

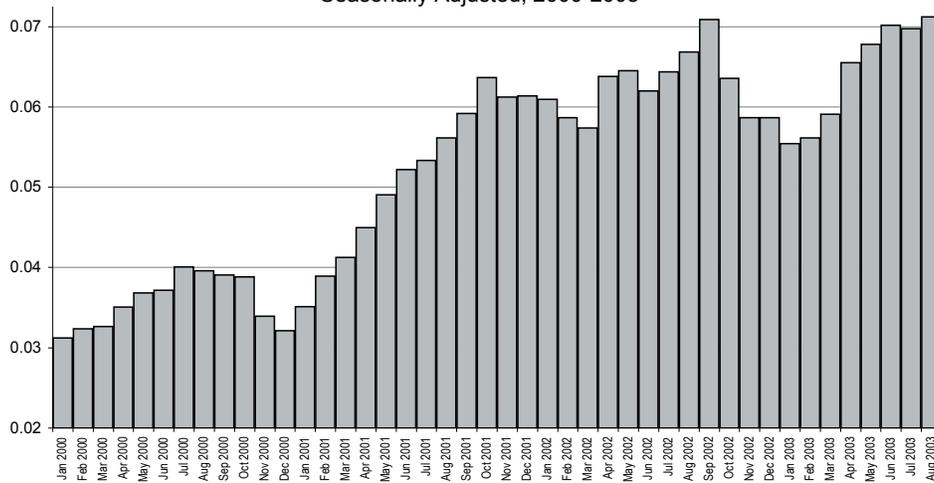
INTRODUCTION

The duration of King County’s economic slowdown now rivals the four years of rapid growth in the late 1990s. Since mid-2000, local economic conditions have deteriorated, punctuated by energy price volatility, the September 11, 2001 terrorist attacks, accounting scandals and the collapse in equity market valuations, and the buildup and aftermath of war in Afghanistan and Iraq. Economic recovery remains elusive. Seasonally adjusted unemployment has reached a 21-year high. The unemployment statistics omit the thousands of workers who have dropped out of the labor market altogether; nearly 54,000 jobs have been lost since 2000.

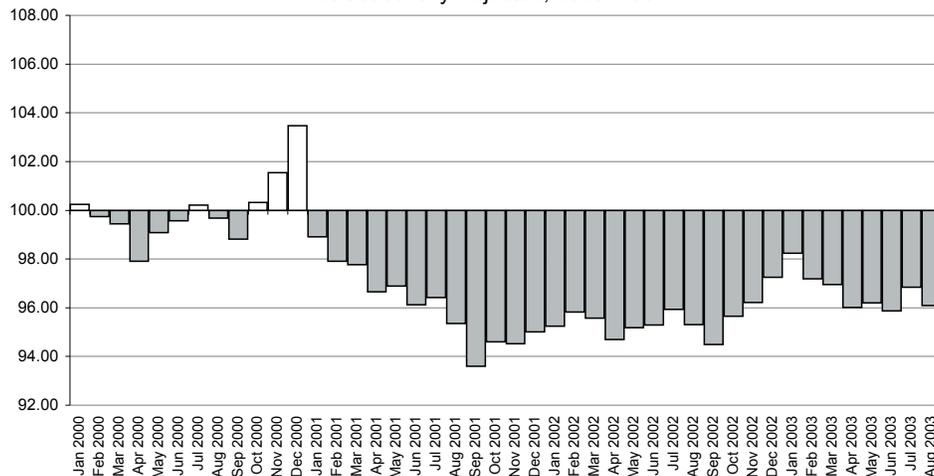
Local business activity has been erratic in the absence of an expanding national market. For nearly two years forecasters have anticipated an imminent recovery in the national economy; instead conditions have stagnated. A stream of mixed news has characterized an economy that has seemed to take two steps back for every step forward. While compelling statistical evidence of a clear turnaround has yet to materialize, there are some signs of shallow improvement.

For 2004, the King County Budget Office anticipates a modest economic recovery. This forecast, developed by surveying local economists, published state and national forecasts, and county econometric models, is the basis for 2004 revenue and expenditure projections. Initial estimates of 2005 and 2006 revenues and expenditures are also prepared from this forecast for the out-year current expense subfund financial plan.

