

June 15, 2007

Honorable County Executive,
Members of the County Council,
and *Pierce County* Residents:

TRANSMITTAL LETTER

I. INTRODUCTION

I am pleased to transmit to you the 2006 Comprehensive Annual Financial Report of *Pierce County*, Washington. This report was prepared by the Budget and Finance Department to present the financial position of the county at December 31, 2006, and the results of its operations and the cash flows of its proprietary funds for the year then ended. Responsibility for accuracy of the data presented, and completeness and fairness of presentation, including disclosures, rests with the county.

The governmental financial reporting model provides a clear picture of the county as a single, unified entity, while continuing to provide traditional fund-based financial statements. Each perspective (government-wide and major fund) allows the reader to address relevant questions, provides a basis for comparison (year to year or government to government), and enhances the county's accountability.

The report is presented in three sections:

1. The introductory section which includes this letter of transmittal is intended to familiarize the reader with the organizational structure of the county, the nature and scope of the services that it provides, and the specifics of its legal operating environment. This letter is designated to complement the management's discussion and analysis (MD&A) of the county's overall financial position and results of operations, and should be read in conjunction with it.
2. The financial section begins with the independent auditor's report and contains the MD&A, the audited basic financial statements including the accompanying note disclosures, and supporting statements to provide readers with a comprehensive understanding of the county's financial activities.
3. The statistical section includes selected financial trends, revenue capacity, debt capacity, operating data, and demographic and economic data.

The Office of the State Auditor conducts annual financial and compliance audits as required by state statutes. The 2006 audit of county financial statements was conducted in accordance with generally accepted auditing standards and resulted in an unqualified audit opinion.

The independent audit of the financial statements was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. Standards governing Single Audit engagements require the independent auditor to report not only on fair presentation of the financial statements, but also on the audited government's system of internal controls and compliance with legal requirements. Special emphasis is placed on internal controls and legal requirements involving the administration of federal awards. The reports on internal control and compliance with legal requirements are available in the county's separately issued Single Audit Report.

The county also maintains an internal audit function to insure the adequacy of internal accounting controls. The county accounting system is structured to facilitate the effectiveness of such internal accounting controls. Internal accounting controls are designed to provide reasonable assurance that assets are safeguarded and that financial records are reliable for preparing financial statements and maintaining accountability of assets. In addition, the Performance Audit Division of the County Council conducts operational audits of county agencies.

I. PROFILE OF THE COUNTY

Pierce County was incorporated in 1852 and operates under a Home Rule Charter adopted by voters in November 1980. The county is organized under the executive-council form of government. Elected administrative officials include the County Executive (the chief executive officer), Prosecuting Attorney, Assessor-Treasurer, and Auditor. The seven-member County Council is elected by district and constitutes the policy-setting legislative body of the county. All elected officials serve four year terms.

Pierce County provides some services on a countywide basis and other services only to unincorporated areas. Within appropriate jurisdictions, the county provides law enforcement, criminal detention, fire prevention, judicial administration, parks and recreation, planning and zoning, road maintenance and construction, a sewage disposal system, human services, tax assessments and collections, community development, and general administrative functions.

Most funds in this report pertain to the entity "*Pierce County* Government" and include all funds, departments, and entities for which the county is considered financially accountable. There are no related organizations which warrant inclusion in the reporting entity. Certain *Agency Funds* pertain to the county's custodianship of assets belonging to independent governments and special districts. Under state statute and the county's Home Rule Charter, the County Executive is the *ex officio* treasurer of all special purpose districts in *Pierce County*, but not of cities and towns. As provided by county ordinance, the Director of Budget and Finance is responsible for the duties of the comptroller and treasurer. Monies received from or for the special purpose districts are deposited in a central bank account. The Director of Budget and Finance disburses or invests the monies according to the instructions of the respective special purpose district's governing body or administrative officer.

