	$ 49,591,117	$ 45,546,424	$ 6,757,847	$ 4,995,515	$ 56,348,964	$ 50,541,939
Buildings/Building Improvements	54,222,366	55,154,820	17,774,019	13,711,591	71,996,385	68,866,411
Improvements other than buildings	17,143,163	16,333,702	155,454,420	140,555,367	172,597,583	156,889,069
Machinery and equipment	10,558,400	9,366,836	339,077	382,403	10,897,477	9,749,239
Construction in progress	14,526,408	14,379,147	8,639,579	12,440,525	23,165,987	26,819,672
Infrastructure	108,384,728	104,037,239	-	-	108,384,728	104,037,239
Art	298,106	295,624	-	-	298,106	295,624
Total	$ 254,724,288	$ 245,113,792	$ 188,964,942	$ 172,085,401	$ 443,689,230	$ 417,199,193

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 the current fiscal year, the City of Redmond had total bonded debt outstanding of $43,284,603. Of this amount, $42,504,603 is general obligation bonds, and $780,000 is special assessment debt with governmental commitment. The Business-Type Activities had no bonded debt outstanding at the end of the current fiscal year.

City of Redmond's Outstanding Debt - General Obligation Bonds

	Governmental Activities		Total	
	2006	2005	2006	2005
General obligation bonds	$ 42,504,603	$ 43,454,879	$ 42,504,603	$ 43,454,879
Special assessment debt with governmental commitment	780,000	1,045,000	780,000	1,045,000
Total	$ 43,284,603	$ 44,499,879	$ 43,284,603	$ 44,499,879

The City of Redmond maintains a AA rating from Standard & Poors and a AA2 rating from Moody's for general obligation debt. Special assessment bonds are unrated.

Washington State statutes limit the amount of general obligation debt a governmental entity may issue to 7.5% of its total assessed valuation, subject to a 60% majority vote of qualified electors. Of the 7.5% limit, 2.5% is for general purposes, 2.5% for open space/park facilities, and

2.5% for utilities. Non-voted (limited tax) general obligation indebtedness is limited to 1.5% of assessed valuation. The combination of unlimited tax and limited tax general obligation debt for all purposes cannot exceed 7.5% of assessed valuation. The City's assessed valuation for 2006 was $10,310,923,556 and remaining debt capacity is as follows:

General	$ 215,514,233
Open Space/Park Facilities	257,773,088
Utilities	257,773,088
TOTAL	$ 731,060,409

The total amount of unlimited tax and limited tax general obligation debt the City may issue is $773,319,264. Additional information on the City of Redmond's long-term debt can be found in Note 13 of this report and in the Statistical Section of the report.

Economic Factors and Next Year's Budgets and Rates

Several factors that affect the economic climate in Redmond were considered when preparing the City's 2007-2008 biennial budget. The outlook for the nation, state and region was weighed in relation to its expected impact on Redmond. The character of the City, including its current and future business activity and its attraction as a place to live, was evaluated. Current financial position and the ability and desire of the City to enhance revenues were also given consideration. Particular attention was paid to labor and medical inflation rates as 70% of the City's budget is personnel costs. Based on this review, Redmond's economic outlook is promising with strong regional and local economies. The City's challenge lies in allocating its revenues wisely among competing current operational and long term capital needs.

Commercial and residential development is very strong in Redmond. Condominium residences are rising in the downtown area and the city's largest employer, Microsoft Corporation, has recently announced that it would accelerate its expansion plans in Redmond. Growth that was expected to take place over a twenty-year period is now planned within the next three years. This has prompted the City to increase staff to handle the development review activities associated with over 7 million square feet of Microsoft office and garage space. The City will be cautious in budgeting for increases in ongoing services due to this expansion, as the primary increase in revenue to be received is limited to property tax under the City and state's current tax system.

Redmond Town Center, a large open air mall, continues to thrive with its hotels, shopping, and entertainment options as do retail centers that house stores such as Home Depot, Target and Fred Meyer. Overall job growth in Redmond is 3% to 4% per year, which adds between 3,000 and 4,000 jobs per year. Population growth is expected to continue at about 1,000 new residents per year.

Redmond as a place to live has many attractions with parks and open spaces, beautiful landscape, and proximity to employment centers. Evidence of the City's attraction can be seen in residential development which has remained strong through 2006 and is continuing into 2007.

Redmond has a history of excellent financial management and prudent fiscal policies. To that end the City reviews its rates and fees on an annual or biennial basis depending on the rate. Business license fees were increased in 2005 and 2007 for inflation. Water/wastewater and stormwater rates are reviewed annually to ensure the City's utilities will remain financially healthy. City water rates will increase 12% for 2007 and 6% for 2008. City wastewater rates will increase 19% in 2007 and 6% in 2008, and the King County wastewater treatment rates passed through to City customers will go up 9.2% in 2007. Stormwater rates will increase 44% in 2007. UPD water rates will increase in 2007 due to a change in the tier structure. The rate increase will average 9.6%. There were no utility rate increases in 2006.

Adherence to prudent financial management practices and policies has served the City well and set the stage for a community that will thrive for many years to come.

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.