King County Unemployment Rate
Seasonally Adjusted, 2000-2003

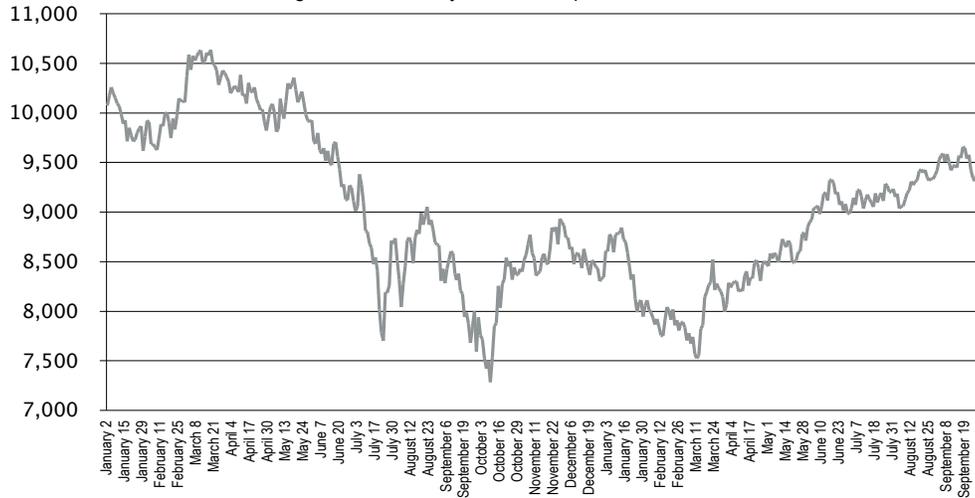


King County Total Employment
Not Seasonally Adjusted, 2000=100



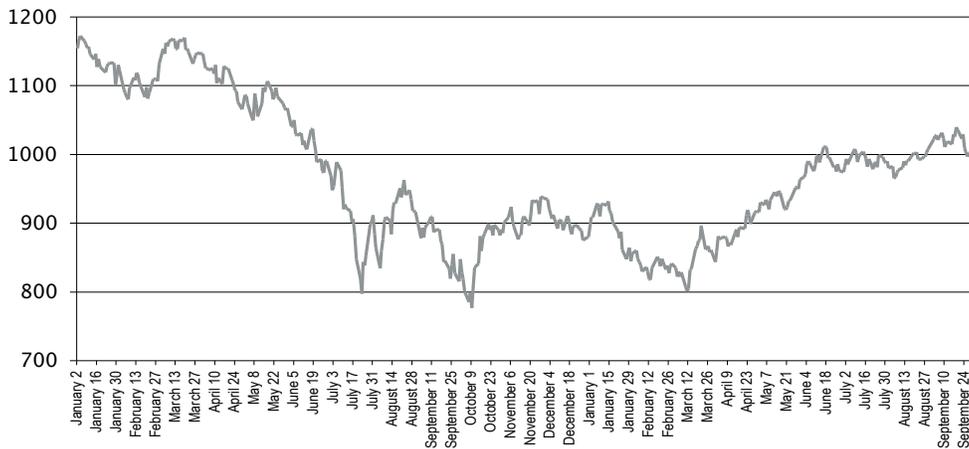
Dow Jones Industrial Average

Closing Values, January 1, 2002 - September 30, 2003



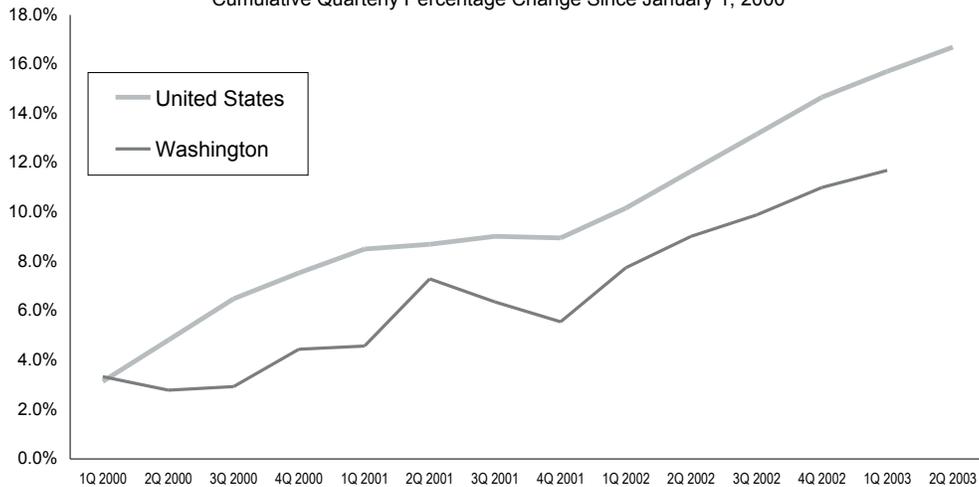
Standard and Poor's 500 Index

Closing Values, January 1, 2002 - July 31, 2003



Nominal Personal Income Growth

Cumulative Quarterly Percentage Change Since January 1, 2000



REVIEW OF ECONOMIC CONDITIONS

Statistically the national recession ended in November, 2001, but the jobless recovery that has followed has generally seen more dislocation than the actual recession. Unemployment has risen 0.7 percent since the end of 2001,¹ while real median household income fell 1.1 percent in 2002.²

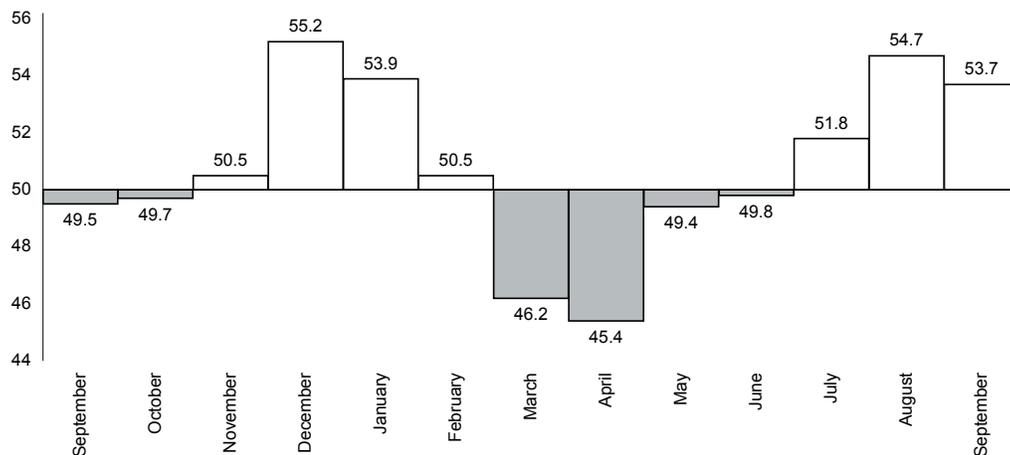
Locally, there are many reminders of the September 11th terrorist attacks. Total passenger traffic at Seattle-Tacoma International Airport for the first eight months of 2003 was 6.6 percent below 2001 levels.³ Hotel occupancy rate have fallen further -- Seattle hotels recorded a 64 percent vacancy through August, despite renewed discounting and additional rate reductions.⁴

For the first time in two decades, Washington state has experienced a drop in real income, despite low inflation. In both 2001 and 2002, Real Per Capita Personal Income declined, for a cumulative change of negative 1.9 percent, while the most recent data indicate that Real Per Capita Gross State Product fell 1.6 percent in 2001.⁵ Bankruptcy filings in Western Washington are up 35.7 percent since the start of 2000.⁶

Although the entire state has suffered during the downturn, it is increasingly apparent that only King County remains mired in recession. In the last twelve months total unemployment in King County is up 4.3 percent; in the rest of the state it is down 3.8 percent.⁷

