



MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Comprehensive Annual Financial Report for *Pierce County* provides an overview of county financial activities for the fiscal year ended December 31, 2006. The intent of the management discussion and analysis is to look at the county financial performance as a whole. We encourage readers to consider the information contained in this discussion in conjunction with additional information contained in our transmittal letter and in the financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

Government-wide statements are designed to provide readers with a broad overview of *Pierce County* finances in a manner similar to that of a private-sector business.

The statement of net assets presents information on all of the county assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the county is improving or deteriorating.

The statement of activities presents information showing changes in the government's net assets during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will actually result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). This is intended to summarize and simplify the reader's analysis of the revenues and costs of various county activities and the degree to which activities are subsidized by general revenues.

Both government-wide financial statements distinguish between functions of *Pierce County* principally supported by taxes and intergovernmental revenues (governmental activities) and other functions that are intended to recover all or a significant portion of operating costs through user fees and charges (business-type activities). The governmental activities of the county include general government, public safety, physical environment, legal, judicial, economic environment, transportation, health and human services, and culture and recreation. Business-type activities include water and sewer utilities, solid waste management and the associated landfill reserve, an airport, ferry services, and three golf courses.

FUND FINANCIAL STATEMENTS

Fund financial statements are designed to report information about groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The county, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. All of the funds of the county can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

GOVERNMENTAL FUNDS

Essentially the same functions reported as governmental activities in the government-wide financial statements are reported in governmental fund financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities as reported in the government-wide statements.

The county maintains a general fund and several other individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the *General Fund*, the *Human Services Fund*, and the *Roads Fund*, all of which are considered to be major funds. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

Budgetary comparison statements are presented for the *General Fund*, *Human Services Fund* and the *Roads Fund* to demonstrate the flow of resources in relation to the legally adopted budget.

PROPRIETARY FUNDS

Pierce County maintains two types of proprietary funds; *Enterprise Funds* and *Internal Service Funds*. *Enterprise Funds* are used to report the same functions presented as business-type activities in the government-wide financial statements. Water and sewer utilities, solid waste management, landfill reserve, airport, ferry services, and the golf courses are accounted for in *Enterprise Funds*. *Internal Service Funds* are a fund type used to accumulate and allocate costs internally among the various county functions. *Pierce County* uses *Internal Service Funds* to account for equipment and fleet services, information services, facilities management, radio communications, general services, self-insurance, and workers compensation activities. Because these services predominantly benefit governmental rather than business-type functions, *Internal Service Funds* have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statement, only in more detail. The proprietary fund financial statements provide separate information for the *Sewer Utility*, *Chambers Bay Golf Course* and the *Ferry Services Fund*, which are considered to be major funds of the county. Data from the other five *Enterprise Funds* and all eight *Internal Service Funds* are combined into individual, aggregated presentations. Individual fund data for each of these nonmajor proprietary funds is provided in the form of combining statements elsewhere in this report.

FIDUCIARY FUNDS

Resources held for the benefit of parties outside the government are accounted for in fiduciary funds. Because the resources of those funds are not available to support county programs, fiduciary funds are not reflected in the government-wide financial statements. The accounting used for fiduciary funds is much like that used for proprietary funds.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Shown below are condensed versions of the government-wide statements of activities and net assets for both governmental and business-type operations. The government-wide statements are presented in detail in the financial section of this report.

STATEMENT OF ACTIVITIES

The following is a summary of the changes in net assets from the statement of activities:

Condensed Summary of Changes in Net Assets (In Thousands)

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Program Revenues:						
Charges for Services	\$ 69,829	\$ 60,642	\$ 37,204	\$ 35,137	\$ 107,033	\$ 95,779
Operating Grants and Contributions	154,182	156,042	2,782	642	156,964	156,684
Capital Grants and Contributions	9,331	6,295	18,183	15,321	27,514	21,616
General Revenues:						
Taxes	233,599	221,340	293	286	233,892	221,626
Interest and Investment Earnings	16,649	8,499	852	557	17,501	9,056
Other General Revenue	961	1,033	–	–	961	1,033
Total Revenues	<u>484,551</u>	<u>453,851</u>	<u>59,314</u>	<u>51,943</u>	<u>543,865</u>	<u>505,794</u>
Expenses:						
General Government	39,872	38,424	–	–	39,872	38,424
Public Safety	122,964	118,726	–	–	122,964	118,726
Physical Environment	22,367	16,067	–	–	22,367	16,067
Transportation	62,054	64,561	–	–	62,054	64,561
Legal and Judicial	64,736	61,355	–	–	64,736	61,355
Economic Environment	35,196	33,614	–	–	35,196	33,614
Health and Human Services	83,413	85,742	–	–	83,413	85,742
Culture and Recreation	10,346	10,241	–	–	10,346	10,241
Interest on Long-Term Debt	3,786	1,489	–	–	3,786	1,489
Sewer Utility	–	–	32,099	30,259	32,099	30,259
Solid Waste Landfill Reserve	–	–	10	40	10	40
Solid Waste Management	–	–	3,372	4,204	3,372	4,204
Airport	–	–	528	539	528	539
Ferry Services	–	–	3,010	2,457	3,010	2,457
Golf Course	–	–	1,874	1,766	1,874	1,766
Water Utility	–	–	48	92	48	92
Total Expenses	<u>444,734</u>	<u>430,219</u>	<u>40,941</u>	<u>39,357</u>	<u>485,675</u>	<u>469,576</u>
Change in Net Assets Before Transfers and Special and Extraordinary Items	39,817	23,632	18,373	12,586	58,190	36,218
Transfers	(2,983)	177	2,983	(177)	–	–
Special Item	2,418	–	–	–	2,418	–
Extraordinary Item	2,032	–	–	–	2,032	–
Change in Net Assets	<u>41,284</u>	<u>23,809</u>	<u>21,356</u>	<u>12,409</u>	<u>62,640</u>	<u>36,218</u>
Net Assets - Beginning of Year	<u>859,074</u>	<u>835,265</u>	<u>441,322</u>	<u>428,913</u>	<u>1,300,396</u>	<u>1,264,178</u>
Net Assets - End of Year	<u>\$ 900,358</u>	<u>\$ 859,074</u>	<u>\$ 462,678</u>	<u>\$ 441,322</u>	<u>\$ 1,363,036</u>	<u>\$ 1,300,396</u>