II. LOCAL ECONOMY

"*Pierce County* is the economic engine of the South Sound, the fastest growing region in Washington State. Home to Tacoma (the state's second largest city) and the booming Port of Tacoma (the nation's sixth largest container port) *Pierce County* is at the cutting edge of new job creation, investment and development. World class companies and innovative entrepreneurs locate here for the top notch workforce, great business climate and exciting array of housing, cultural and educational choices." (Economic Development Board for Tacoma-Pierce County)

Historically the county was a resource and manufacturing based economy. However, regional, state and national trends have shown a shift towards wholesale and retail trade, and services. Since 1990 the percentages of nonagricultural employment in *Pierce County* have changed as follows:

<u>NAICS Category</u>	<u>1990</u>	<u>2006</u>	<u>Change</u>
Construction	6.1 %	8.3 %	2.2 %
Manufacturing	10.0	7.4	(2.6)
Transportation, Warehousing and Utilities	3.6	4.3	0.7
Wholesale Trade	4.3	3.9	(0.4)
Retail Trade	12.7	11.6	(1.1)
Information	1.6	1.3	(0.3)
Financial Activities	5.3	5.3	0.0
Professional and Business Services	7.5	8.7	1.2
Educational and Health Services	13.6	14.6	1.0
Leisure and Hospitality	9.4	9.8	0.4
Other Services	4.0	4.6	0.6
Government	21.9	20.2	(1.7)
Total	<u>100.0 %</u>	<u>100.0 %</u>	

According to the Regional Labor Economist, “The ongoing housing correction that is impacting home sales, housing starts, and median existing house price appreciation likely will produce some fallout in employment among housing-related industries. Not only does this involve occupations in industries directly associated with the construction of homes, but also industries that involve landscaping and interior design services. The correction is not expected to be severe, but should temper overall job growth in 2007. Local residential construction flourished during the current economic expansion, and has added an average of 1,700 jobs annually since December 2002. Of the 6,900 jobs added by the Tacoma-Pierce economy in 2006, Construction is the industry that added the most jobs. The local area labor market enjoyed another strong year, even though the annual number of jobs added this year was below the 9,400 mark reached the year before.”

MANUFACTURING

Products manufactured in *Pierce County* include aerospace parts, chemicals, machinery, hardware, food products, and electronics. The ten largest manufacturers are:

<u>Company</u>	<u>City</u>	<u>Product/Service</u>	<u>Employees</u>
Boeing	Frederickson	Aerospace	1,395
Milgard Mfg. Inc.	Fife	Glass & window mfg.	1,118
Simpson Investment Company	Tacoma	Wood products	695
The News Tribune	Tacoma	Printing/publishing	650
Atlas Castings & Technology	Tacoma	Steel Manufacturer	462
Manke Lumber Co.	Tacoma	Sawmill & planing mill	348
Gensco Inc.	Fife	Sheet metal mfg.	283
Brown & Haley	Tacoma	Confectionary products	260
Toray Composites (America) Inc.	Frederickson	Composite materials	260
Mission Foods	Fife	Food mfg.	248

PORT FACILITIES

A 2005 economic impact study described the Port of Tacoma as, “a growing focal point of regional economic development, creating thousands of jobs, driving the economy of Pierce County, and serving as a statewide catalyst for economic development.”

As one of the nation’s top five container ports, the Port of Tacoma plays an important part in the local economy. The deep-water port covers 2,400 acres and offers a combination of facilities and services including 11 deepwater berths, two million square feet of warehouse and office space, and 131 acres of industrial yard. The same 2005 economic impact study showed that more the 43,000 jobs in *Pierce County* are related to Port activities.

SERVICE

One of the largest components of the service sector is health care. The largest employers include the Franciscan Health System (3,896) and Multicare Medical System (3,874). In addition, DaVita, the nation's second largest provider of dialysis services, employees 792 people in *Pierce County*.

