QUARTERLY ECONOMIC REPORT
1st Quarter
2005

KING COUNTY
OFFICE OF MANAGEMENT AND BUDGET

SUMMARY

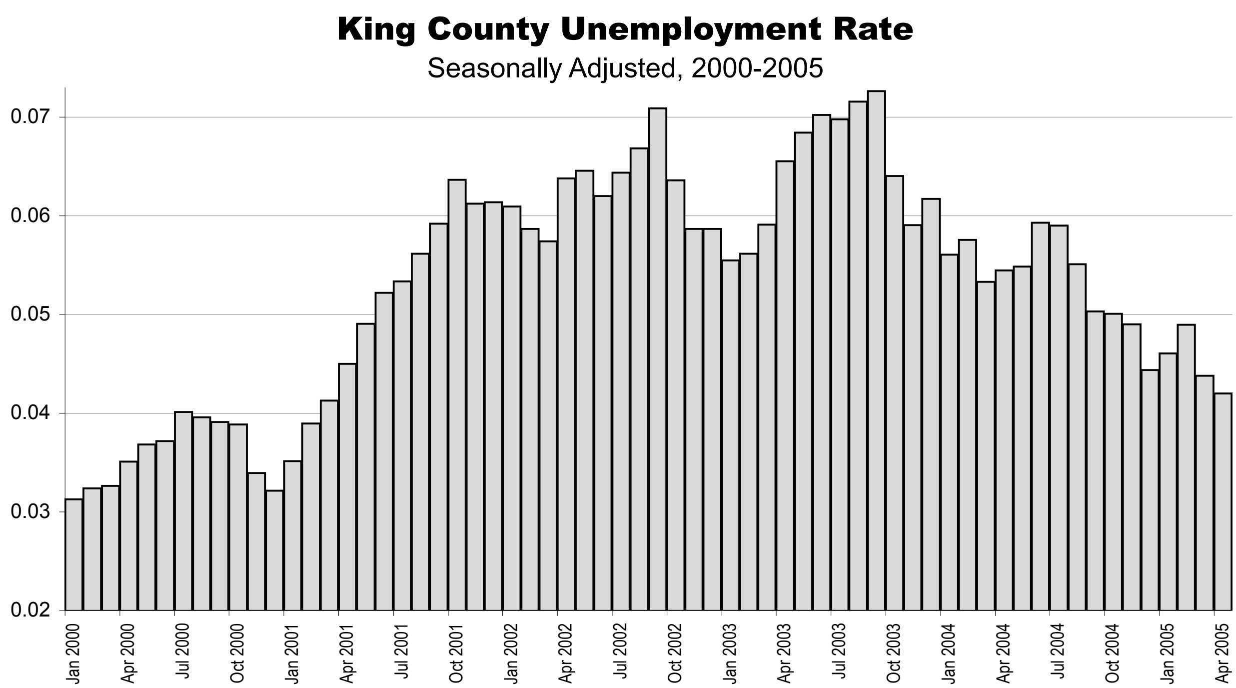
Weathering most challenges, national economic growth has proven resilient, if somewhat inconsistent. Volatile energy prices and unusual currency speculation in asian markets could presage longer term problems, but immediate conditions are indicative of steady, if somewhat modest, growth.

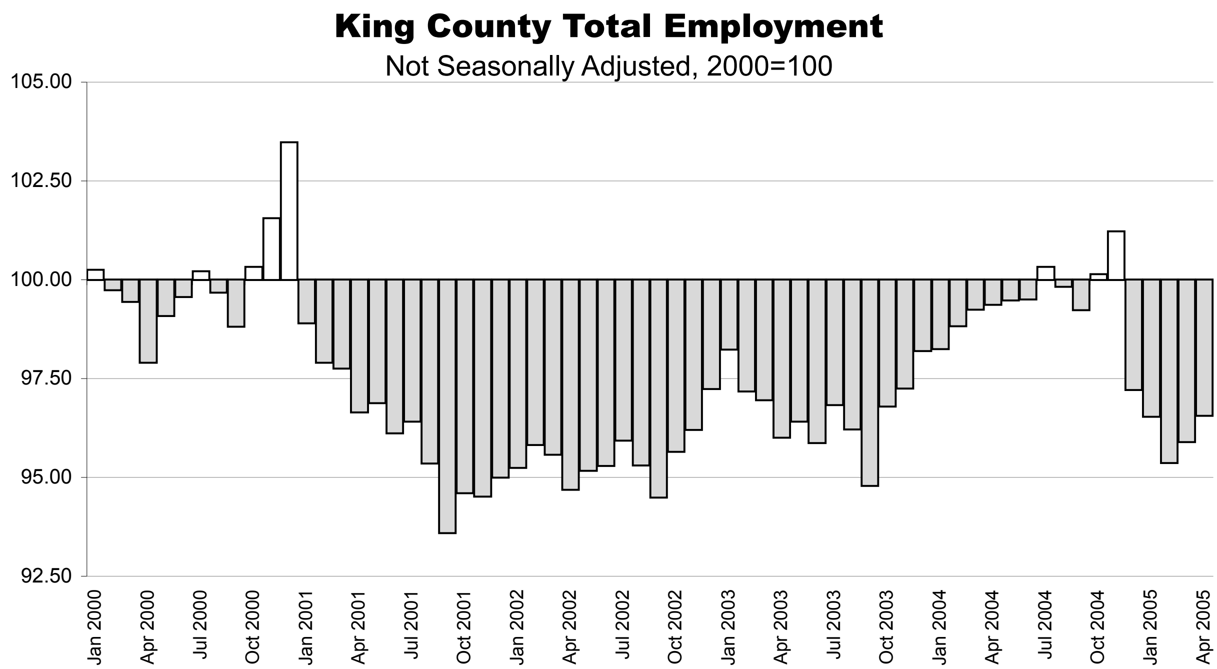
Despite mixed national news, the local outlook for 2005 remains bright. From Boeing's success in securing orders for the new 787 passenger jet to the improving local employment market, the region has finally ended the ambiguity surrounding recovery from the 2001 recession.