Financial Highlights

- ✦ Total Expenses for 2006 were approximately \$486 million, consisting of \$445 million (92%) for governmental activities and \$41 million (8%) for business-type activities.
- ✦ The increase in Total Expenses was 3.4%, with governmental activities increasing by 3.4% and business-type activities by 4.0%.
- ✦ Total government-wide program revenues plus general revenues equaled \$548 million and exceeded total government-wide expenses of \$486 million. This resulted in government-wide net assets increasing \$63 million during fiscal 2006, which is approximately a 75% increase in net assets change compared to the prior year.
- ✦ Total Program Revenues for all activities were \$292 million and funded approximately 60% of the total expenses for Pierce County. This is slightly above the 58% from 2005. The remaining expenses were financed through general revenues (principally taxes, but also with a large increase in interest earnings).
- ✦ The most significant change in Expenses was an increase in Physical Environment due to the acquisition of open space property and increased storm water protection activities.
- ✦ Governmental activities were funded by program revenues of approximately \$233 million (52%), with general revenues financing the remaining 48% of governmental activities expenses. These are the same percentages present in 2005.
- ✦ Business-type activities generated program revenues of approximately \$58 million, which exceeded related expenses by \$17 million. Most of this positive margin occurred in the *Sewer Utility*.

The following table directly compares governmental and business-type activities with associated program revenues:

Comparative Statement of Activities

(In Thousands)

Governmental Activities	2006			2005	
	Expenses	Program Revenues		Net Revenues (Expenses)	Net Revenues (Expenses)
		Charges For Services	Grants And Contributions		
Public Safety	\$ 122,964	\$ 4,321	\$ 23,218	\$ (95,425)	\$ (89,024)
Legal and Judicial	64,736	12,337	9,466	(42,933)	(40,383)
Transportation	62,054	846	28,708	(32,500)	(42,785)
Health and Human Services	83,413	905	81,922	(586)	(3,320)
All Other Programs	111,567	51,420	20,199	(39,948)	(31,729)
	<u>\$ 444,734</u>	<u>\$ 69,829</u>	<u>\$ 163,513</u>	(211,392)	(207,241)
General Revenues				252,676	231,050
Change in Net Assets				<u>\$ 41,284</u>	<u>\$ 23,809</u>

Business-Type Activities	2006			2005	
	Expenses	Program Revenues		Net Revenues (Expenses)	Net Revenues (Expenses)
		Charges For Services	Grants And Contributions		
Sewer Utility	\$ 32,099	\$ 29,235	\$ 16,652	\$ 13,788	\$ 11,776
Golf Course	1,874	1,774	—	(100)	(971)
Ferry Services	3,010	2,155	3,011	2,156	1,299
All Other Programs	3,958	4,040	1,302	1,384	(362)
	<u>\$ 40,941</u>	<u>\$ 37,204</u>	<u>\$ 20,965</u>	17,228	11,742
General Revenues				4,128	667
Change in Net Assets				<u>\$ 21,356</u>	<u>\$ 12,409</u>

Financial Highlights

- ✦ As would be expected in governmental activities, programs requiring the greatest general revenue support were public safety, and the legal and judicial system (combined support of \$138 million).
- ✦ The gap between total governmental activities expenses and related program revenues increased slightly, from \$207 million in 2005 to \$211 million in 2006.
- ✦ However, the county generated a \$41 million increase in net assets for governmental activities because general revenues were more than sufficient to cover the remaining funding gap between expense and program revenues.
- ✦ Business-type activities reported a \$21 million increase in net assets, which is 72% more than the 2005 increase of \$12 million, most of which was funded by program revenue increases. The major source of the increase was the strong fiscal performance of the *Sewer Utility Fund*.

STATEMENT OF NET ASSETS

The following is a summary of the government-wide statement of net assets presented in detail in the financial section of this report:

Condensed Statement of Net Assets (In Thousands)

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Current Assets	\$ 342,252	\$ 296,191	\$ 32,031	\$ 31,236	\$ 374,283	\$ 327,427
Restricted Assets/Joint Ventures	1,011	870	55,369	68,224	56,380	69,094
Capital Assets	739,861	690,459	436,772	401,732	1,176,633	1,092,191
Total Assets	1,083,124	987,520	524,172	501,192	1,607,296	1,488,712
Current Liabilities	76,432	78,512	11,669	10,690	88,101	89,202
Noncurrent Liabilities	106,334	49,934	49,825	49,180	156,159	99,114
Total Liabilities	182,766	128,446	61,494	59,870	244,260	188,316
Total Net Assets	\$ 900,358	\$ 859,074	\$ 462,678	\$ 441,322	\$ 1,363,036	\$ 1,300,396

Financial Highlights

- ✦ Approximately \$900 million (66%) of total net assets are related to governmental activities, while \$463 million (34%) are related to business-type activities. These percentages are unchanged from 2005.
- ✦ As indicated earlier, net assets increased by \$63 million in 2006, the majority of which was generated by governmental activities. However, as show below, most of this increase was in restricted assets.
- ✦ Capital assets account for approximately 73% of total assets, and 86% of total net assets. The 2005 percentages were similar.
- ✦ Capital assets accounted for 68% of Governmental Activities total assets, and 82% of total net assets. The comparable figures for the Business-Type Activities are 83% and 94%.