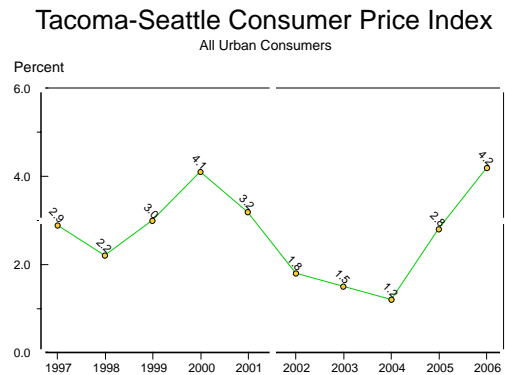
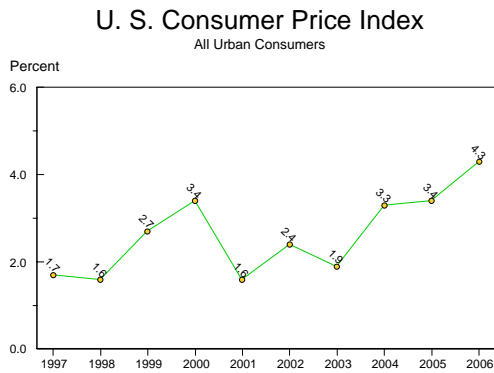
Fort Lewis Army Base and Madigan Army Medical Center occupy 86,000 acres in southwest *Pierce County* while the adjacent McChord Air Force Base includes 5,000 acres. Together, these facilities employ over 49,900 military and civilian personnel. Unlike many military installations across the country, Fort Lewis and McChord have expanded as people are transferred from closed facilities to the northwest. In addition, more than \$585M worth of new projects are planned for the military installations over the next few years.

Financial and insurance services companies are also significant employers in *Pierce County*. These include Russell Investment Group (1,035), State Farm Insurance (965), KeyBank (600), Columbia Bank (456), and Regence BlueShield (488).

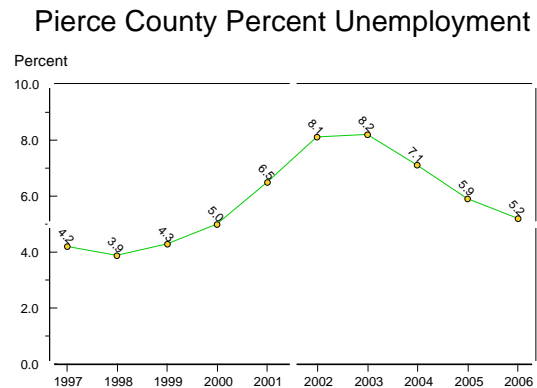
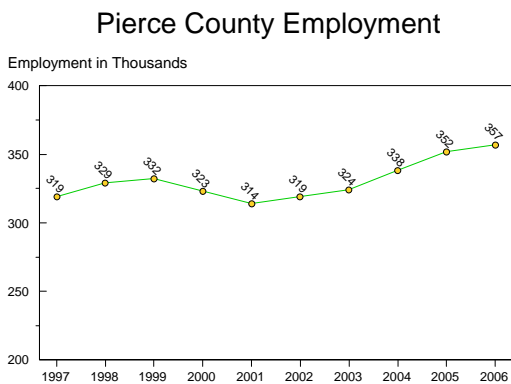
ECONOMIC INDICATORS

The following indicators are key elements in the evaluation of current economic conditions and are useful when developing projections or economic forecasts.

Inflation. Based on the Seattle-Tacoma-Everett Consumer Price Index for all urban consumers, inflation increased from 2.8% in 2005 to 4.2% in 2006. During the same period, the U. S. average (CPI-U) increased from 3.4% in 2005 to 4.3% in 2006.