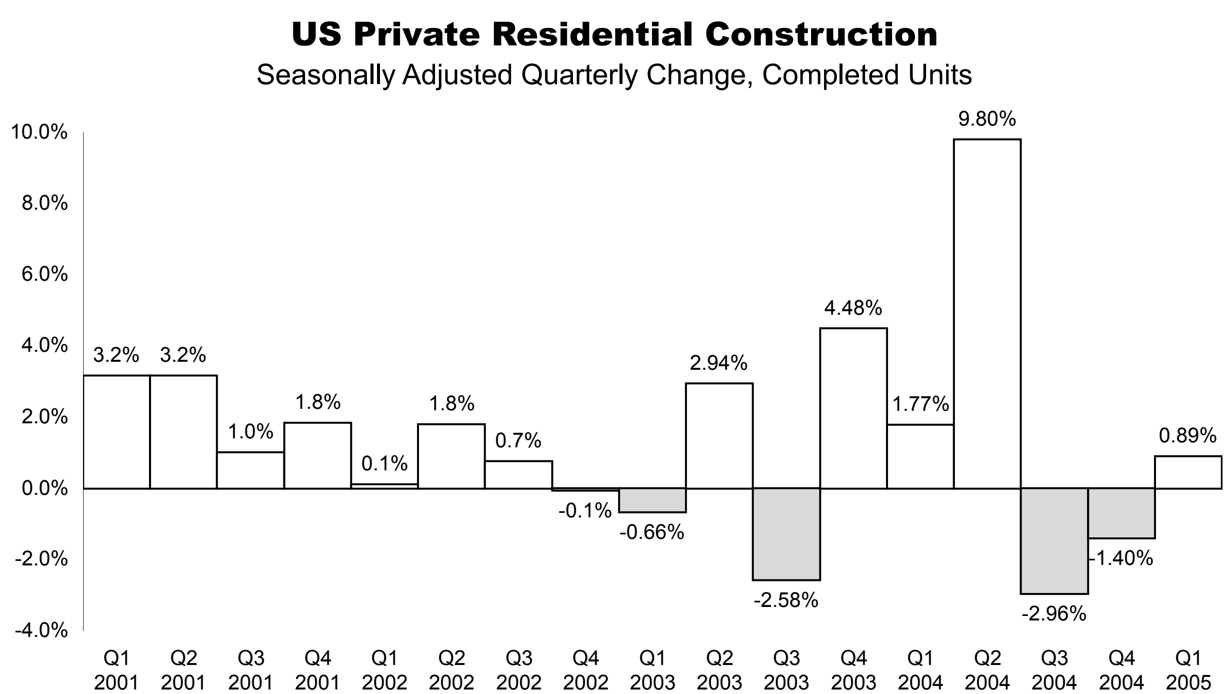
REVIEW OF ECONOMIC CONDITIONS

Recent economic news confirms budget office assumptions of steady but lackluster growth. Estimated first quarter gross domestic product growth was revised from an initial estimate of 3.1 percent to 3.5 percent. Fourth quarter growth was 3.8 percent. While short of the 4.0 to 4.5 percent growth necessary to generate sustainable employment growth, the numbers are nonetheless reassuring in light of speculation that the economy had entered a "soft patch" of diminished growth.

After briefly flirting with the $60 per barrel threshold in April, energy prices appear to have stabilized around $51. Although sustained crude prices over $50 per barrel can be expected to adversely effect the economy, core prices have proven remarkably resistant to inflation. With growing global demand and tight supplies, there is no end in sight to energy price fluctuations.

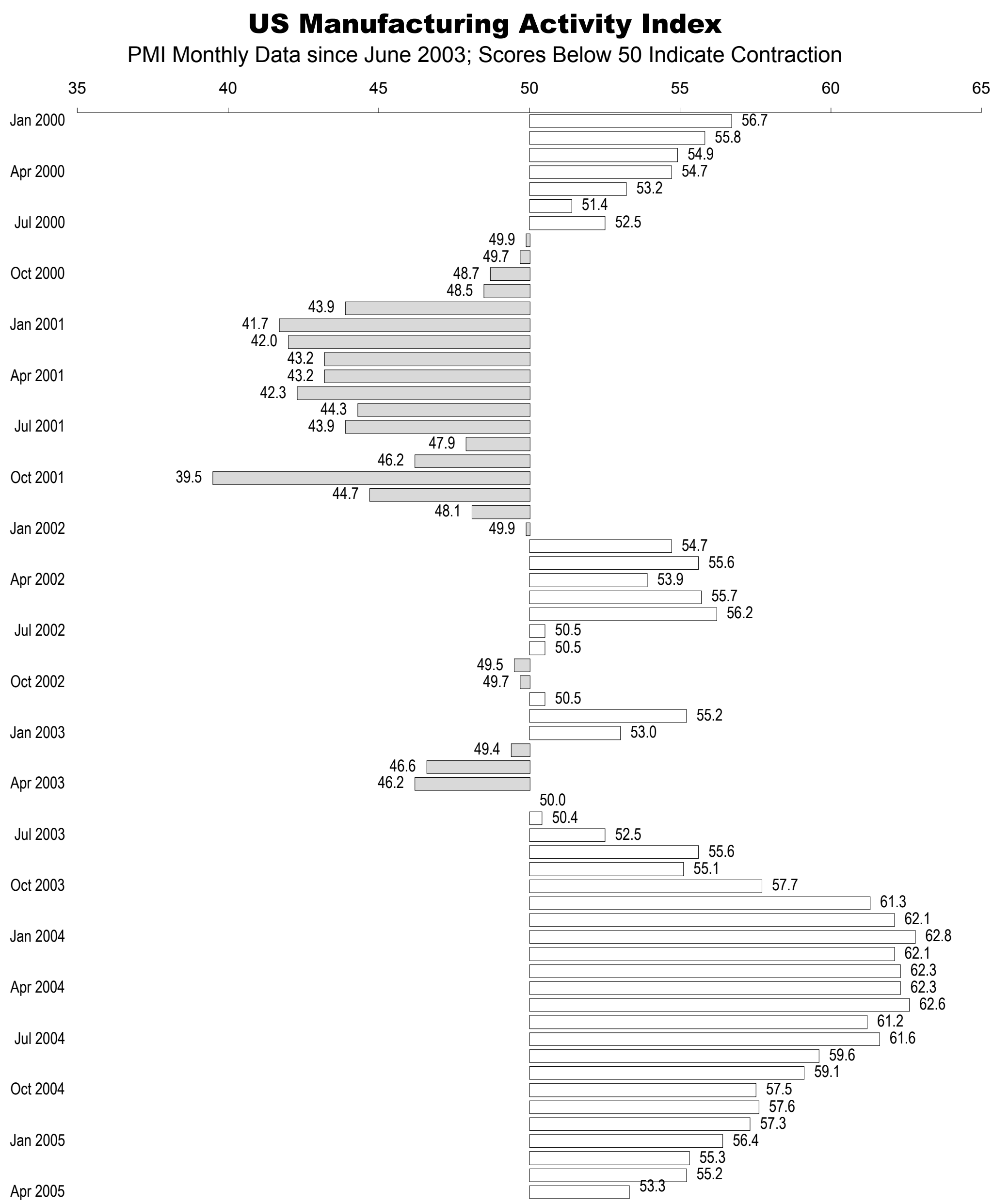



King County Total Employment
Not Seasonally Adjusted, 2000=100
105.00
102.50
100.00
97.50
95.00
92.50
Jan 2000
Apr 2000
Jul 2000
Oct 2000
Jan 2001
Apr 2001
Jul 2001
Oct 2001
Jan 2002
Apr 2002
Jul 2002
Oct 2002
Jan 2003
Apr 2003
Jul 2003
Oct 2003
Jan 2004
Apr 2004
Jul 2004
Oct 2004
Jan 2005
Apr 2005