✦ Net assets can be further summarized as follows:

Summary of Net Assets
(In Thousands)

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Capital Assets (Net of Related Debt)	\$ 634,239	\$ 632,997	\$ 391,180	\$ 371,875	\$ 1,025,419	\$ 1,004,872
Restricted Net Assets	173,790	135,781	45,124	43,327	218,914	179,108
Unrestricted Net Assets	92,329	90,296	26,374	26,120	118,703	116,416
Total Net Assets	<u>\$ 900,358</u>	<u>\$ 859,074</u>	<u>\$ 462,678</u>	<u>\$ 441,322</u>	<u>\$ 1,363,036</u>	<u>\$ 1,300,396</u>

- ✦ 10% of governmental activities net assets are unrestricted, while only 6% of the business-type activities net assets are unrestricted.
- ✦ Unrestricted net assets increased by only \$2.3 million in 2006, due mostly to the Governmental Activity funds.

FINANCIAL ANALYSIS OF MAJOR COUNTY FUNDS

GENERAL FUND

Revenues. The *General Fund* receives unrestricted county revenue which is used to finance such activities as law enforcement, county detention facilities, the judicial system, planning and development regulation, general governmental services, parks and recreation programs, and various human and health services. Revenue and all other financing sources for the *General Fund* totaled \$254.1 million in fiscal 2006, representing only a 6.9% increase from the prior year. Revenue categories, with the changes from last fiscal year, are summarized as follows:

Summary of General Fund Revenues and Other Financing Sources
(in thousands)

Category	Amount		Increase (Decrease)	
	2006	2005	Amount	Percent
Revenue:				
Property and Other Taxes	\$ 104,078	\$ 100,456	\$ 3,622	3.6 %
Sales Tax	54,679	49,589	5,090	10.3 %
Licenses and Permits	8,557	8,882	(325)	(3.7) %
Intergovernmental	28,819	29,537	(718)	(2.4) %
Charges for Services	33,855	33,120	735	2.2 %
Fines and Forfeits	5,418	4,665	753	16.1 %
Interest	14,939	7,629	7,310	95.8 %
Miscellaneous Revenue	2,026	2,061	(35)	(1.7) %
Total Revenue	252,371	235,939	16,432	7.0 %
Other Financing Sources	1,703	1,655	48	2.9 %
Total Funding Sources	<u>\$ 254,074</u>	<u>\$ 237,594</u>	<u>\$ 16,480</u>	6.9 %

A more detailed discussion of the major changes from the prior year follows:

- ✦ **Sales Taxes.** The 10% increase reflected very strong economic growth in both our cities and in the surrounding unincorporated areas.
- ✦ **Fines and Forfeits.** The large revenue increase was due to the reinstatement of license revocations for failure to pay delinquent traffic infractions, and “emphasis patrols” by the State Patrol.
- ✦ **Interest Revenues.** The recent increase in short term interest rates resulted in a significant growth in interest revenues.

As illustrated in the graph below, the 6.9% increase in revenue was the largest percentage growth in the

last 5 years. Two factors are largely responsible for this growth rate: the continued strong growth in the local economy and the sharp increase in short term interest rates.

It is likely that revenue increases for the rest of the decade will be closer to the 2002-2003 levels due to the continued impact of a voter approved initiative (effective 2002), which limits property tax revenue increases from existing property to 1%.

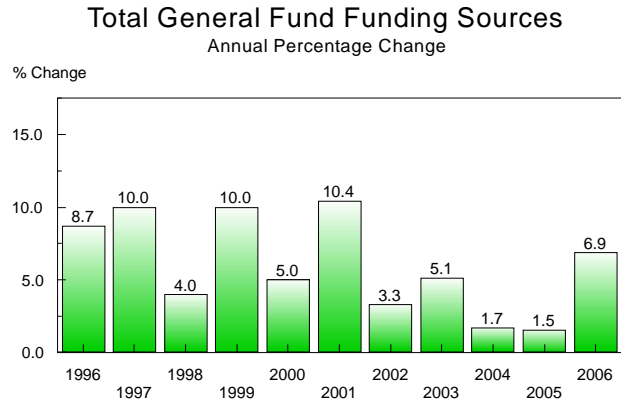


Figure 1

The chart below presents the percentage of 2006 funding sources by category for the *General Fund*. The chart illustrates continued strong dependence on property and sales taxes (a combined 62.5%) as the major revenue sources. During much of the last ten years, the percentage of revenues from such taxes has declined slightly as service charges and interest revenue percentages have grown.

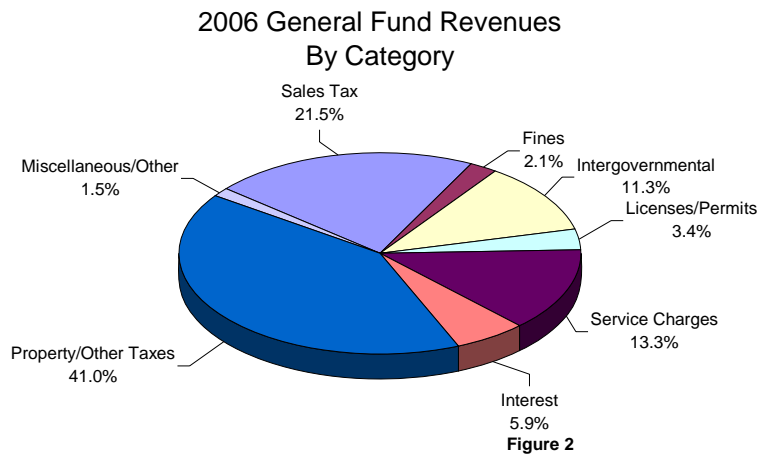


Figure 2

Expenditures. Fiscal 2006 *General Fund* expenditures and transfers out totaled \$250.3 million, representing an increase of \$12.7 million (5.3%) from 2005. All transfers are classified into related functional areas and are included in the comparison of expenditures.