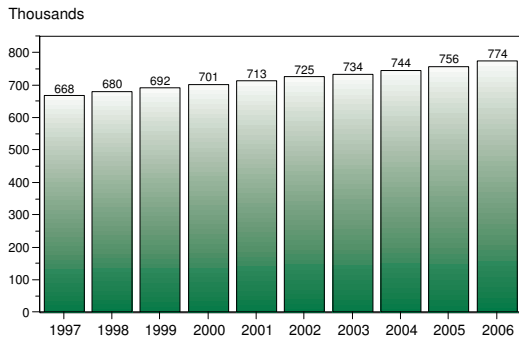


Employment. Total employment in the county increased to 357,000 while unemployment decreased to 5.2%. County unemployment is slightly worse than both the statewide average of 4.9% and the U.S. average of about 5.0%.

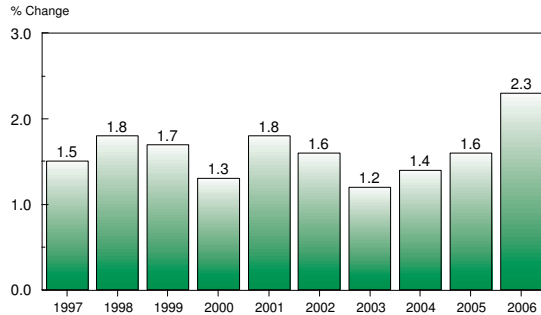


Population. *Pierce County* is home to an estimated 773,500 people, making it the second largest county in the state. The five largest cities are: Tacoma (199,600), Lakewood (59,000), Puyallup (36,360), University Place (31,140), and Bonney Lake (15,230).

Pierce County Population History

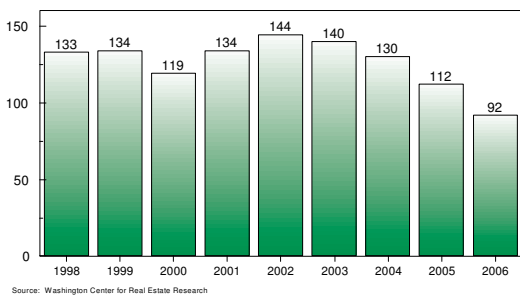


Pierce County Population Percent Change

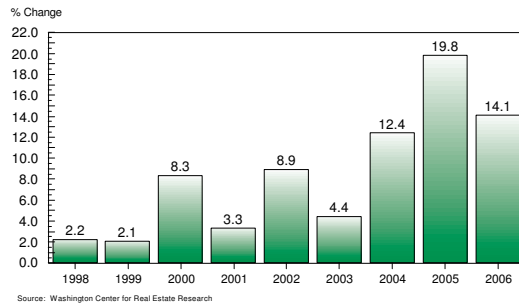


Housing. *Pierce County*, like the rest of the state and nation, has been experiencing a “hot” housing market the past few years. According to data compiled by the Washington Center for Real Estate Research/Washington State University, the median price of a house in *Pierce County* doubled between 1998/Q3 and 2006/Q3 to \$279,500. Price inflation and the number of resales have cooled since the peak change of 19.8% in 2005. As pointed out by *BusinessWeek* (July 7, 2006), “The weaker housing market will affect the economy in two ways: First, falling construction activity will have a direct negative impact. Second, higher mortgage rates and an end to strong home appreciation will restrict American’s ability to take cash out of their homes.” Rapid appreciation also impacts affordability. The Washington Center for Real Estate Research calculates a Housing Affordability Index which measures the ability of a middle income family to carry the mortgage payments on a median price home. When the index is 100 there is a balance between the family’s ability to pay and the cost. Higher indexes indicate housing is more affordable. The index has been falling the last two years.