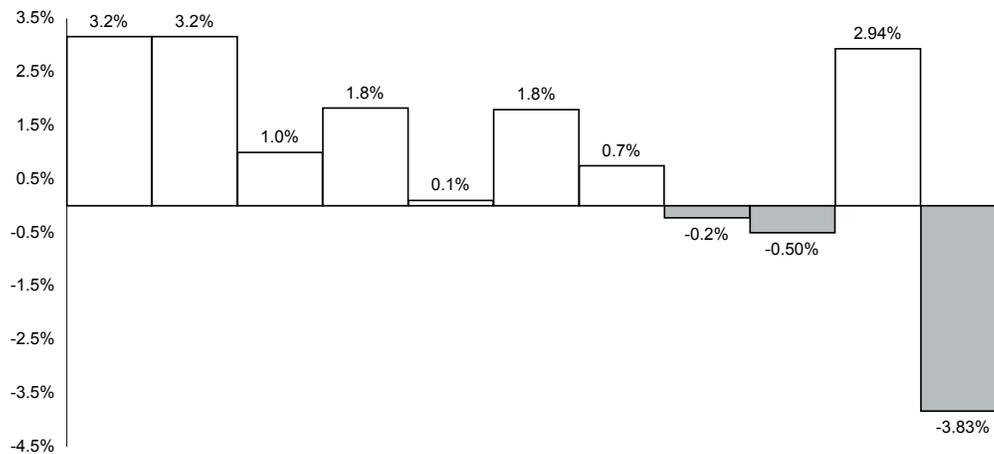
US Manufacturing Activity Index

PMI Monthly Data since August 2002; Scores Below 50 Indicate Contraction



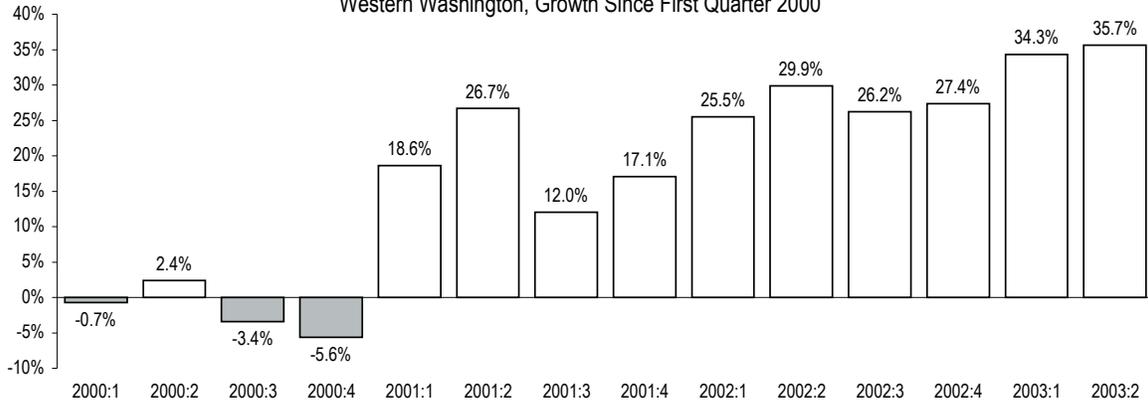
US Private Residential Construction

Quarterly Change, Completed Units



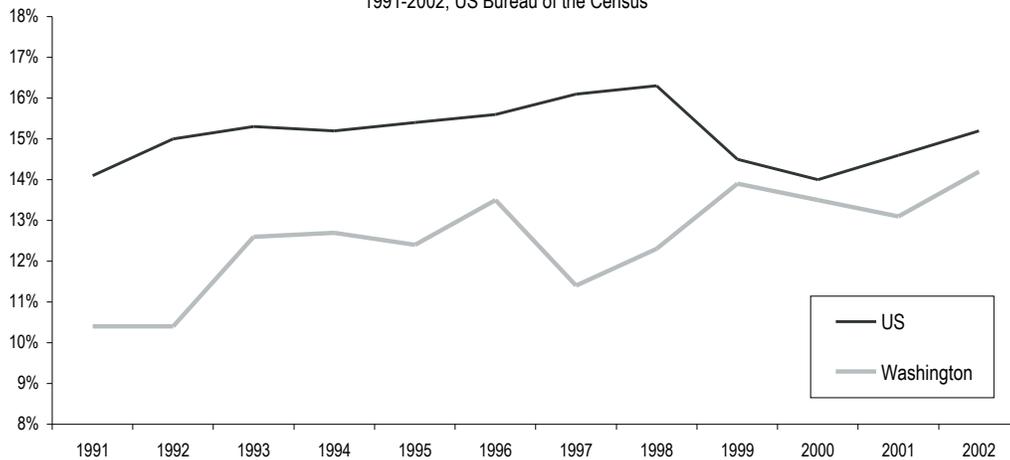
Quarterly Bankruptcy Filings: Cumulative Percentage Change

Western Washington, Growth Since First Quarter 2000



Percentage of Population without Health Insurance

1991-2002, US Bureau of the Census



The region has been hit the hardest in manufacturing, where employment is down 11.7 percent in the last year. The decline is not explained by aerospace employment, which is unchanged after falling 14.2 percent last year. Finance, insurance, and real estate, a source of growth at the state and national levels, is largely unchanged. The service sector experienced 1.1 percent growth, fueled largely by strong growth in health care.

Although health care employment has been strong, there are signs of problems ahead. Medical cost inflation, after abating in the mid-1990s, has returned to the growth rates of the late 1980s and early 1990s. Meanwhile the proportion of the population without health insurance has reached an all-time high in Washington state. The market for the direct purchase of insurance, which a decade ago covered 15 percent of Washington residents, now only serves 10.6 percent of the population.⁸ Insurance is increasingly limited to employees of large companies and Medicare and Medicaid recipients.

One of the few bright spots has been residential real estate. Sales in August are at near record levels, and prices have continued to appreciate in spite of economic conditions. The market has been strong even with a boom in residential construction activity, driven mainly by unprecedented low mortgage rates and, to a lesser extent, the complete collapse in commercial construction activity.

The local market for commercial real estate remains bleak. The commercial office space vacancy rate for Seattle has increased from 14.6 percent to 16.2 percent in the last year. Across the county, over twelve million square feet of office space is vacant.⁹ With completion of projects initiated before the recession, commercial construction has largely stopped, with little development activity expected until the end of next year.

Summary Economic Forecast

Percentage Change from Preceding Year

	2001	2002	2003	2004	2005	2006
King County						
Employment	-3.9%	-0.6%	0.0%	1.6%	2.9%	2.4%
Nominal Personal Income	1.7%	1.5%	2.0%	4.3%	5.1%	5.5%
Housing Permits	-18.7%	-4.0%	2.2%	-3.9%	-1.4%	0.5%
Population	1.1%	1.0%	0.3%	0.5%	0.9%	0.9%
Consumer Price Index *	3.7%	1.9%	2.0%	2.1%	2.3%	2.3%
Washington State						
Employment	-2.9%	1.7%	0.6%	1.6%	2.2%	2.0%
Nominal Personal Income	2.6%	3.4%	3.5%	4.4%	4.9%	5.6%
Housing Permits	-1.7%	4.8%	4.0%	-3.8%	-3.0%	-1.1%
United States						
Employment	0.2%	-1.1%	-0.2%	1.4%	2.0%	1.9%
Nominal Personal Income	3.3%	2.7%	3.3%	4.9%	5.3%	5.9%
Housing Starts	2.0%	6.5%	0.0%	-3.8%	-0.9%	-0.8%
Three-month Treasury Yield	-22.0%	-47.1%	-11.3%	4.6%	53.5%	53.5%
Consumer Price Index	2.8%	1.6%	2.2%	2.1%	2.2%	2.3%
Real GDP	0.3%	2.4%	2.1%	3.0%	3.3%	3.3%

* Puget Sound Region

ECONOMIC FORECAST

As a measure of aggregate output, Gross Domestic Product is one of the best indicators of economic performance. But as an accounting device, GDP estimates can be distorted in the short-term. In the first quarter of 2002, GDP growth was artificially inflated by extremely low inventories. In the second quarter of 2003, GDP has surged again, this time boosted by the highest defense spending levels since the Vietnam War. In each case, growth has not been sustainable.

A more persistent pattern of growth is anticipated in 2004. Business investments should offset slackening consumer demand to yield modest growth. Although it will take some time to return to 1998-2000 levels, or to even see a meaningful drop in the unemployment rate, employment growth should accelerate in the second half of the year. Residential real estate and construction will fall off after being artificially boosted by low interest rates.