Comparisons of expenditures for the last two years are presented below:

Summary of General Fund Expenditures and Transfers Out
(in thousands)

Functional Area	Amount		Increase (Decrease)	
	2006	2005	Amount	Percent
General Government	\$ 35,227	\$ 37,111	\$ (1,884)	(5.1) %
Public Safety	114,671	110,294	4,377	4.0 %
Physical Environment	1,609	1,551	58	3.7 %
Legal and Judicial	69,902	61,825	8,077	13.1 %
Health and Human Services	3,252	3,301	(49)	(1.5) %
Transportation	292	–	292	∞
Culture and Recreation	7,280	7,303	(23)	(0.3) %
Economic Environment	18,117	16,299	1,818	11.2 %
Total Expenditures and Transfers Out	<u>\$ 250,350</u>	<u>\$ 237,684</u>	<u>\$ 12,666</u>	5.3 %

The major changes from last year are explained below:

- ✦ **General Government.** This decrease is the result of a large, one time allocation for building improvements made in 2005.
- ✦ **Legal and Judicial.** The large increase resulted primarily from a large allocation for the judicial system building remodeling project.
- ✦ **Economic Environment.** The large increase reflected additional resources allocated to development center permit and land use processing activities.

The chart on the following page graphically illustrates relative budget allocations to the various county functional activities. Combined expenditures for public safety, and legal and judicial functions make up almost 74% of the total *General Fund* expenditures, and the 2006 increase in these two areas almost equaled the total increase in *General Fund* expenses. The combined percentage for these two major functions would be close to 80% if the related general government support costs were all allocated to each department. Similarly, over 80% of the increase in total *General Fund* expenditures over the last ten years occurred in these two major functional areas. This trend of increased spending in Public Safety and Legal and Judicial functions is expected to continue into the next few years with increased demand for sheriff services, growing court caseloads, full operation of the new jail facility, and large remodeling expenses for judicial system facilities.

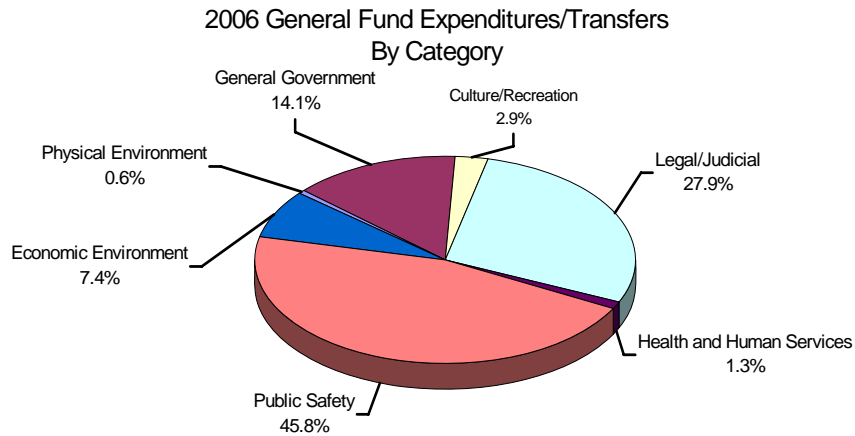


Figure 3

As previously indicated, total 2006 expenditures and transfers increased by 5.3% over 2005 levels. The 2006 percentage increase was the highest in the last four years, reflecting the strong revenue growth discussed earlier. Corresponding percentage increases from prior years are presented below:

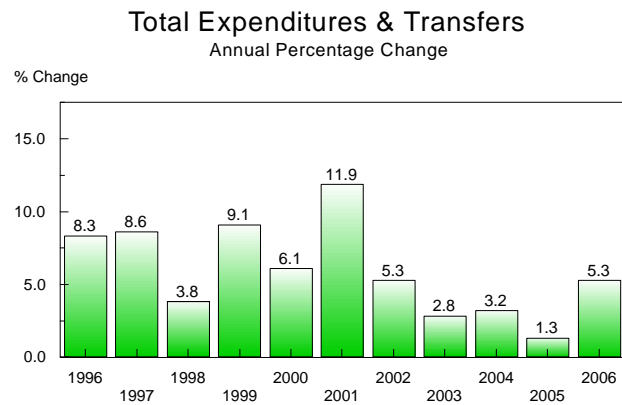


Figure 4

The 2006 “bottom-line” fiscal result for the *General Fund* was quite positive, generating a “surplus” of approximately \$3.7 million summarized as follows:

**Summary of General Fund Changes in Fund Balance
(in thousands)**

Revenues	\$ 252,371	
Expenditures	<u>238,943</u>	
Excess of Revenues Over Expenditures		\$ 13,428
Other Financing Sources (Uses), Net		<u>(9,704)</u>
Change in Fund Balance		<u><u>\$ 3,724</u></u>

The graph on the following page illustrates the relationship between Resources (including all revenues and transfers in) and Uses (including all expenditures and transfers out) for 2006 and the past ten years. The early trend had been quite positive; with Resources exceeding Uses every year from 1996 through 2001. However, three of the next four years produced negative results, although the “net” result was only a slight decline of \$300,000. The strong result in 2006 more than off-set the 2002-2005 decline.

General Fund Summary
Annual Difference Between Resources & Uses

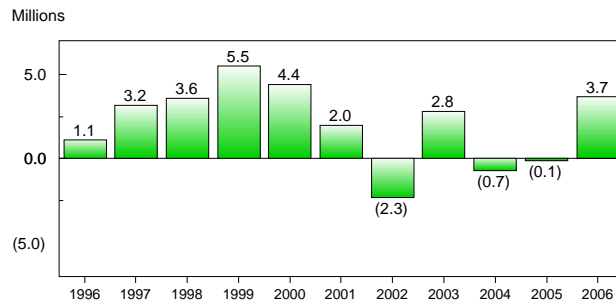


Figure 5

Budget Comparisons. The original *General Fund* budget passed by the County Council totaled \$249.8 million. Reasons for budget increases of \$4.06 million during the year included the following:

- ✦ An increase of \$220 thousand for aggravated murder cases expenses.
- ✦ A \$14 thousand allocation for various community projects and services specified by the County Council.
- ✦ Increases totaling \$3.1 million reflecting various grants, service contracts, and reimbursements of election cost, all which are essentially self-funding.
- ✦ An increase of \$1 million for overtime in the jail.

The above budget increases were financed as follows:

Summary of General Fund Budget Increase
(in thousands)

Taxes	\$	920
Transfers In		14
Grants, Service Contracts, and Election Cost Reimbursement		3,123
Total Budget Increase Financing	\$	4,057

Actual expenditures totaled 98.6% of the final budgeted amounts, and consequently there were no significant variances between the final approved budget and actual expenditures.