US Private Residential Construction
Seasonally Adjusted Quarterly Change, Completed Units
10.0%
8.0%
6.0%
4.0%
2.0%
0.0%
-2.0%
-4.0%
3.2%
3.2%
1.0%
1.8%
0.1%
1.8%
0.7%
-0.1%
-0.66%
2.94%
-2.58%
4.48%
1.77%
9.80%
-2.96%
-1.40%
0.89%
Q1 2001
Q2 2001
Q3 2001
Q4 2001
Q1 2002
Q2 2002
Q3 2002
Q4 2002
Q1 2003
Q2 2003
Q3 2003
Q4 2003
Q1 2004
Q2 2004
Q3 2004
Q4 2004
Q1 2005

Factoring in energy price increases, the national consumer price index was up an annualized 6.9 percent through the first four months of 2005. Inflation grew at a similar annualized rate of 5.9 percent for the first half of 2004, before receding in the second half of the year. Retail gasoline prices are a bit higher than current future contracts, suggesting that at least some relief to inflationary pressure is on the horizon.

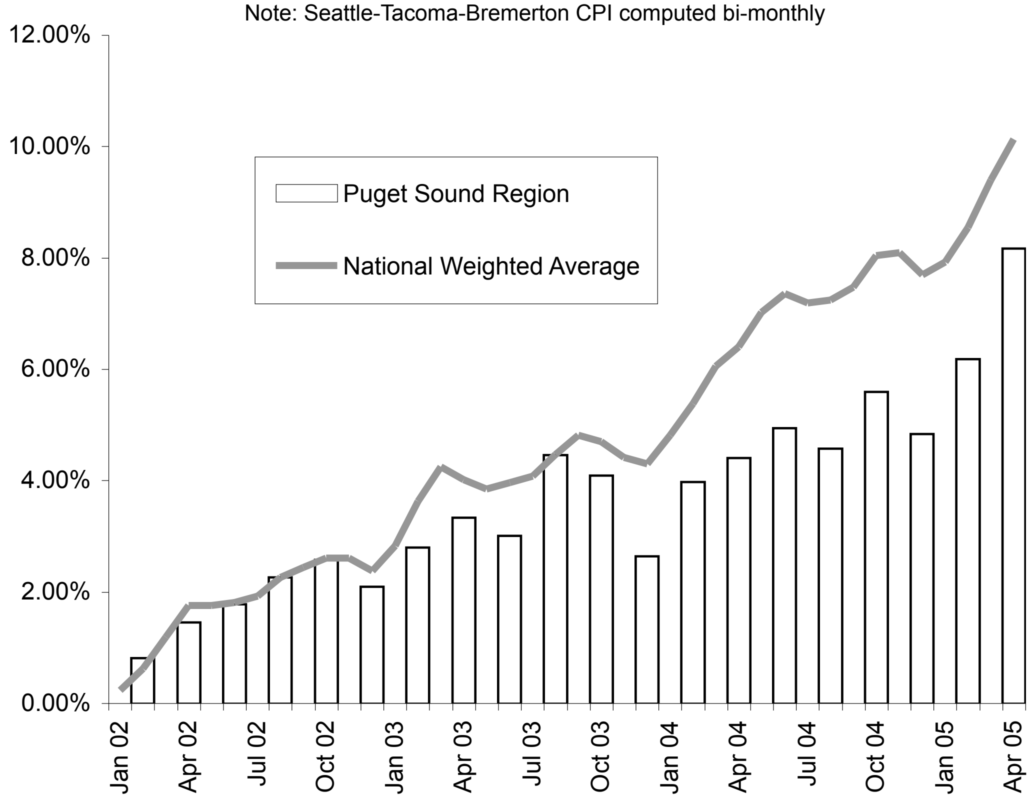
There has been little improvement to national employment numbers, but the local recovery continues. Unemployment in King County through March has returned to January's level of 4.6 percent, down from February's 5.1 percent. Seasonally adjusted, however, unemployment is at 4.4 percent, the lowest level in four years.