The Federal Reserve Board of Governors have now reduced the federal funds rate a total of 500 basis points since January 2001. The forecast anticipates no increase in 2004, before a gradual build-up in interest rates occurs in response to increased economic activity over the course of 2005.

For the first time in four years, total regional employment is expected to rise in 2004. Although unemployment will remain high for the foreseeable future, personal income should rebound, but far short of the levels attained in the late 1990s. The engine of personal income growth in the technology boom was the

ECONOMIC AND REVENUE FORECAST

stock option. The 11 percent year-to-date increase in the Dow Industrial Average through the end of third quarter will help, but many options issued at the end of the technology boom are at prices unlikely to be approached by the market in the foreseeable future.

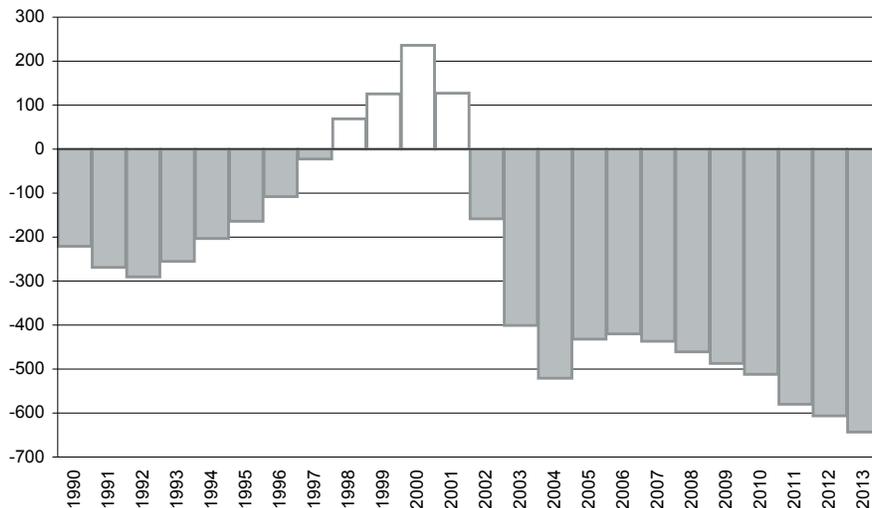
In the short term, a rebound in equity valuations will undoubtedly supply personal income growth both this year and next, but compensation changes, most notably by Microsoft, will significantly reduce the variability – and positive upside – of employee stock ownership. Given the likely spread of this policy across the industry, this forecast assumes only a limited boost to personal income levels from option and bonus income in the future.

After rising by over 3.6 percent in both 2000 and 2001, the Seattle area consumer price index stabilized at 1.9 percent in 2002, and is unlikely to significantly exceed two percent in the coming years. Low inflation in 2003 has occurred in spite of volatile energy costs, which remain as a potential threat to overall price stability. Indeed, lagging growth has maintained a small degree of deflationary risk.

While not yet affecting the economic forecast, the startling rise in the federal budget deficit, and deteriorating outlook for the coming decade could undermine long-term interest rates.

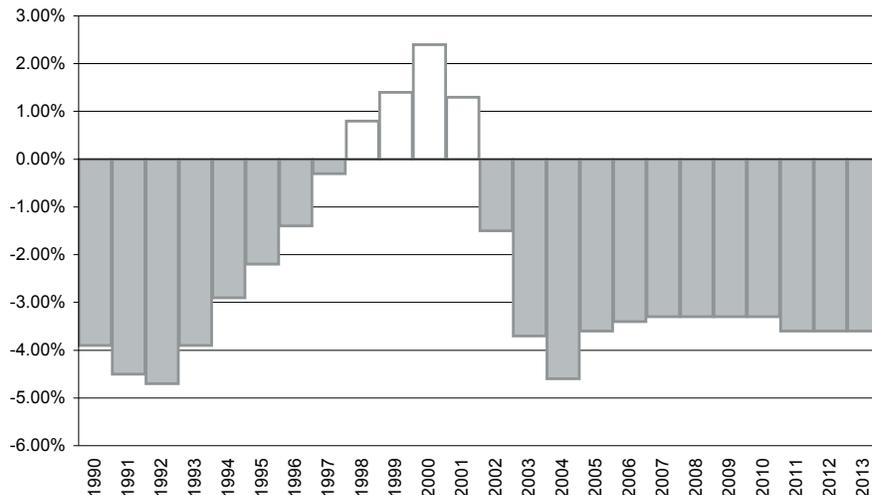
Nominal Federal Budget Deficit

Federal Fiscal Years, 1990-2002 Actuals, 2003-2013 Center on Budget and Policy Priorities Projection



Federal Budget Deficit as a Percentage of GDP

Federal Fiscal Years, 1990-2002 Actuals, 2003-2013 Center on Budget and Policy Priorities Projection
Gross Domestic Product forecast by Congressional Budget Office



ECONOMIC AND REVENUE FORECAST

KING COUNTY REVENUES

Total revenue into the county exceeds \$2 billion dollars,¹⁰ which King County distributes into over 50 separate funds. The largest funds include those for transit, wastewater, surface water management, roads, and the county general fund. The largest revenue source is taxes, followed by charges for services; together they account for over half of all revenues. Taxes include three major property tax levies, three different sales tax assessments, and taxes on real estate transactions. Charges for services include both direct contracts, interfund payments, and other services provided by the county.

All King County Funds
Major Revenue Sources, 1998-2004

	1998 Adopted	1999 Adopted	2000 Adopted	2001 Adopted	2002 Adopted	2003 Adopted	2004 Proposed
TAXES	717,567,775	765,481,815	719,275,061	715,108,733	746,850,357	768,926,884	803,289,418
LICENSES & PERMITS	16,064,790	16,040,636	18,022,369	18,066,214	18,472,802	20,692,723	24,570,022
INTERGOVERNMENTAL REVENUE	28,640,718	26,756,947	26,756,947	26,756,947	35,829,205	-	-
FEDERAL GRANTS-DIRECT	24,137,304	26,852,073	28,650,976	30,207,497	32,359,967	36,380,703	36,012,144
FEDERAL SHARED REVENUES	721,204	732,617	678,590	688,182	699,091	1,069,761	1,080,642
FEDERAL GRANTS-INDIRECT	46,529,744	47,740,164	44,605,870	62,580,257	65,173,089	87,214,090	91,976,906
STATE GRANTS	81,134,564	81,737,617	99,941,683	103,615,392	100,044,636	122,000,403	131,252,575
STATE SHARED REVENUES	151,721	177,911	176,000	1,301,000	1,045,016	-	14,687
STATE ENTITLEMENTS	29,530,487	26,326,768	46,590,108	53,726,160	30,125,795	30,932,093	35,673,353
GRANTS FROM LOCAL UNITS	150,175	300,732	1,448,525	1,435,851	4,087,240	1,786,320	797,178
INTERGOVERNMENTAL PAYMENT	104,876,440	118,425,668	123,027,845	135,928,603	124,894,603	117,013,776	136,783,110
CHARGES FOR SERVICES	543,716,432	599,020,549	661,206,645	741,870,293	811,142,004	816,623,983	806,071,081
FINES & FORFEITS	6,300,462	6,493,323	7,069,093	7,232,871	7,537,213	7,803,918	9,119,402
STADIUM OPERATING REVENUES	9,744,434	6,853,074	221,000	-	-	-	-
OTHER	1,076,293,410	1,045,807,767	814,292,570	844,656,259	983,258,002	1,002,896,364	1,023,072,177
ALL FUNDS TOTAL	2,685,559,660	2,769,718,509	2,591,963,282	2,744,603,933	2,964,476,448	3,125,459,912	3,223,028,404