General Fund Balance. The unreserved fund balance for the *General Fund* was approximately \$28.4 million at December 31, 2006, reflecting an increase of approximately \$3.7 from 2005. This increase resulted from the aforementioned operating surplus.

Fund balance serves several purposes for the county. It provides working capital until the receipt of first half property tax payments at the end of April. During the first four months of each year the *General Fund* expends approximately \$30 million more for payroll and services than is received in revenues. Fund balance provides the necessary cash to finance normal activities without borrowing. Fund balance also provides a reserve for unanticipated emergency expenditures. Finally, fund balance can be used to support subsequent budgets, especially to finance one-time expenditures.

The graph on the following page illustrates the trend in the unreserved fund balance over the past decade. The trend had been positive through 2001 and relatively steady after the decline in 2002. The 2006 results returned to our previous high level achieved in 2001. This level of fund balance has been sufficient to meet the needs referenced above.

Unreserved General Fund Balance

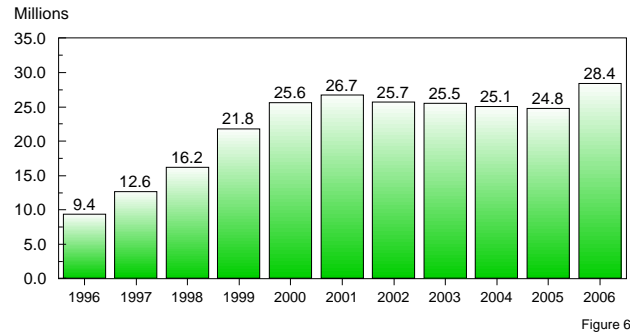


Figure 6

The figure below illustrates the trend in unreserved fund balance as a percent of budget. The county goal is to maintain an unreserved fund balance which is between 5% and 8% of current *General Fund* budget. At the end of 2006 the unreserved fund balance represented 11.2% of the 2006 budget. Approximately \$3.1 million of this fund balance has been designated in 2007 to support several one time obligations. Should 2007 actual revenues and expenditures occur as budgeted, the unreserved percentage will be reduced to an estimated 9.5% at the end of 2007.

Unreserved General Fund Balance as a Percent of the General Fund Budget

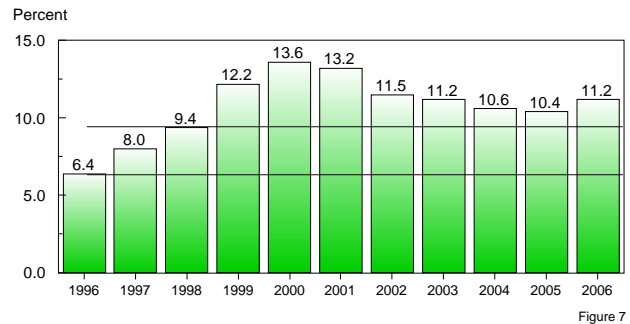


Figure 7

ROADS FUND

The *Roads Fund* finances the road maintenance, traffic control, general engineering, and general administrative activities for all county roads and bridges. This fund also allocates significant monies (\$14.2 million in fiscal 2006) to support major road construction and transportation building projects. All these activities totaled \$55.1 million in fiscal 2006. The major funding sources for these activities are property taxes (\$40.6 million), and gasoline tax revenues from the state (\$10.3 million).

A summary for the last five years of all revenues and other financing sources versus expenditures and other uses follows:

Five Year Summary of Roads Fund Revenues and Expenditures (in thousands)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Revenues/Sources	\$ 48,920	\$ 51,931	\$ 52,947	\$ 54,657	\$ 56,637
Expenditures/Uses	45,204	48,053	60,952	56,040	55,126
Revenues/Sources Over (Under) Expenditures/Uses	<u>\$ 3,716</u>	<u>\$ 3,878</u>	<u>\$ (8,005)</u>	<u>\$ (1,383)</u>	<u>\$ 1,511</u>

Fiscal 2006 resulted in a modest “surplus” for the fund. This reversed the trend from the previous 2 years when very large allocations were made for major roadway system improvements.

The fund balances for the *Roads Fund* for the last seven years are shown below. These balances will be used in subsequent years to maintain a solid road maintenance program, and to provide monies for capital improvement projects.

Road Fund Balance

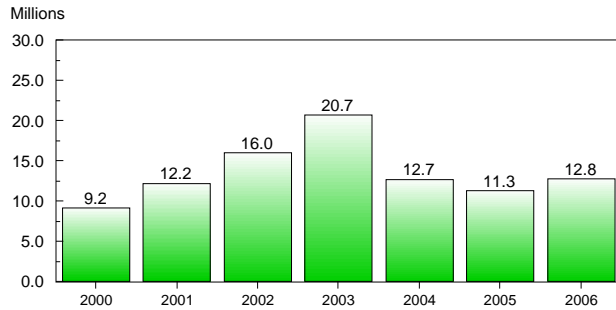


Figure 8

HUMAN SERVICES FUND

The *Human Services Fund* provides financing for the county programs dealing with aging and long-term care, mental health, chemical dependency, and developmental disabilities. The vast majority of the financing is derived from state and federal grants.

As the figures on the following page indicate, this fund has experienced a significant fluctuation in fiscal status. This fluctuation is primarily due to: a) maintaining existing programs and services as federal and state funding levels were decreased (2000-2002); b) the receipt of substantial monies in 2003 and 2006 from successfully concluded litigation regarding claims previously disallowed by the state; and c) a build-up of stabilization reserves in 2004 and the use of a portion of those reserves in 2005.