National and Local Inflation Comparison

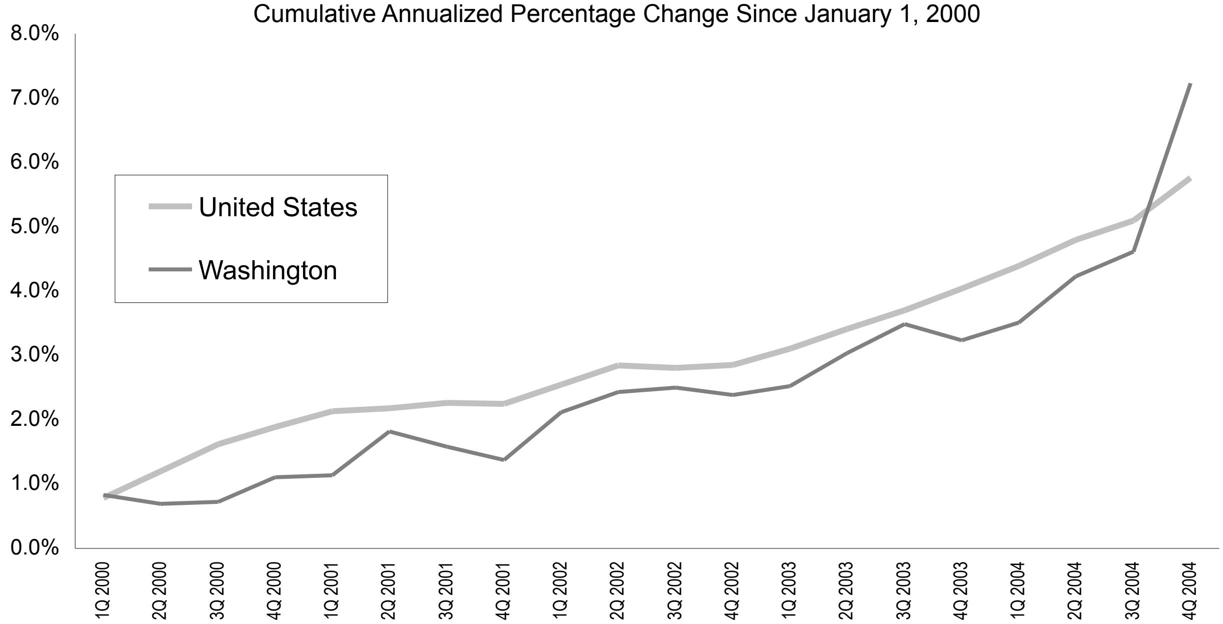
CPI-U, cumulative change since 2001

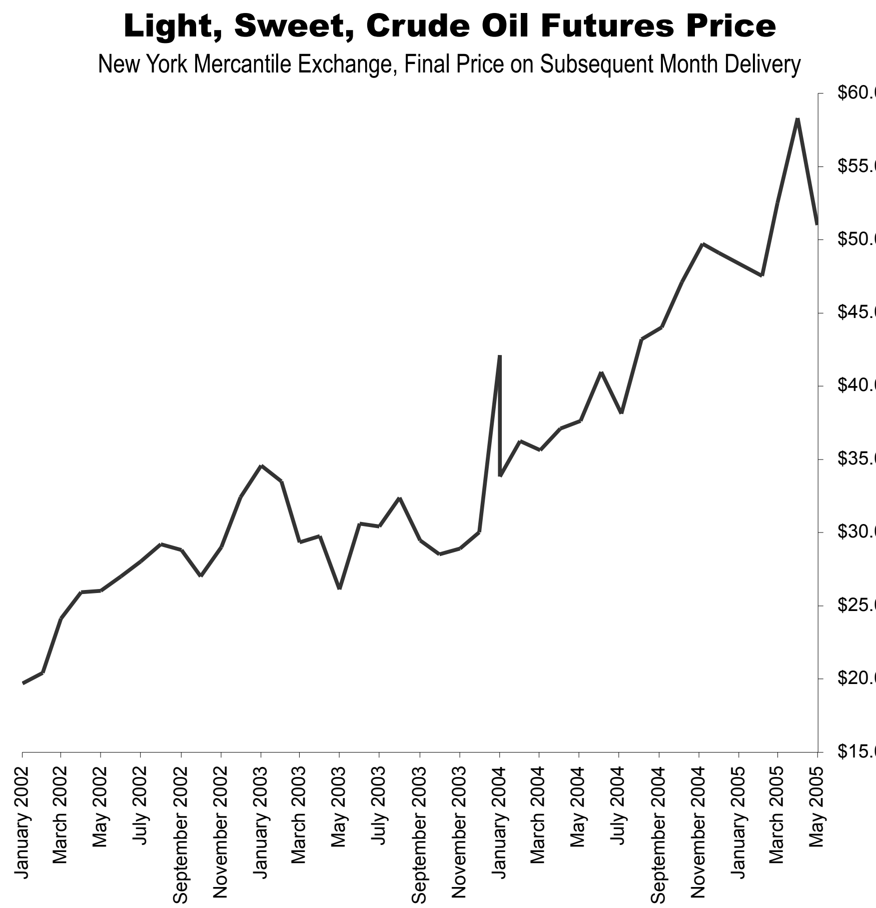
Note: Seattle-Tacoma-Bremerton CPI computed bi-monthly

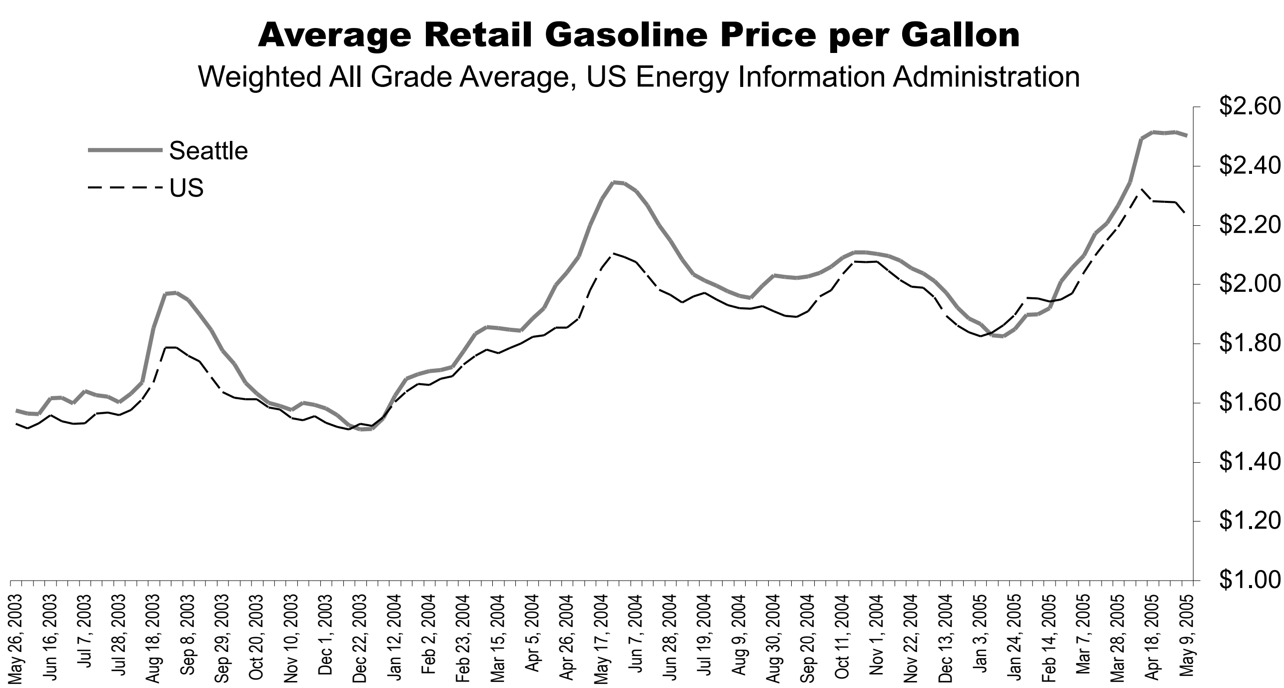


Nominal Personal Income Growth

Cumulative Annualized Percentage Change Since January 1, 2000




Light, Sweet, Crude Oil Futures Price
New York Mercantile Exchange, Final Price on Subsequent Month Delivery
$60.00
$55.00
$50.00
$45.00
$40.00
$35.00
$30.00
$25.00
$20.00
$15.00
January 2002
March 2002
May 2002
July 2002
September 2002
November 2002
January 2003
March 2003
May 2003
July 2003
September 2003
November 2003
January 2004
March 2004
May 2004
July 2004
September 2004
November 2004
January 2005
March 2005
May 2005


Average Retail Gasoline Price per Gallon
Weighted All Grade Average, US Energy Information Administration
Seattle
US
$2.60
$2.40
$2.20
$2.00
$1.80
$1.60
$1.40
$1.20
$1.00
May 26, 2003
Jun 16, 2003
Jul 7, 2003
Jul 28, 2003
Aug 18, 2003
Sep 8, 2003
Sep 29, 2003
Oct 20, 2003
Nov 10, 2003
Dec 1, 2003
Dec 22, 2003
Jan 12, 2004
Feb 2, 2004
Feb 23, 2004
Mar 15, 2004
Apr 5, 2004
Apr 26, 2004
May 17, 2004
Jun 7, 2004
Jun 28, 2004
Jul 19, 2004
Aug 9, 2004
Aug 30, 2004
Sep 20, 2004
Oct 11, 2004
Nov 1, 2004
Nov 22, 2004
Dec 13, 2004
Jan 3, 2005
Jan 24, 2005
Feb 14, 2005
Mar 7, 2005
Mar 28, 2005
Apr 18, 2005
May 9, 2005

Considerable economic strength in both real estate and construction is tied to long term interest rates. The virtually unprecedented disconnect between rising short term rates and historically low mortgage rates has been attributed to a variety of causes, from the growing capital account surplus with China to outflows into bonds from equity markets.