King County Current Expense Subfund
Major Revenue Sources, 1998-2004

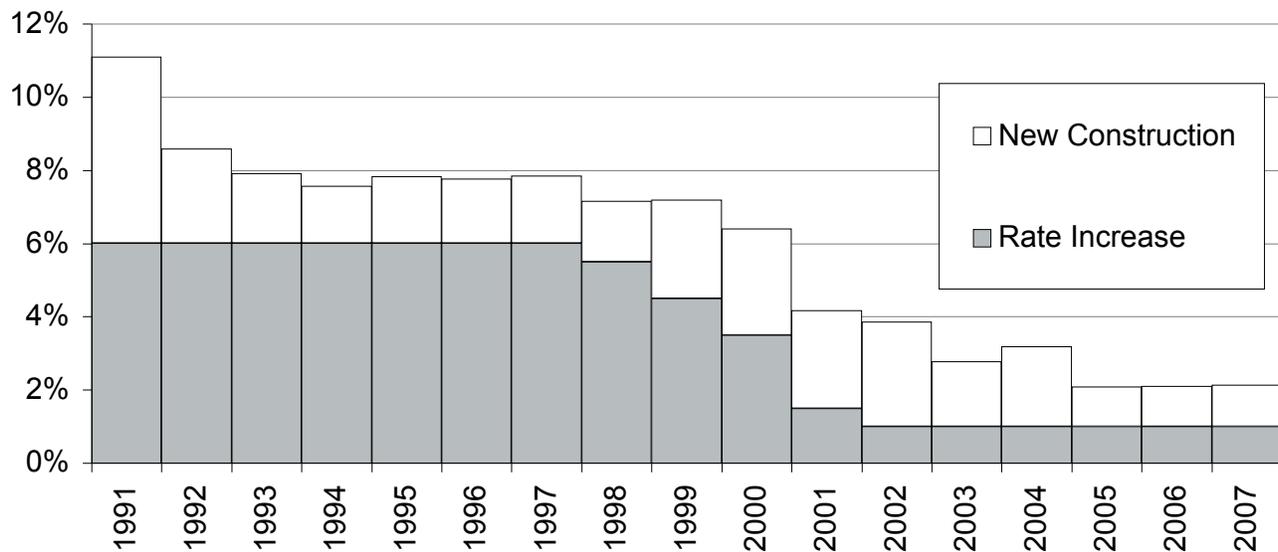
	1998 Adopted	1999 Adopted	2000 Adopted	2001 Adopted	2002 Adopted	2003 Adopted	2004 Proposed
TAXES	243,205,844	252,491,551	269,023,158	286,051,603	297,677,856	301,795,404	312,363,482
LICENSES & PERMITS	5,159,300	4,858,255	4,886,200	5,140,510	5,694,121	5,661,661	6,059,253
FEDERAL GRANTS-DIRECT	567,654	1,105,599	1,879,779	1,897,000	954,000	2,361,514	1,959,555
FEDERAL SHARED REVENUES	38,000	39,140	39,140	39,140	40,314	50,000	60,000
FEDERAL GRANTS-INDIRECT	4,293,999	4,657,898	4,328,755	5,900,152	4,817,776	6,546,708	6,734,208
STATE GRANTS	1,624,236	1,548,526	1,637,478	1,535,680	1,712,365	1,863,402	2,653,350
STATE SHARED REVENUES	141,000	167,030	176,000	176,000	181,280	-	-
STATE ENTITLEMENTS	1,317,000	1,257,917	1,297,505	1,554,125	1,383,967	1,424,505	1,407,505
GRANTS FROM LOCAL UNITS	70,728	20,320	14,000	14,000	2,614,420	-	-
INTERGOVERNMENTAL PAYMENT	46,388,515	49,080,342	52,656,427	55,772,028	56,733,723	52,269,056	52,578,158
CHARGES FOR SERVICES	57,621,784	70,993,265	76,991,057	80,258,079	82,639,182	89,547,761	83,989,918
FINES & FORFEITS	6,223,771	6,420,929	6,810,093	7,164,871	7,524,713	7,780,918	9,079,402
OTHER	33,800,723	24,250,729	25,658,174	25,082,650	19,903,635	18,503,578	21,053,596
CURRENT EXPENSE TOTAL	400,452,554	416,891,501	445,397,766	470,585,838	481,877,352	487,804,507	497,938,427

NOTE: Zero values for Intergovernmental and State Shared Revenues caused by phase-out of Title XIX and Motor Vehicle Excise Tax backfill funds, respectively.

Taxes are the largest source of revenues to King County, accounting for 24.9 percent of total revenues and 62.7 percent of current expense subfund revenue. The major tax sources for the county include property taxes, sales and use taxes, hotel and motel taxes, and telephone excise taxes to support the enhanced-911 system. Total King County tax revenue is projected to be \$803.3 million in 2004, an increase of 4.4 percent over the adopted 2003 budget. These revenues support operating expenses, debt service, and some capital projects. Property taxes are the largest single tax source for the county, with a proposed levy of approximately \$370.9 million in 2004, including \$53.8 million collected for Emergency Medical Services, \$18.7 million of which is disbursed directly to the city of Seattle.