Human Services Fund Balance

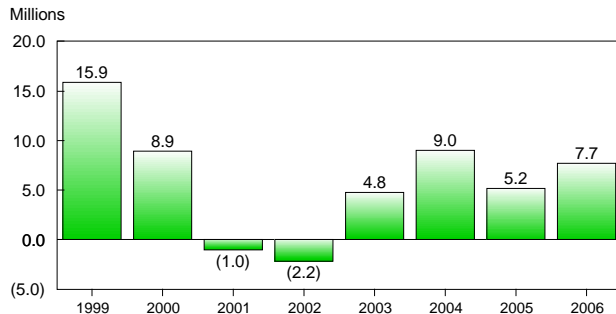


Figure 9

The 2006 expenditures were almost exactly equal to the revenues, and the fund balance increase was due to receipt of lawsuit settlement proceeds.

SEWER UTILITY FUND

The *Sewer Utility* is by far the county's largest enterprise fund, with total customer accounts of approximately 82,400. The primary source of operating revenue is from service charges collected from residential and commercial customers using wastewater collection and treatment services. Residential customers are billed on a bimonthly basis and commercial customers on a monthly basis. Secondary sources of operating revenue are provided from permit and plan review fees, and from miscellaneous billings.

A comparison of the components of sewer utility net assets for fiscal 2006 and 2005 follows:

Summary of Sewer Utilities Net Assets (In Thousands)

	Amount		Increase (Decrease)	
	2006	2005	Amount	Percent
Current and Other Assets	\$ 59,945	\$ 58,397	\$ 1,548	2.7 %
Capital Assets	377,811	367,509	10,302	2.8 %
Total Assets	<u>437,756</u>	<u>425,906</u>	<u>11,850</u>	2.8 %
Long-Term Liabilities	16,752	18,632	(1,880)	(10.1) %
Other Liabilities	6,186	6,450	(264)	(4.1) %
Total Liabilities	<u>22,938</u>	<u>25,082</u>	<u>(2,144)</u>	(8.5) %
Net Assets:				
Invested in Capital Assets - Net of Related Debt	359,309	347,071	12,238	3.5 %
Restricted	40,698	37,799	2,899	7.7 %
Unrestricted	14,811	15,954	(1,143)	(7.2) %
Total Net Assets	<u>\$ 414,818</u>	<u>\$ 400,824</u>	<u>\$ 13,994</u>	3.5 %

A comparison of results of operation in the sewer utility for fiscal 2006 and 2005 follows:

Summary of Sewer Utilities Revenues, Expenses, and Changes in Net Assets (In thousands)

	Amount		Increase (Decrease)	
	2006	2005	Amount	Percent
Operating Revenues	\$ 27,321	\$ 26,948	\$ 373	1.4 %
Nonoperating Revenues	2,478	1,950	528	27.1 %
Total Revenues	<u>29,799</u>	<u>28,898</u>	<u>901</u>	3.1 %
Operating Expenses	20,418	18,413	2,005	10.9 %
Depreciation	11,216	11,120	96	0.9 %
Nonoperating Expenses	616	857	(241)	(28.1) %
Total Expenses	<u>32,250</u>	<u>30,390</u>	<u>1,860</u>	6.1 %
Loss before transfers and contributions	(2,451)	(1,492)	(959)	(68.2) %
Transfers	(191)	(247)	56	22.7 %
Capital Contributions	16,636	13,557	3,079	22.7 %
Change in Net Assets	13,994	11,818	2,176	18.4 %
Beginning Net Assets	400,824	389,006	11,818	3.0 %
Ending Net Assets	<u>\$ 414,818</u>	<u>\$ 400,824</u>	<u>\$ 13,994</u>	3.5 %

Financial Highlights:

- ✦ Total assets at year end were \$437.8 million and exceeded liabilities of \$23 million, yielding total net assets of \$414.8 million. Total net assets increased by \$13.9 million, which is an increase of 3.5% from 2005. Of the total net assets, \$14.8 million was unrestricted and available to support short-term operations or to fund capital improvement projects. This represents a small decline from 2005.
- ✦ Operating revenues increased by \$374 thousand (1.4%) to \$27.3 million, which simply reflects normal growth in the Utility’s customer base.
- ✦ Operating expenses (excluding depreciation) increased by \$2.0 million (11.2%) to \$20.5 million. A combination of salary and benefit increases plus higher costs for replacement, repairs and maintenance of aging utility plant and equipment account for this change.
- ✦ Since Total Expenses grew by more than Total Revenues, the “Loss Before Transfers and Contributions” widened to \$2.5 million in 2006 versus \$1.5 million in 2005.
- ✦ The Utility invested \$11 million in the acquisition of property, plant and equipment during the year.
- ✦ The Utility transferred several completed projects with a cost of \$17 million from construction work in progress during the year. The largest of these was the \$13.2 million Fertilizer Manufacturing Facility project.
- ✦ Bonds outstanding at year-end total \$18.4 million, which is \$1.9 million less than the end of 2005 figure of \$20.3 million.
- ✦ Capital contributions increased by \$3.1 million (23%) to \$16.6 million, compared to \$13.5 million for 2005. This increase was principally due to strong development activity in the county in 2006, and the related donation of \$10.7 million in public sewer systems to our utility.

CHAMBERS BAY GOLF COURSE

This new golf course is under construction, and is currently on-time and on-budget. It is anticipated to be completed and open for play in late June 2007. Approximately \$14 million worth of construction was completed in 2006, bringing the total course construction costs to \$19 million as of year end.

FERRY SERVICES FUND

The most notable aspect of this fund in 2006 was the construction work in progress for the county’s new ferry, which will be placed in service in early 2007. The financial results from the system operations appear as follows (amounts in thousands):

	<u>2006</u>	<u>2005</u>	<u>Increase</u>	<u>% Change</u>
Operating Revenues	\$ 2,086	\$ 1,622	\$ 464	29 %
Operating Expenses	<u>2,974</u>	<u>2,443</u>	<u>531</u>	22 %
Operating Loss	(888)	(821)	(67)	(8) %
Non-Operating Revenues/ Transfer and Contributed Capital	<u>6,120</u>	<u>2,105</u>	<u>4,015</u>	191 %
Changes in Net Assets	<u>\$ 5,232</u>	<u>\$ 1,284</u>	<u>\$ 3,948</u>	307 %

Financial Highlights:

- ✦ Operating Expenditures increased by slightly more than Operating Revenues, resulting in a small increase in the Operating Loss figure.
- ✦ Non-Operating Revenues (grants) and Transfers In increased significantly in 2006, resulting in a large increase in Net Assets.
- ✦ Most of the increase in Net Assets was related to the aforementioned new ferry construction work in progress.