On May 3rd, the Open Market Committee raised the federal funds rate 25 basis points for the eighth time in as many meetings. The Federal Reserve's dilemma is growing: raise short term rates further to boost long term bond yields and risk contracting the money supply, or allow long term rates to remain artificially low and allow a possible speculative bubble in real estate to continue to build. Future markets are assuming just a 15 basis point increase in the federal funds rate over the next six months, belying the lack of consensus on how to proceed.

SPECIAL REPORT:

State Pension Policy

Employer and employee contribution rates to the Public Employees Retirement System are determined by the legislature. PERS I, II, and III employer contribution rates are the same, but support very different programs.

PERS II employer contribution rates are designed to fully fund the PERS II liability, plus an additional amount to compensate for the typical two-year delay between valuation and imposition of new rates.

Since 1989, the rate for PERS II has also included an additional amount to amortize the Unfunded Accrued Actuarial Liability (UAAL) for PERS I, although in recent years this rate has been omitted by the legislature. Employer contributions for all PERS participants are first allocated to the PERS II/III fund. Once this liability is fully covered, the remainder is allocated to PERS I, under the present goal of full amortization by June 2024. Increases in the PERS I UAAL therefore affect employer contribution rates for PERS II/III participants.

Since 2001, the legislature has used a variety of mechanisms to keep employer contribution rates artificially low. Recent liability calculations have been based on the 2000 actuarial valuation in conjunction with the 1995-2000 investment experience study, effectively assuming a continuation of the exceptional growth of the late 1990s. As a consequence, contribution rates over the past four years have been extremely low by both historic standards and relative to actual market conditions.

For the second consecutive biennium, the legislature has suspended payment against the PERS I Unfunded Actuarial Accrued. In 2003, the Office of the State Actuary valued the PERS I UAAL at $2.62 billion, a liability directly linked to low market returns. Similarly, payments to cover gain-sharing as a material benefit have been suspended since 2003 to maintain lower employer contribution rates.

Changes in economic assumptions have provided further impetus for low employer contribution rates, even when contradicted by recent market performance. In 2001, the legislature raised the interest rate

Recent Pension Methodology Changes

2005

Pension Funding Methodology
ESHB 1044 – Effective 7/1/05

Delays employer pension contribution rate increases to hold costs below actuarially recommended levels during the 2005-2007 biennium. Future employer contributions will have to be higher to recapture this shortfall.

The legislation also delays funding of gain-sharing benefits until 2007-2009, and explicitly mandates reliance on a 2002 investment experience study of 1995-2000 results, coinciding with the run up of internet and technology startups of the late 1990s while ignoring the subsequent downturn in equity markets after 2000.

2004

Asset Smoothing Corridor
SB 6249

The stated purpose for this legislation is to prevent wild fluctuation in employer pension contribution rates. The practical effect is to hold rates at historic lows, diluting actuarial recommendations by limiting annual market valuation changes.

Public Safety Employees Retirement System II
HB 2537

Public Safety Employees Retirement System II created from members of the Public Employee Retirement System.

Increased minimum benefit changes
SHB 2538

Increased minimum benefits for PERS I and TRS I members retired at least 20 years with at least 25 years of service. Funded on a pay as you go basis, this legislation had the effect of increasing unfunded pension liabilities by $1.8 million.

2003

Altered Asset Valuation Methodology
EHB 2254 – Effective 7/1/03

Spreads recognition over eight years of market performance variance from the assumed investment rate of return.

2001

Pension policy assumptions
ESSB 6167 – Effective 7/1/01, some sections 7/1/02

Altered economic assumptions (increased salary growth and investment return), while introducing asset value smoothing to spread recognition of 2000-2001 equity market declines over four years.