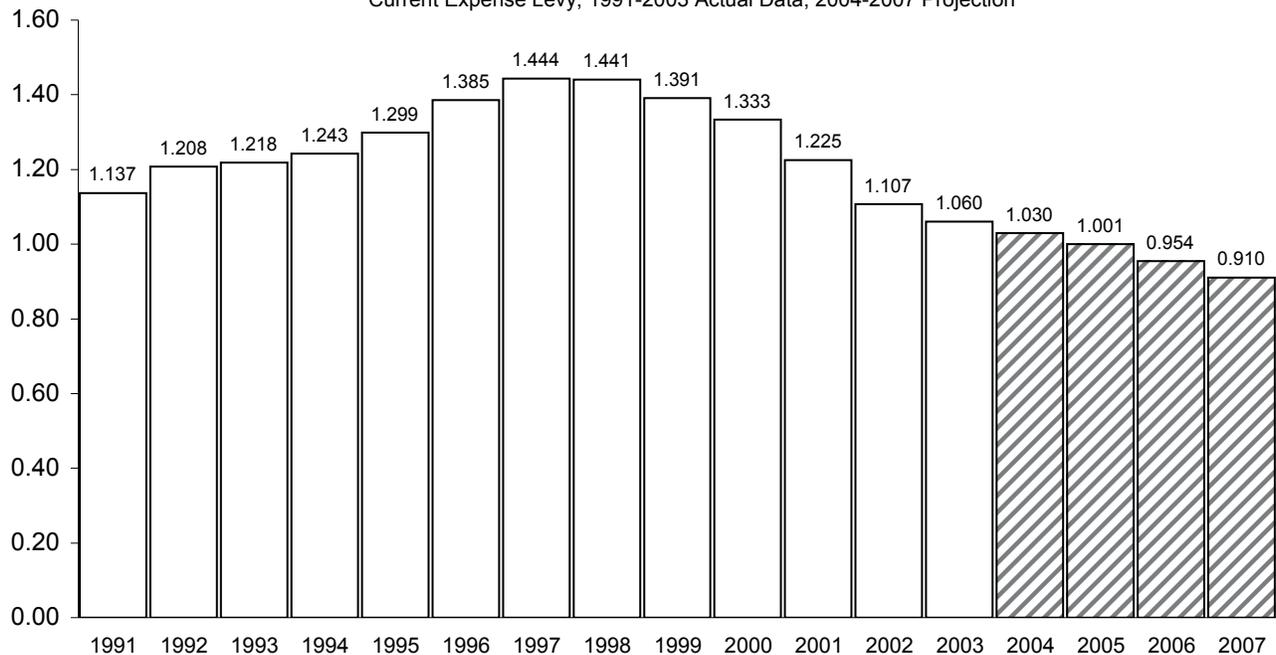
Property Tax Revenue Growth Components

Current Expense Fund Levy, 1991-2002 Actual Data, 2003-2007 Projection



Property Tax Rate per \$1,000 of Assessed Valuation

Current Expense Levy, 1991-2003 Actual Data, 2004-2007 Projection



PROPERTY TAX

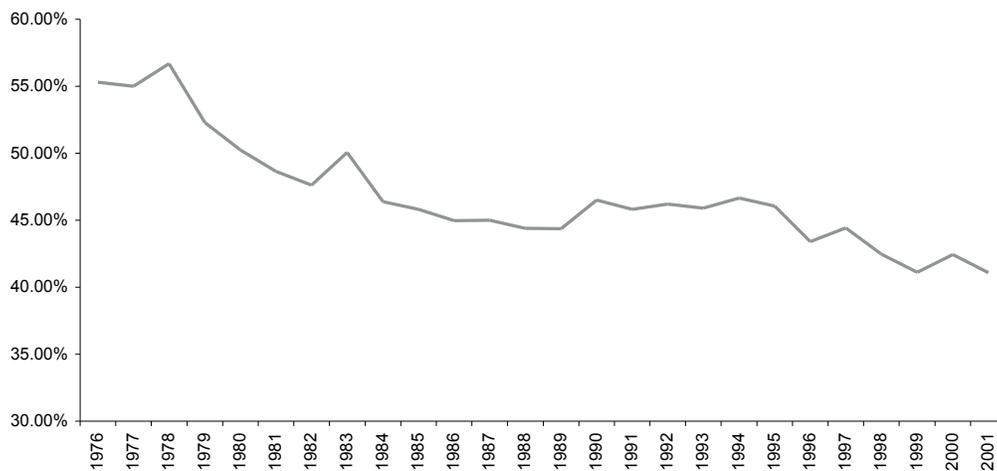
Property taxes are collected through the countywide levy, the unincorporated area levy, the Emergency Medical Services levy, and voter approved debt. These monies are dedicated to various funds within King County.

Property taxes are limited by both county policy and state law. Under Initiative 747, approved by Washington voters in 2001 (but rejected by a majority of King County voters), the regular levy can grow at only one percent annually, plus the increase in new construction. With inflation typically running two or three percent, this measure is gradually decreasing the effective tax paid by typical property owners, and reducing the dollars available for the current expense fund.

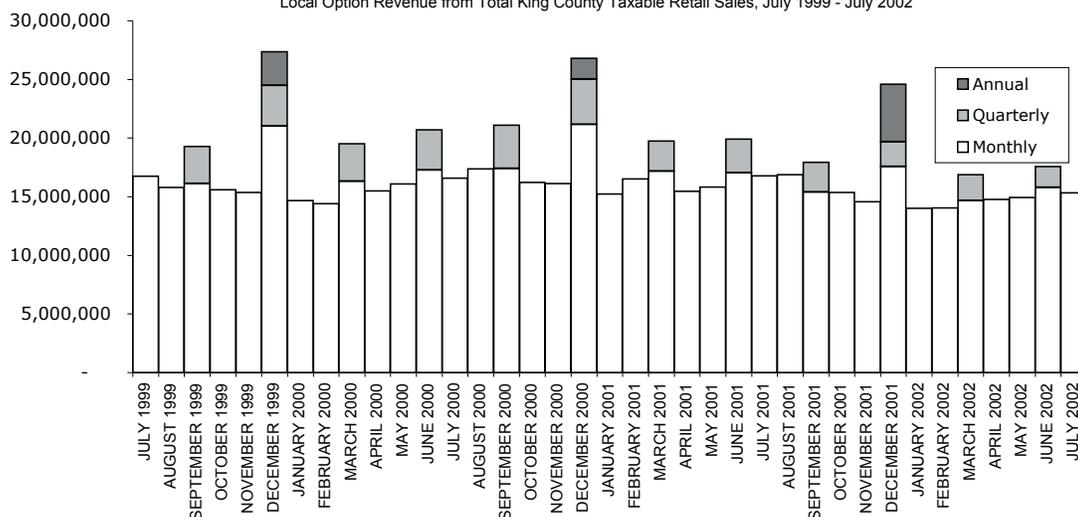
The countywide levy¹¹ is projected to grow by roughly 3.2 percent in 2004, with new construction accounting for 2.2 percent of the increase. The overall countywide levy is projected to increase from \$258.0 million to \$278.5 million in 2004 (\$11.8 million of the increase is accounted for by the new Metropolitan Parks Levy, approved by county voters in May). The amount remaining for the current expense subfund is the total levy capacity less distributions for debt service, parks, the Automated Fingerprint Identification System, river improvement, veterans, and other designations. Current expense revenues from the property tax levy are estimated at \$225.7 million.

The unincorporated area levy (traditionally known as the road levy) is proposed at \$63.9 million for 2004.