NONMAJOR SPECIAL REVENUE FUNDS (COMBINED)

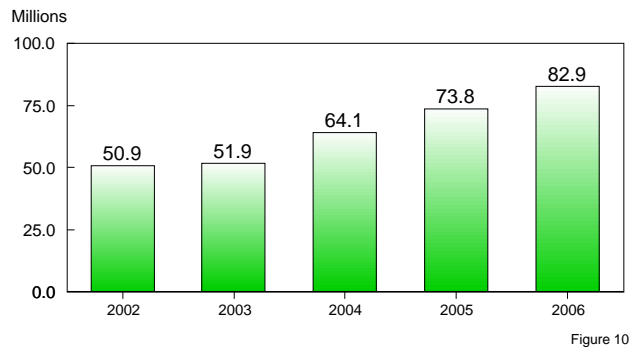
The *Nonmajor Special Revenue Funds* (35 funds) experienced a positive fiscal year in 2006 as follows (amounts in thousands):

Combined Revenues	\$ 79,422
Combined Expenditures	<u>87,176</u>
Excess Expenditures Over Revenues	(7,754)
Combined Other Sources (Uses)	<u>16,975</u>
Net Change in Fund Balance	<u><u>\$ 9,221</u></u>

The largest increases in fund balances occurred in the *Real Estate Excise Tax River Improvement Fund* (a \$2.4 million wetland credit payment for capital project funding) and the build-up of reserves in the *Conservations Futures fund* (\$3.3 million) for subsequent parcel acquisitions.

The combined fund balances for the last five fiscal years are as show below. A major portion of these balances (\$36.8 million) has been allocated in the 2007 budget, mostly for one-time capital projects.

Non-Major Special Revenue Funds Balance



INTERNAL SERVICE FUNDS

The 2006 financial results for the Internal Service funds were generally positive, as the figures below demonstrate. (amounts in thousands)

Operating Revenues	\$ 54,835
Operating Expenses	<u>52,741</u>
Operating Income	2,094
Nonoperating Revenues and Net Transfers	<u>573</u>
Change in Net Assets	<u><u>\$ 2,667</u></u>

Only three funds generated a negative change in Net Assets (Radio Communications, General Services, and Workers Compensation).

Total Net Assets were \$70.5 million as of December 31, 2006. Of this amount \$27.7 million was Invested in Capital Assets, with the remaining \$42.8 million being Unrestricted. Only the Workers Compensation fund has a negative Net Asset position (\$235 thousand), which will be addressed with rate increases in 2007.

The recent totals for Unrestricted Net Assets are shown below. The basic trend is a gradual increase in such balances, which are likely to be used in future years for capital equipment replacement and system enhancements.

Unrestricted Net Asset Totals

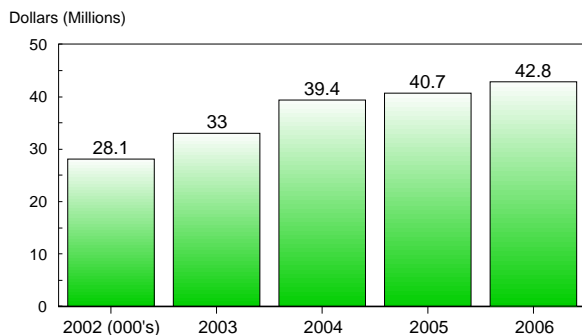


Figure 11

CAPITAL ASSETS

The county investment in capital assets for governmental and business-type activities totals \$1.177 billion at December 31, 2006. This investment in capital assets includes land, infrastructure, buildings and other improvements, furnishings, equipment, as well as construction in progress. Additional information on *Pierce County* capital assets can be found in Note 5 to the financial statements.

Total capital assets for the county increased by \$84.4 million in fiscal 2006 as follows:

Summary of Capital Asset Activity (in thousands)

Asset Category	Governmental Activities		Business-Type Activities	
	2006 Changes	Ending Asset Values	2006 Changes	Ending Asset Values
Land and Land Rights	\$ 16,438	\$ 100,656	\$ 83	\$ 47,530
Buildings and Systems	11,882	178,496	827	89,719
Improvements Other Than Buildings	515	14,448	2,060	14,822
Machinery and Equipment	4,317	82,248	11,139	56,559
Infrastructure	17,054	346,932	14,032	355,831
Avigation Rights	—	—	—	562
Accumulated Depreciation	(11,534)	(135,109)	(11,905)	(172,151)
Capital Assets, Net	38,672	587,671	16,236	392,872
Construction In Progress	10,731	152,191	18,804	43,900
Total Capital Assets, Net	\$ 49,403	\$ 739,862	\$ 35,040	\$ 436,772

HIGHLIGHTS

Governmental Activities:

- ✦ Capital assets for governmental activities experienced a \$49.4 million net increase which represents a net increase of \$38.7 million in capital assets in service and a net increase of \$10.7 million in construction in progress costs.
- ✦ The \$38.7 million net increase in capital assets in service consists of \$67.7 million in capital asset additions (\$59.6 million of completed projects from construction in progress and \$8.7 million of capital asset purchases), and decreases of \$29.1 million (\$17.2 of depreciation expense and \$11.9 million net amount of capital assets disposed in 2006).
- ✦ The \$67.7 million of capital asset additions consists of land (\$20.0 million), buildings and improvements (\$12.4 million), equipment (\$10.3 million), and infrastructure (\$25.0 million). Of the \$67.7 million of capital asset additions, \$14.3 million was land and construction of roads, \$13.6 million was conservation futures land acquisitions, \$12.2 million was land and construction of paths and trails, \$11.4 million was parks improvements, \$4.9 million was flood and surface water projects, \$9.9 million was various equipment and vehicle purchases, and \$1.4 million was other facility improvements.
- ✦ Construction in progress experienced a net increase of \$10.7 million which represents \$88.9 million of additional expenditures for ongoing and new projects reduced by \$59.6 million of projects completed and placed in service and further reduced by \$18.6 million of project costs written-off in 2006.
- ✦ Capital assets values experienced a total decrease of \$47.6 million consisting of the \$17.2 million of depreciation and \$30.4 million value of asset disposals and construction projects written off. The \$30.4 million of asset disposals and write-offs includes \$17.5 million of roads capital assets donated to or annexed by other local governments, \$9.8 million of conservation futures land donated to other local governments and agencies, \$1.3 million value of equipment disposals, and \$1.8 million expensed for various minor improvements and repairs.