1998

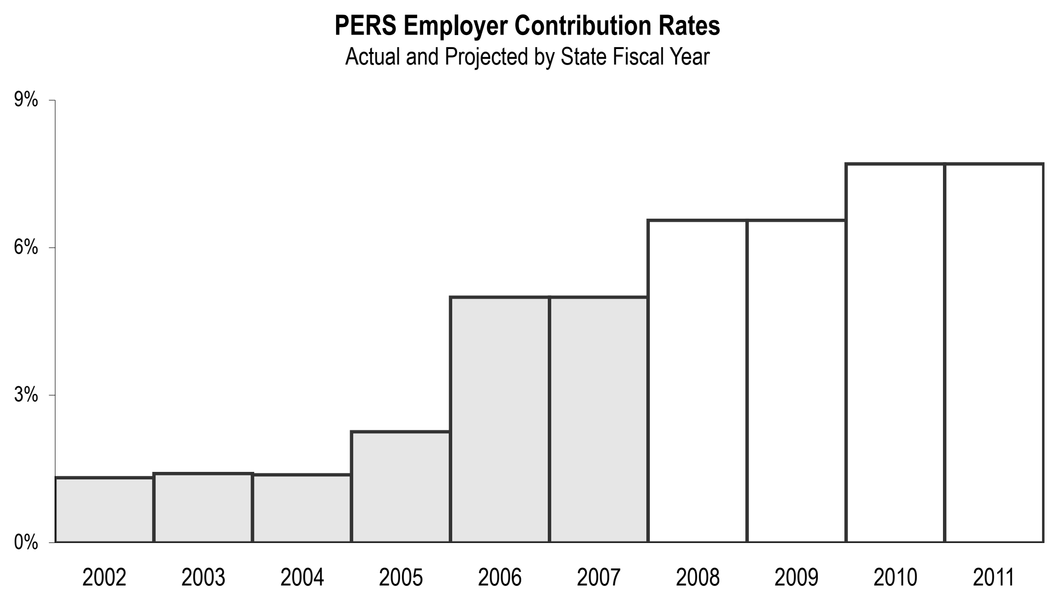
Gain Sharing
ESHB 2491

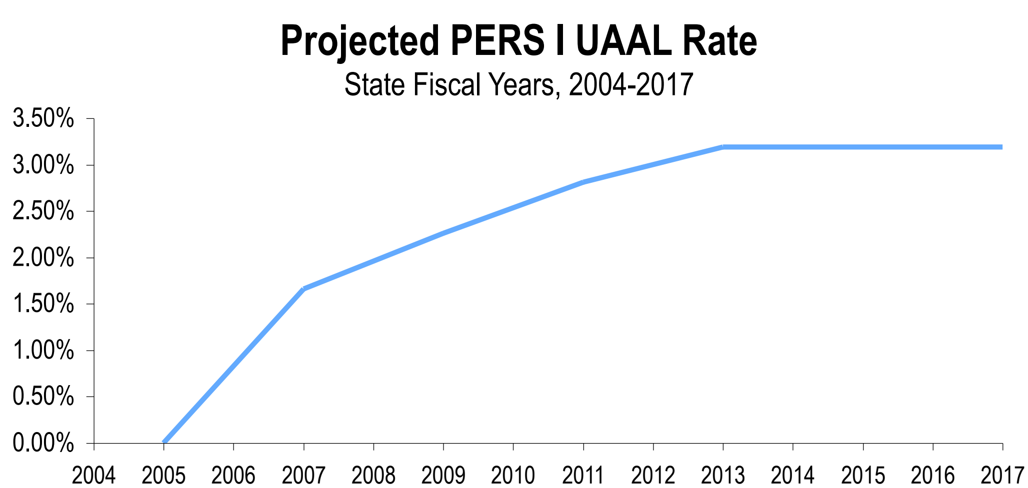
Allocates 4-year compound average market returns in excess of 10 percent to increased benefits and accelerate amortization of PERS I costs.

assumption 50 basis points to eight percent just as equity markets fell dramatically on the eve of a dramatic decline in long term interest rates. No correction has been made in the intervening four years.

With employer contribution rates at or near all-time lows, the legislature has reduced and delayed increases under the guise of making rates more predictable. As a consequence, employer contribution rates will remain at low, unsustainable levels through the 2005-2007 biennium, even applying optimistic actuarial valuation, economic assumptions, and suspended UAAL and gainsharing payments.

In both 2001 and 2003 the legislature adopted asset value smoothing techniques. In 2001, Senate Bill 6167 directed valuations of assets that vary from long-term assumptions to be recognized over four years. In 2003, House Bill 2254 extended certain asset valuation periods up to eight years. Negative effects are muted by initiating this policy during a period of poor market returns, keeping employer contribution rates low. In the long term, this type of asset smoothing will lead to more predictable and stable rates, but the reverse is the case when taken in concert with unsustainable employer contribution rates.