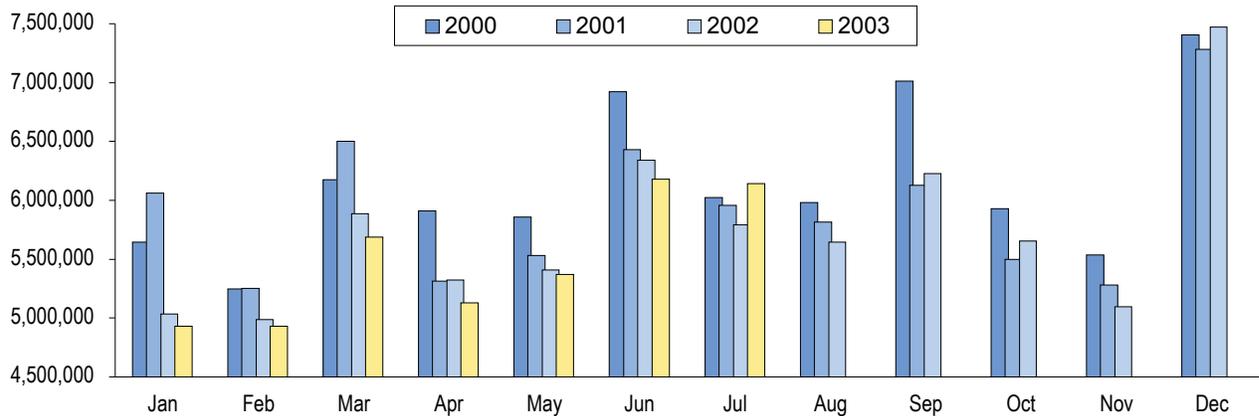
Taxable Retail Sales as a Proportion of Personal Income
Inclusive of Use Tax payments, 1976-2001



Sales Tax Collections by Reporting Frequency
Local Option Revenue from Total King County Taxable Retail Sales, July 1999 - July 2002



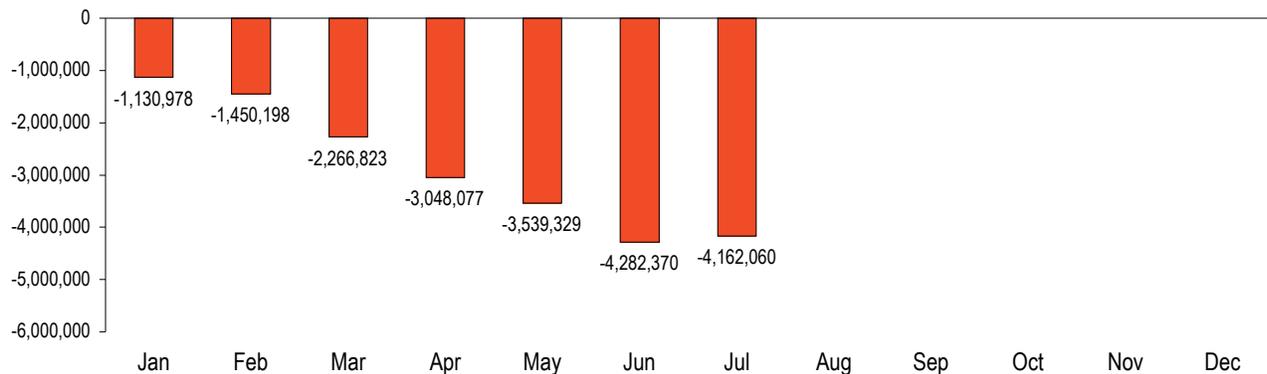
King County Monthly Sales Tax Collections



Monthly Collection Detail

	January	February	March	April	May	June	July	August	September	October	November	December
2000	5,643,746	5,247,801	6,175,848	5,908,357	5,860,285	6,924,611	6,023,919	5,982,095	7,013,757	5,929,100	5,534,585	7,407,359
2001	6,062,931	5,251,282	6,503,883	5,313,379	5,533,086	6,431,011	5,958,177	5,815,392	6,127,737	5,499,377	5,280,576	7,282,334
2002	5,036,669	4,988,719	5,884,638	5,321,370	5,407,187	6,339,046	5,792,913	5,645,463	6,228,228	5,656,303	5,096,438	7,471,553
2003	4,931,954	4,932,061	5,687,259	5,127,102	5,369,033	6,181,570	6,144,228					

Year-to-Date 2003 Variance from 2000-2001 Peak



Year-to-Date Collection Detail

	January	February	March	April	May	June	July	August	September	October	November	December
2000	5,643,746	10,891,548	17,067,396	22,975,752	28,836,037	35,760,649	41,784,567	47,766,662	54,780,419	60,709,520	66,244,105	73,651,464
2001	6,062,931	11,314,213	17,818,096	23,131,476	28,664,562	35,095,573	41,053,750	46,869,143	52,996,879	58,496,256	63,776,832	71,059,166
2002	5,036,669	10,025,388	15,910,026	21,231,396	26,638,583	32,977,629	38,770,542	44,416,005	50,644,233	56,300,536	61,396,974	68,868,527
2003	4,931,954	9,864,015	15,551,273	20,678,376	26,047,409	32,228,980	38,373,208					

* Data presented are total local option sales tax collections less Department of Revenue 1 percent administration fee. 90.4 percent of County sales tax receipts are deposited in the current expense fund. The remainder are dedicated to the Sales Tax Contingency Reserve (5.0 percent) and the Children and Families Set-Aside (4.6 percent).

SALES TAX

Sales taxes constitute Washington’s largest revenue source, and King County’s second largest source of tax receipts. A sales tax rate of 8.80 percent is assessed in the county, distributed as follows:

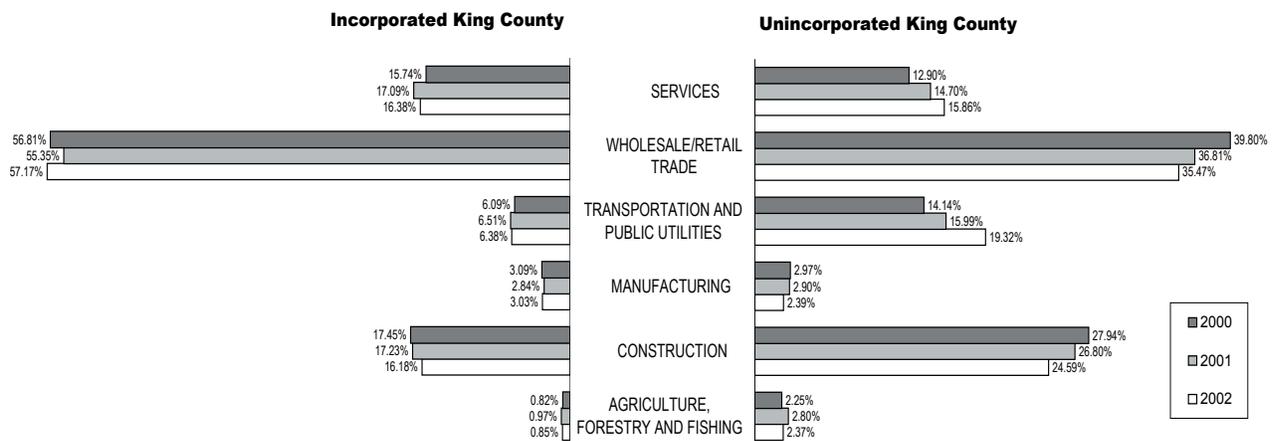
- 6.50 percent is collected by the state;
- 1.00 percent is a local option tax divided between cities and the county;¹²
- 0.80 percent is collected to support Metro Transit;¹³
- 0.40 percent is collected by the Regional Transit Authority (Sound Transit);¹⁴
- 0.10 percent is collected to support criminal justice programs.¹⁵