Business-Type Activities:

- ✦ Capital assets for business-type activities increased \$35.0 million which represents a net increase of \$28.1 million in capital asset cost reduced by \$11.9 million of net change in accumulated depreciation, and a net increase of \$18.8 million in construction in progress cost.
- ✦ The \$28.1 million net increase in capital asset cost consists of \$17.0 million of completed projects from construction in progress, and \$11.1 million of capital asset acquisitions. Completed projects from construction in progress included a \$13.2 million fertilizer production facility and \$3.8 million of other capital improvements.
- ✦ The \$11.9 million change in accumulated depreciation consists of \$12.0 million for 2006 depreciation expense reduced slightly by accumulated depreciation for capital asset disposals.
- ✦ Construction in progress experienced a net increase of \$18.8 million including \$35.8 million of additional expenditures for completed, ongoing and new projects reduced by \$17.0 million of projects completed and transferred out of construction in progress in 2006.
- ✦ The \$35.8 million of additional construction in progress costs includes \$14.0 million added to ongoing construction of an 18-hole golf course, \$10.4 added for ongoing construction of a new ferry, and \$11.4 million for other ongoing or completed capital improvement projects.

DEBT ADMINISTRATION

The ratios of net direct tax supported bonded debt to assessed valuation and to population (per capita) present useful indicators of the relative county debt burden. The ratios at December 31, 2006 follow:

	<u>Ratio of Debt To Estimated Actual Value</u>	<u>Debt Per Capita</u>
Net Direct Tax Supported Bonded Debt*	0.0595	\$ 198.26

* Defined as Limited and Unlimited General Obligation Bonds net of assets available in *Debt Service Funds* for payment of principal.

Comparable ratios based on assessed valuation and per capita from Standard and Poors Public Finance for 2005 are 0.70 and \$535, respectively, for the average of all other counties with a population of greater than 150,000. This comparison dramatically illustrates the relatively low debt burden enjoyed by *Pierce County* residents.

A summary of outstanding debt is presented below:

Summary of Outstanding Debt (in thousands)

	<u>Governmental Activities</u>		<u>Businss-Type Activities</u>		<u>Totals</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
General Obligation Bonds	\$ 103,825	\$ 57,396	\$ 25,255	\$ 26,235	\$ 129,080	\$ 83,631
Sewer Revenue Bonds	-	-	13,920	14,835	13,920	14,835
Installment Contracts	2,795	1,324	7,556	4,473	10,351	5,797
Total Debt	<u>\$ 106,620</u>	<u>\$ 58,720</u>	<u>\$ 46,731</u>	<u>\$ 45,543</u>	<u>\$ 153,351</u>	<u>\$ 104,263</u>

The County's total debt outstanding increased \$49.1 million or 47% in 2006. The increase is the result of the issuance of \$64.9 million of new debt less \$15.8 million of redemptions.

In February the county issued \$31.8 million of Limited Tax General Obligation Bonds, 2006 to refund the \$10.1 million Limited Tax General Obligation Revolving Credit Grant And Bond Anticipation Note, 2004 (LOC) and to acquire land for the purpose of developing future parks and preserving open space land. The bonds have an average coupon of 4.17% and are serial bonds with average annual debt service of \$2.3 million.

In October \$27.4 million of Limited Tax General Obligation Bonds, 2006 Series B were issued to design, acquire land and construct a central maintenance facility for the Public Works and Utilities Department. The serial bonds have an average coupon of 4.5% and an average annual debt service of \$2.1 million.

During 2006 \$5 million was drawn on the Washington State Public Works Trust Fund Loans (Installment Loans), \$1.5 million for the road construction project and \$3.5 million for the new ferry boat construction. These loans provide for 85% of the construction costs, the repayment of which will be made in equal installments at .5% interest over the 20 loan period.

The *Sewer Utility Fund* is required to maintain a revenue bond debt service coverage ratio of 1.25 times the aggregate annual debt service of the utility's bonds outstanding. The revenue bond coverage ratio was 5.26 for 2005 and 10.68 for 2006. This increase in coverage was mainly the result of the 2005 advance refunding of \$6.2 million of revenue bonds with \$5.5 million of limited tax general obligation bonds. The total bond coverage was 5.26 for 2005 and 6.07 for 2006.

In the next five years, the county will retire 21% of the general obligation bond debt (\$26.5 million), 26% of the sewer revenue bond debt (\$3.7 million), and 27% of the Public Works Trust Fund Loans (\$2.9 million). In the next ten years, the retirement amounts are 43%, or \$55.6 million, 59%, or \$8.2 million, and 56% or \$5.8 million respectively.

The Moody's Investor Service bond ratings are Aa-3 for *Pierce County* limited tax general obligation bonds and A-1 for its sewer revenue bonds. The Standard & Poor's bond ratings are AA- for both *Pierce County* limited tax general obligation bonds and the sewer revenue bonds. These ratings are exceptionally high for a county and indicate to investors that *Pierce County* bonds are a good investment risk. Additional information on county long-term debt can be found in Note 6 to the financial statements.

REQUEST FOR INFORMATION

This financial report is designed to provide various interested parties with a general overview of county finances and to show the county's accountability for the money it receives. Questions concerning the information provided in this report or requests for additional financial information should be addressed to Pierce County Budget & Finance, 615 South 9th Street, Tacoma, Washington, 98405.