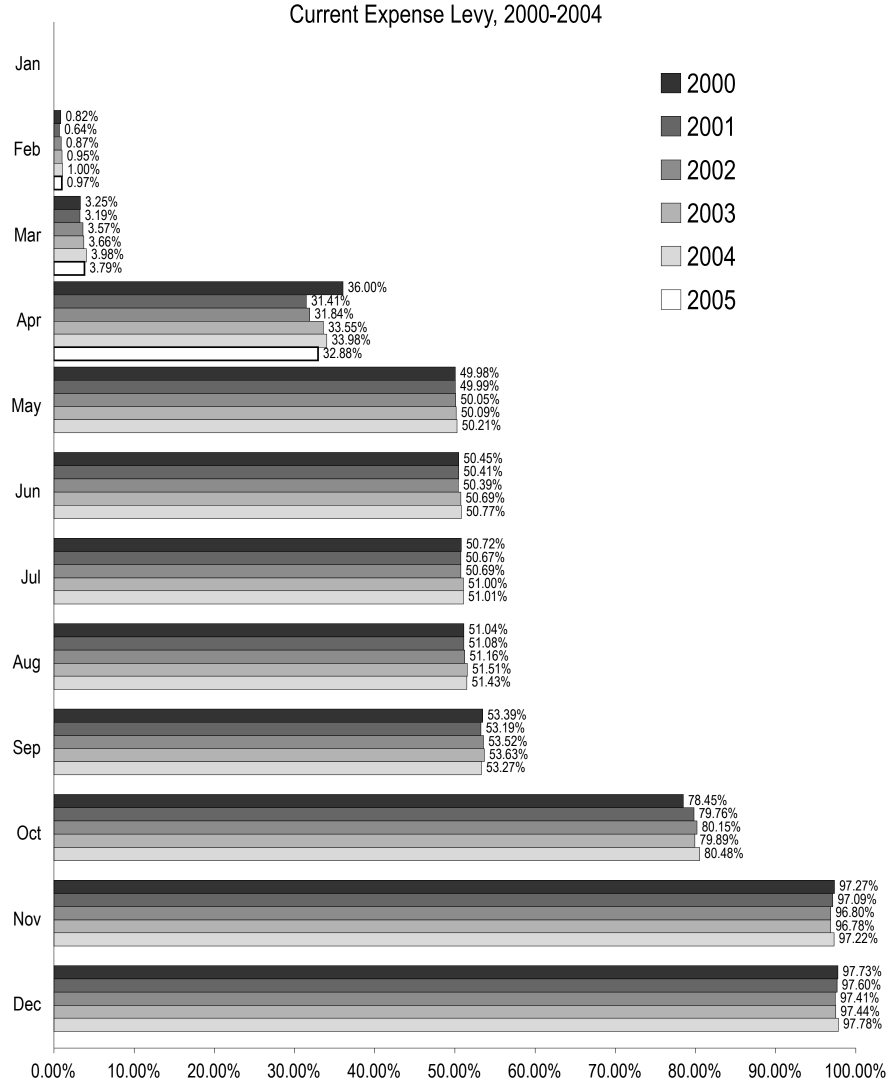


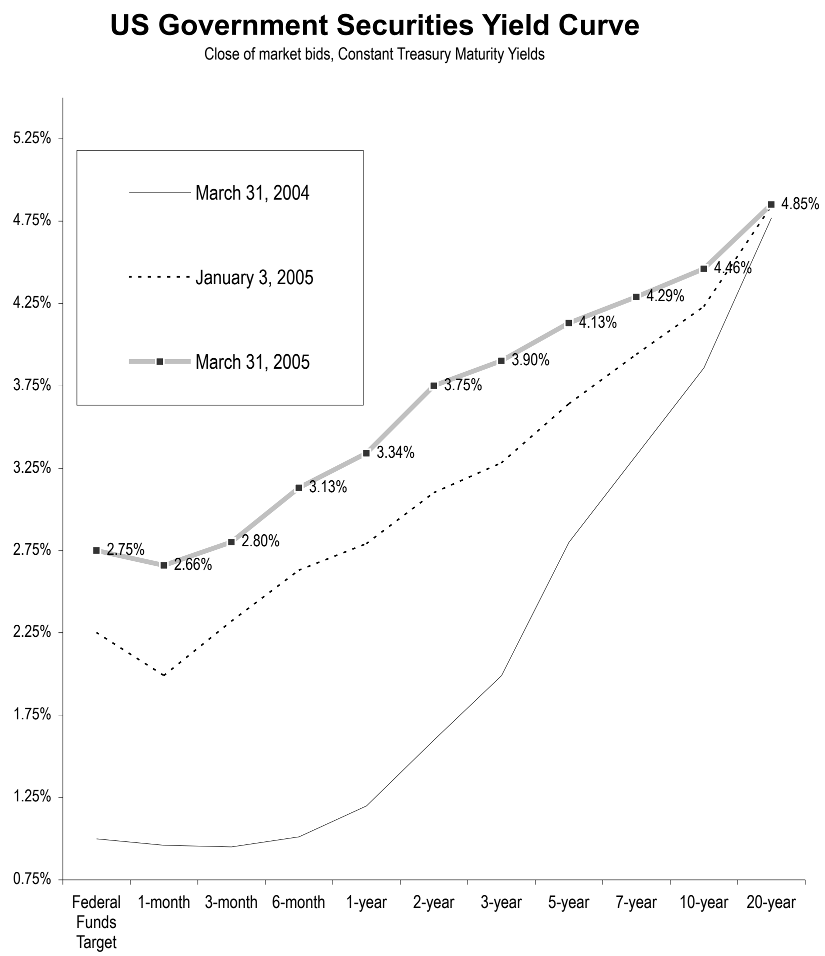


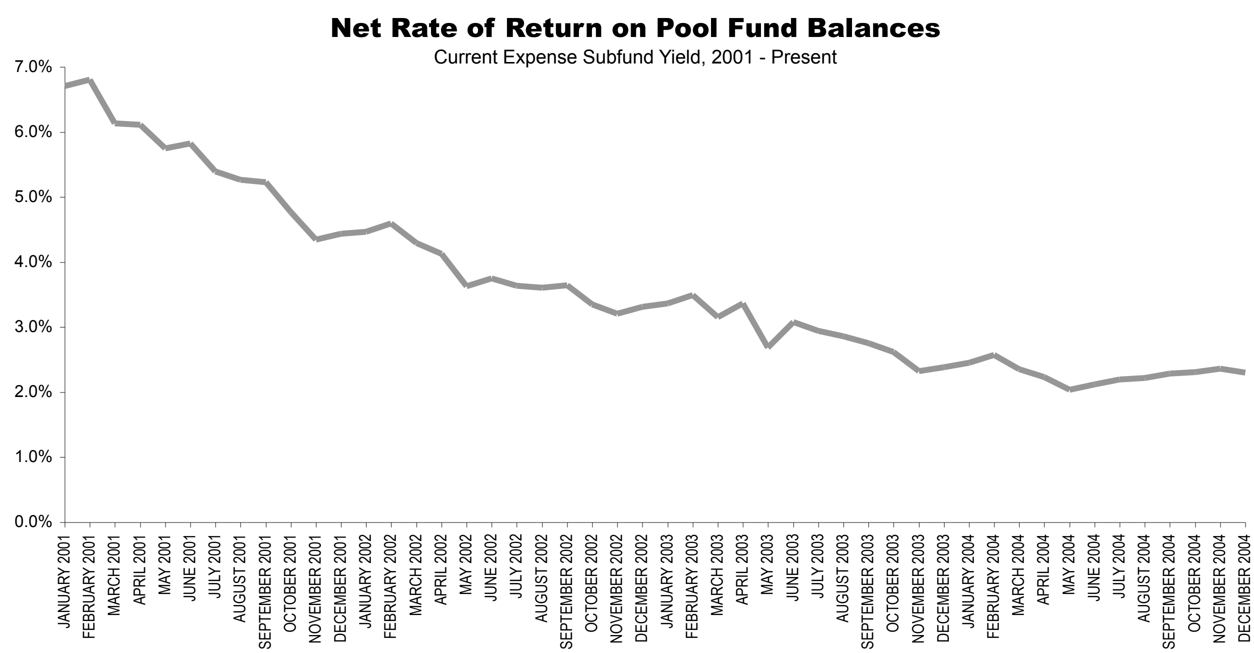
In 2004, Senate Bill 6249 established a smoothing corridor of thirty percent; this means that the actuarial value of the assets may not deviate by more than thirty percent (positively or negatively) from the market value of the assets. Ironically, this strategy would have kept contribution rates higher starting in 2001, which would have reduced the impact of delayed or phased rate increases. Undertaken now, it is merely another sidestep of recent poor market performance.

Under any methodology, employer contribution rates will necessarily have to rise to meet PERS obligations. Through recent legislation the state has chosen to delay payments against this obligation, substantially increasing future costs in exchange for smaller immediate savings.

Cumulative Monthly Property Tax Collections
Current Expense Levy, 2000-2004




US Government Securities Yield Curve
Close of market bids, Constant Treasury Maturity Yields
March 31, 2004
January 3, 2005
March 31, 2005
5.25%
4.75%
4.25%
3.75%
3.25%
2.75%
2.25%
1.75%
1.25%
0.75%
2.75%
2.66%
2.80%
3.13%
3.34%
3.75%
3.90%
4.13%
4.29%
4.46%
4.85%
Federal Funds Target
1-month
3-month
6-month
1-year
2-year
3-year
5-year
7-year
10-year
20-year


Net Rate of Return on Pool Fund Balances
Current Expense Subfund Yield, 2001 - Present
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
JANUARY 2001
FEBRUARY 2001
MARCH 2001
APRIL 2001
MAY 2001
JUNE 2001
JULY 2001
AUGUST 2001
SEPTEMBER 2001
OCTOBER 2001
NOVEMBER 2001
DECEMBER 2001
JANUARY 2002
FEBRUARY 2002
MARCH 2002
APRIL 2002
MAY 2002
JUNE 2002
JULY 2002
AUGUST 2002
SEPTEMBER 2002
OCTOBER 2002
NOVEMBER 2002
DECEMBER 2002
JANUARY 2003
FEBRUARY 2003
MARCH 2003
APRIL 2003
MAY 2003
JUNE 2003
JULY 2003
AUGUST 2003
SEPTEMBER 2003
OCTOBER 2003
NOVEMBER 2003
DECEMBER 2003
JANUARY 2004
FEBRUARY 2004
MARCH 2004
APRIL 2004
MAY 2004
JUNE 2004
JULY 2004
AUGUST 2004
SEPTEMBER 2004
OCTOBER 2004
NOVEMBER 2004
DECEMBER 2004