The sales tax is strongly influenced by changes in the economy and by the geographic areas from which it is collected. The public transportation and criminal justice funds receive revenues from countywide retail sales, with unincorporated areas constituting a little over four percent of the tax base. In contrast, over 17.6 percent of King County’s general fund sales tax revenue is collected in unincorporated areas. Differences in the geographical composition of taxable retail sales also complicate analysis of revenue over the course of the business cycle. For example, the relative dominance of the construction sector in unincorporated King County makes the current expense subfund more sensitive to economic conditions than countywide taxes for transit and criminal justice.

Sales taxes are traditionally criticized for placing a disproportionate burden on lower income households. Over time, the inability to tax internet transactions and a general lag behind personal income growth will also prevent King County sales tax receipts from keeping pace with the cost of delivering most government services.

Total projected 2004 general fund sales tax revenue is \$68.7 million, an increase of 2.50 percent over estimated 2003 receipts. Of the total, \$3.2 million will be deposited in the children and family services subfund while \$3.4 million is earmarked for the sales tax reserve subfund, the proceeds of which are used to support major maintenance expenses. The remaining \$62.1 million is dedicated to the current expense subfund. These subfunds, along with the inmate welfare subfund, comprise King County’s general fund.

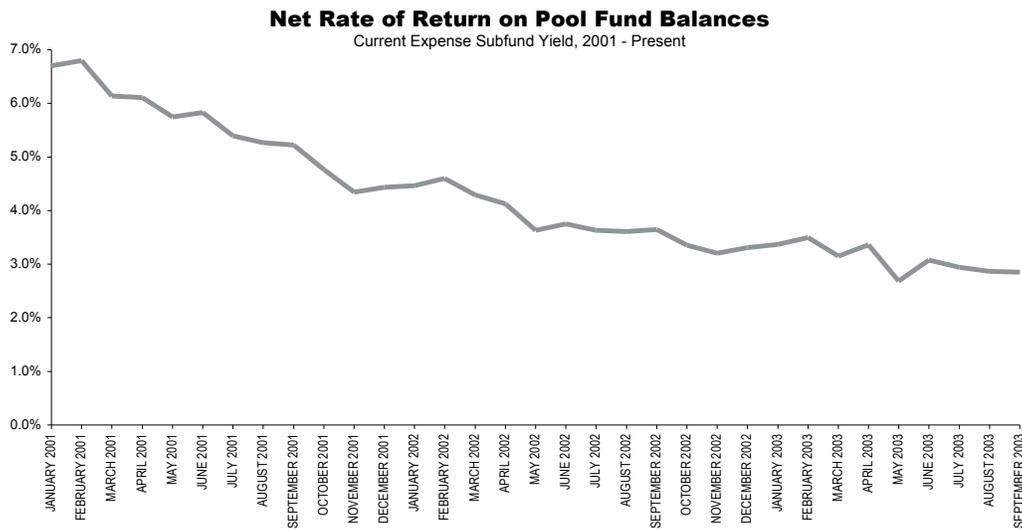
Taxable Retail Sales by Standard Industrial Classification
 January - July 2002 Business Activity (March - September 2002 Department of Revenue Disbursements)



Sales Tax Forecast Detail					
	2001 Actuals	2002 Actuals	2003 Adopted	2003 Estimated	2004 Proposed
General Local Option					
Current Expense	64,237,486	62,258,958	61,154,089	60,548,603	62,062,318
Children and Family	3,268,722	3,168,044	3,111,823	3,081,013	3,158,038
Sales Tax Reserve	3,552,958	3,443,526	3,382,416	3,348,927	3,432,650
Total	71,059,166	68,870,529	67,648,329	66,978,543	68,653,007
Criminal Justice					
Total	10,958,675	10,485,286	10,331,066	10,331,066	11,074,145
Public Transportation					
Total	277,796,000	297,136,000	302,199,000	298,028,000	308,041,000

REAL ESTATE EXCISE TAX

King County levies the Real Estate Excise Tax (REET) in unincorporated King County and administers state and city REET taxes throughout the county. Reflecting unprecedented low interest rates, real estate sales have remained remarkably high in 2003. Tax collections have also been boosted in the last two years by three unusually large timber tract transactions. Reflecting the slowdown in construction and the decreased stimulus effect of low mortgage rates, high REET revenues will almost certainly decline over the next two to three years. REET consists of two 0.25 percent taxes on real estate transactions. Each is forecasted at just under \$5.0 million in 2004, a decline of 28.6 percent from 2003 projected collections.



INTEREST EARNINGS

Because of high volatility, attributable to variance in both interest rates and county fund balances, the Budget Office continues to provide a conservative interest earnings forecast. Interest rates have been projected using futures prices on the New York and London markets and correlating them with historic pool earning performance. For 2004, a rate of return of 2.25 percent is assumed. This forecast will be revised following the Federal Reserve Open Market Committee meeting on October 28, 2003.

FOOTNOTES

¹ US Department of Labor, Bureau of Labor Statistics.

² US Department of Commerce, Bureau of Economic Analysis.

³ Port of Seattle, *Airport Activity Report*.

⁴ Wolfgang Rood Hospitality Consulting.

⁵ US Department of Commerce, Bureau of Economic Analysis.

⁶ American Bankruptcy Institute.

⁷ Washington State Employment Security Department.

⁸ US Bureau of the Census.

⁹ Commercial Space Online, Inc. survey data [<http://www.officespace.com>] and Cushman and Wakefield.

¹⁰ Interfund transfers, overhead rates, and other transactions duplicate some funds in the total revenue figure of \$3.2 billion.

¹¹ The countywide levy includes the current expense fund and dedicated millage for mental health/developmental disabilities, river improvement, human services, veterans' aid, intercounty, and limited bond redemption.

¹² Within cities, 0.15 percent is distributed to the county, and 0.85 percent to the city. King County receives the full 1.00 percent collected in unincorporated areas.

¹³ This tax was approved in April 2001 to replaced funds lost with the repeal of the Motor Vehicle Excise Tax by Initiative 695 in November 1999.

¹⁴ This tax is not collected in the rural part of King County where the sales tax rate is 8.40 percent.

¹⁵ 90 percent of these funds are allocated to the cities on the basis of population. King County receives a share based on unincorporated population, in addition to the remaining 10 percent. This tax was approved by county voters in 1992.