Pierce County Housing Affordability Index

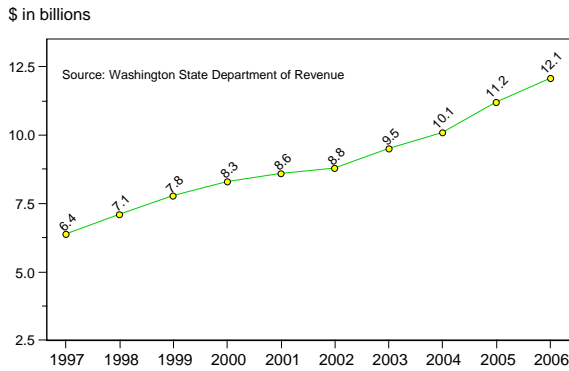


Pierce County Percent Change in Median Home Price

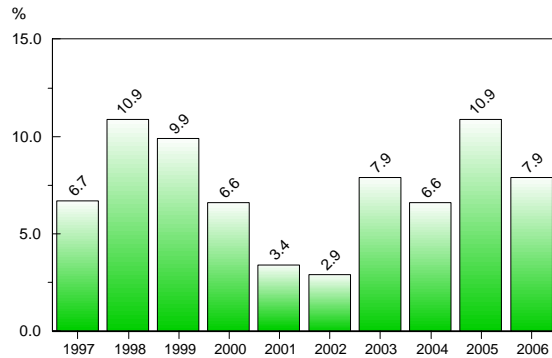


Taxable Retail Sales. Taxable retail sales continued very strong in 2006 increasing 7.9% compared to 2005.

Pierce County Taxable Retail Sales

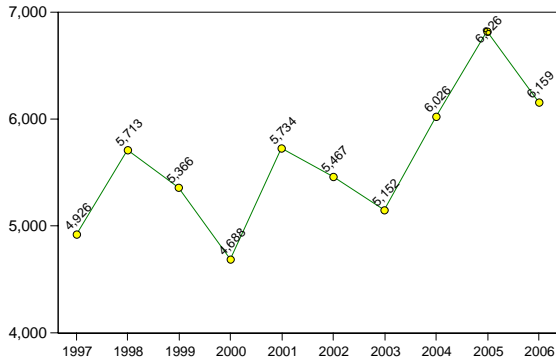


Percent Change Taxable Retail Sales

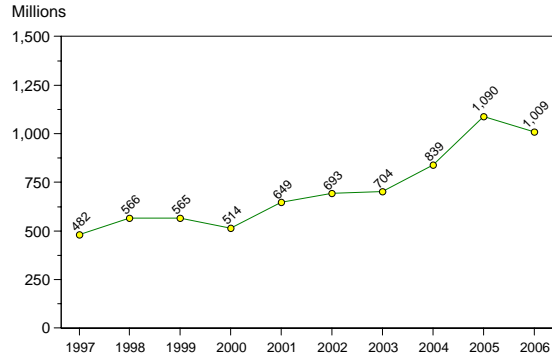


Construction. New construction activity is an important economic indicator that greatly impacts county operations and workload in areas such as planning, permits, land services, public works, and public construction. Property tax revenues are also affected by fluctuations in new construction activity. The number and value of permits issued is an indicator of future growth in the county property tax base. The figures below illustrate that although growth is slowing the *Pierce County* residential housing market remains strong.

Residential Construction Activity
New Housing Units, U.S. Census Bureau



Value of Residential Permits Issued
New Housing Units, U.S. Census Bureau



FUTURE CONCERNS AND DEVELOPMENTS – LONG TERM PLANNING

Although the net asset balances for most county funds remain positive, *Pierce County* faces several challenges that will require earnest attention during the next few years. These issues affect the county’s long range planning forecasts and add a significant element of uncertainty to those forecasts:

- ✦ **Public Safety.** Workload levels in law enforcement and the judicial system are expected to increase in the near future.
- ✦ **New Jail.** A new adult corrections facility is now open, and has resulted in a significant increase in annual jail related expenses, both debt service and operations. We anticipate more fiscal pressure in future years as the inmate population continues to grow.

- ✦ **Pension Rate Increases.** The state pension system (of which we are a member) has scheduled a series of rate increases needed to adequately fund the pension plans. This will result in a significant rise in related expenses between 2007 and 2009.
- ✦ **Facilities.** Current office facilities are not adequate to house expanding county departments. New space must be considered in the near future for additional court facilities and other justice system departments, and to reduce our outside space rental expenses.
- ✦ **Federal and State Grants.** Budget cutbacks at either level could well result in reductions in grants which currently support several county programs.
- ✦ **Transportation.** The growth in the local economy plus population increases are placing great pressure on our transportation infrastructure. Several funding proposals are under consideration to expand our capacity and relieve congestion.