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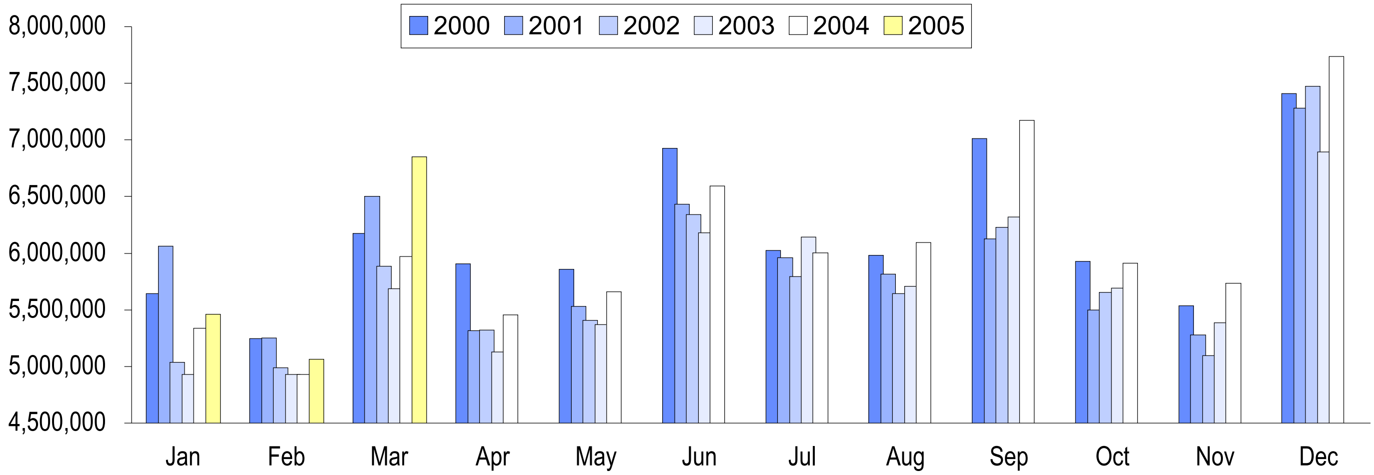
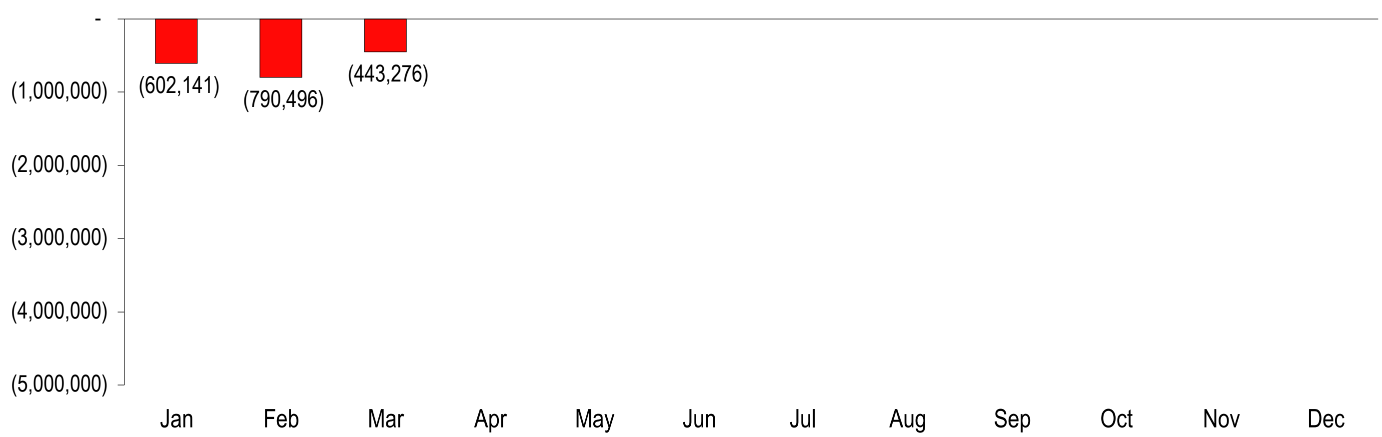
King County Monthly Sales Tax Collections



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	5,708,742	6,321,403	5,689,569	5,385,641	6,894,946
2004	5,338,022	4,928,659	5,970,150	5,454,094	5,657,854	6,592,828	6,004,537	6,096,735	7,175,660	5,912,824	5,737,184	7,738,012
2005	5,460,791	5,062,926	6,851,104									

Year-to-Date 2005 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	44,081,950	50,403,353	56,092,922	61,478,563	68,373,509
2004	5,338,022	10,266,682	16,236,832	21,690,926	27,348,780	33,941,609	39,946,146	46,042,880	53,218,540	59,131,364	64,868,548	72,606,560
2005	5,460,791	10,523,717	17,374,821									

* 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).

Review of Revenue Collections

Sales tax collections for the first three months of 2005 are running 7 percent ahead of the same period in 2004. While it is too early to revise the forecast, the year-to-date performance is nonetheless welcome news.

Regular property tax collections in the Current Expense Subfund were at 32.88 percent of the 2005 levy as of the end of April. This collection pace is slightly ahead of the average for the last four years.

Investment pool yield rates have exceeded forecasted levels by 9.5 basis points through the end of April, with a rate of return of 2.80 percent. Cash balances in the Current Expense subfund remain strong, running a monthly average of $55.4 million ahead of forecast through the first third of the year.

Economic Forecast

The outlook for 2005 is largely unchanged. Strengthening local labor conditions more than offset concerns about inflationary pressures or uneven national growth.

Economic Assumption Summary

Percentage Change from Preceding Year

	2001	2002	2003	2004	2005	2006	2007	2
King County								
Employment	-3.9%	-0.6%	-0.7%	1.4%	2.7%	2.5%	2.0%	
Nominal Personal Income	1.7%	1.5%	2.0%	4.4%	5.5%	6.0%	5.3%	
Housing Starts	-2.9%	32.9%	9.9%	5.8%	-0.3%	-11.0%	0.5%	
Population	1.1%	1.0%	0.3%	0.5%	0.9%	0.9%	0.9%	
Consumer Price Index *	3.7%	1.9%	1.6%	2.5%	2.4%	2.5%	2.3%	
COLA **	3.11%	2.32%	2.00%	2.03%	2.19%	2.34%	2.10%	2
Washington State								
Employment	-2.9%	1.7%	0.6%	1.7%	2.2%	1.9%	2.0%	
Nominal Personal Income	2.6%	3.4%	3.5%	4.4%	5.3%	5.5%	5.2%	
Housing Starts	-1.7%	4.8%	6.5%	15.0%	1.2%	-7.9%	-1.1%	-
United States								
Employment	0.2%	-1.1%	-0.3%	1.1%	2.0%	1.6%	1.6%	
Nominal Personal Income	3.3%	2.7%	3.3%	5.6%	5.8%	5.5%	5.0%	
Housing Starts	2.0%	6.5%	8.2%	2.7%	1.8%	-7.3%	-4.5%	-
Three-month Treasury Yield	-22.0%	-47.1%	-11.3%	34.0%	51.3%	18.8%	9.5%	
Consumer Price Index	2.8%	1.6%	2.3%	2.7%	2.7%	2.4%	2.6%	
Real GDP	0.3%	2.4%	2.7%	4.4%	3.3%	2.8%	3.0%	

* Puget Sound region