FINANCIAL POLICIES

The county maintains a set of financial policies to guide fiscal and budgetary decision making. Such financial policies include:

- ✦ **County Investment Policies and Procedures**
- ✦ **County Debt Management Policies**
- ✦ **Budget and Finance Department Fiscal Policies**
 - Budget guidelines
 - Fund balance policies
 - Revenue policies
 - Expenditure policies

MAJOR INITIATIVES

Although several initiatives involving new or expanded programs and services were commenced or were in progress in 2006, most will not have a major impact upon our future fiscal position. However, a few such initiatives were of major importance:

- ✦ **New “Destination” Golf Course.** Projected to open in 2007 and be self-supporting with green fees.
- ✦ **New Roads Maintenance Facility.** Will combine several shops and reduce long-term expenses.
- ✦ **New Parks and Recreation Facilities.** Several projects are currently underway and construction will be funded by parks sales tax and real estate excise taxes. Future operational costs will be financed by parks sales taxes and cooperative funding arrangements with various cities within the county.
- ✦ **Emergency Operations Center.** Design work for this new facility began in 2005, with construction anticipated to be completed by the early part of 2008.

CASH MANAGEMENT

At year-end, *Pierce County* had invested funds with a fair market value of approximately \$1.38 billion (excluding investments held by trustees). Funds managed and invested for the direct benefit of the county with a value of \$483 million, with the balance of approximately \$897 million invested for the direct benefit of other taxing districts for which the county serves as treasurer.

At December 31, 2006, the investment portfolio mix of county operating and trust funds (excluding other taxing districts) is presented on the following page:

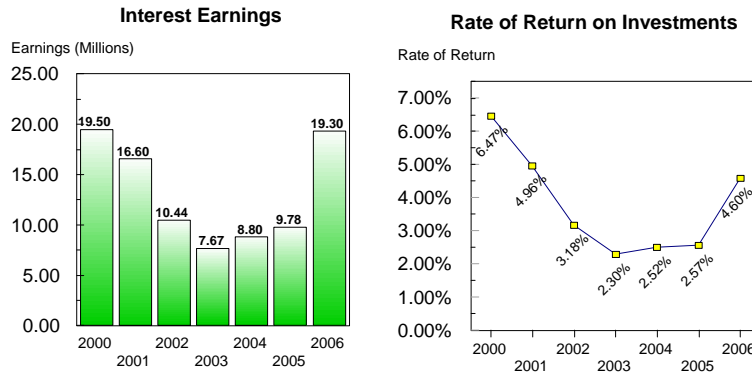
Type of Investment	Amount (In Thousands)	Percent of Portfolio
State Investment Pool	\$ 132,000	27.32 %
Certificates of Deposits	239,050	49.47 %
U.S. Government Agencies	110,380	22.85 %
Registered Warrants	1,717	0.36 %
Total	\$ 483,147	100.00 %

Days to Maturity	Amount (In Thousands)	Percent of Portfolio
1 - 30	\$ 248,700	51.48 %
31 - 90	45,000	9.31 %
91 - 180	43,669	9.04 %
181 - 365	38,467	7.96 %
Over 1 Year	107,311	22.21 %
Total	\$ 483,147	100.00 %

The average yield on county invested funds for 2006 was approximately 4.60%. Total interest earnings on county funds were \$19.3 million, an increase of \$9.5 million from 2005. Both the yield and total interest earnings are inclusive of a fair market value decrease of \$2.6 million. Increased interest earnings resulted from an increase in the average yield (as adjusted for fair market value) on investments plus an increase of approximately \$38.6 million in the average daily balance of invested funds.

Comparative figures for interest earnings and rates of return for county funds during the past 7 years are presented in the figures shown below. As is evident from these charts, interest earnings declined dramatically between 2000 and 2004, due to the sharp drop in short term interest rates. This trend reversed in 2004.

Interest Earnings and Rates of Return



Investment income includes the reduction in the fair market value of investments. Decreases in fair market value during the current year, however, do not necessarily represent trends that will continue; nor do they mean that such losses will be realized, especially in the case of investments that the government intends to hold to maturity.

RISK MANAGEMENT

Pierce County maintains an active risk management program emphasizing loss prevention, safety, and insurance purchase coordination. The *Self-Insurance Fund* is responsible for assessing charges to county funds, paying claim settlements, and purchasing risk insurance policies. Interfund charges are based primarily on the loss experience of the various contributing funds.

The activities of the workers compensation program are accounted for in the *Workers Compensation Fund*. The risk management department and a service company administer the program. Funding is provided through premium charges to county departments.

As indicated below, over the last five years the cash and investment balances for both funds, and net assets for the *Self-Insurance Fund* have increased significantly.

(In Thousands)	Self-Insurance		Workers Compensation	
	2001	2006	2001	2006
Cash and Investment Balance	\$ 13,624	\$ 25,962	\$ 1,312	\$ 2,178
Net Assets	\$ 4,692	\$ 17,676	\$ (270)	\$ (235)

The county has achieved its goal of maintaining a cash and investment balance of at least \$15 million in the *Self-Insurance Fund* and \$1.5 million in the *Workers Compensation Fund*. Such balances are deemed sufficient to fund two very large losses in each program. A second goal is simply to achieve positive net assets, which is currently not the case for the *Workers Compensation Fund*.

I. AWARDS AND ACKNOWLEDGEMENTS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to *Pierce County* for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended December 31, 2005. The county has received this award every year since 1983.

To earn the Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR whose contents conform to program standards and satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. The current report continues to conform to the Certificate of Achievement program requirements, and is being submitted to GFOA to determine eligibility for another certificate.

The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated service of our Chief Accountant, Judy Taylor, and the entire Accounting Division of the Budget and Finance Department. We also wish to express our appreciation to all other county personnel for their assistance and cooperation during the year in implementing financial system enhancements. In particular, we wish to thank the County Executive and the County Council whose interest in, and support of, the financial obligations of *Pierce County* have significantly contributed to a quality financial operation.

Respectfully submitted,

Patrick Kenney
Director of Budget and Finance

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Pierce County
Washington

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

ELECTED OFFICIALS

December 31, 2006

COUNCIL:

District 1	Shawn Bunney
District 2	Calvin Goings
District 3	Roger Bush
District 4	Tim Farrell
District 5	Barbara Gelman
District 6	Dick Muri
District 7	Terry Lee

COUNTY EXECUTIVE

John Ladenburg

PROSECUTING ATTORNEY

Gerald Horne

AUDITOR

Pat McCarthy

ASSESSOR/TREASURER

Ken Madsen

JUDICIAL:

Superior Court Judges:

Stephanie A. Arend	Thomas P. Larkin
Sergio Armijo	Linda CJ Lee
Rosanne Buckner	John A. McCarthy
Bryan E. Chushcoff	Kathryn J. Nelson
Ronald Culpepper	James Orlando
Frank E. Cuthbertson	Susan K. Serko
Thomas J. Felnagle	D. Gary Steiner
Frederick W. Fleming	Katherine M. Stolz
Beverly G. Grant	Brian Tollefson
John R. Hickman	Kitty-Ann van Doorninck
Vicki L. Hogan	Lisa Worswick

District Court Judges:

Karla E. Buttorff	David M. Kenworthy
Franklin L. Dacca	Jack F. Nevin
James R. Heller	Pat O'Malley
Judy Rae Jasprica	Margaret Vail Ross

COUNTY-WIDE ORGANIZATIONAL CHART
Pierce County
2006

