

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Financial Statements

For the Years Ended December 31, 2010 and 2009

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Independent Auditors' Report***Cities' Municipal Employees' Benefit Trust Committee
Municipal Employees' Benefit Trust
Bellevue, Washington***Certified Public
Accountants
and Consultants

We have audited the accompanying statements of net assets of the Municipal Employees' Benefit Trust (the Trust) as of December 31, 2010 and 2009, and the related statements of changes in net assets and trust balance for the years then ended. These financial statements are the responsibility of the Cities' Municipal Employees' Benefit Trust Committee. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Trust as of December 31, 2010 and 2009, and the changes in its net assets and trust balance for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying statements are those of the Trust, which is established under the employee retirement benefit plans (the Plans) of certain entities in the State of Washington as described in Note 1; the statements do not purport to present the net assets available for benefits or the changes therein of the Plans. The statements do not contain certain information on net assets available for benefits and other disclosures necessary for a fair presentation of the net assets available for benefits of the Plans in conformity with accounting principles generally accepted in the United States of America.

Certified Public Accountants
June 28, 2011

MUNICIPAL EMPLOYEES' BENEFIT TRUST

**Statements of Net Assets
December 31, 2010 and 2009**

| | <u>2010</u> | <u>2009</u> |
|------------------------------------|-----------------------|-----------------------|
| Assets: | | |
| Investments, at fair value- | | |
| Mutual funds | \$ 221,471,735 | \$ 157,256,338 |
| Collective trust funds | 103,280,436 | 89,996,231 |
| Mortgage-backed securities | | 2,402,706 |
| Corporate bonds | | 10,376,627 |
| Common and preferred stock | 164,120,202 | 178,390,497 |
| Money market fund | 16,159,992 | 15,519,564 |
| Interest-bearing cash | 3,434,149 | 3,620,238 |
| | <hr/> | <hr/> |
| Total investments | 508,466,514 | 457,562,201 |
| Receivables- | | |
| Employer contributions | 58,832 | 11,739 |
| Employee contributions | 69,808 | 12,947 |
| Accrued investment income | 917,648 | 333,064 |
| Notes receivable from participants | 2,933,621 | 2,640,406 |
| | <hr/> | <hr/> |
| Total receivables | 3,979,909 | 2,998,156 |
| Total Assets | 512,446,423 | 460,560,357 |
| Liabilities: | | |
| Accrued administrative fees | 417,902 | 374,854 |
| | <hr/> | <hr/> |
| Net Assets | \$ 512,028,521 | \$ 460,185,503 |

See accompanying notes.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

**Statements of Changes in Net Assets
For the Years Ended December 31, 2010 and 2009**

| | <u>2010</u> | <u>2009</u> |
|---|------------------------------|------------------------------|
| Additions to Net Assets: | | |
| Contributions- | | |
| Employer | \$ 15,773,166 | \$ 16,313,084 |
| Employee | 18,068,247 | 18,465,525 |
| Rollovers | 14,008 | 125,230 |
| | <u>33,855,421</u> | <u>34,903,839</u> |
| Total contributions | | |
| Investment income- | | |
| Interest and dividends | 17,857,575 | 12,423,840 |
| Net appreciation in fair value of investments | 35,957,478 | 77,427,649 |
| | <u>53,815,053</u> | <u>89,851,489</u> |
| Total investment income | | |
| Total Additions | 87,670,474 | 124,755,328 |
| Deductions from Net Assets: | | |
| Benefits paid to participants | 31,627,593 | 15,367,945 |
| Insurance premiums | 1,889,809 | 2,154,983 |
| Administrative expenses | 2,310,054 | 1,849,290 |
| | <u>35,827,456</u> | <u>19,372,218</u> |
| Total Deductions | 35,827,456 | 19,372,218 |
| Net Increase in Net Assets | 51,843,018 | 105,383,110 |
| Net Assets: | | |
| Beginning of year | 460,185,503 | 354,802,393 |
| End of Year | <u>\$ 512,028,521</u> | <u>\$ 460,185,503</u> |

See accompanying notes.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 1 - Overview / Description of the Trust

The following description of the Municipal Employees' Benefit Trust (the Trust) is provided for general information purposes only. More complete information regarding the Trust's provisions may be found in the Trust document and individual entity plan documents.

General - The Trust was created to manage the assets of the employee retirement benefit plans (the Plans) of certain entities in the State of Washington, which currently include the cities of Bellevue, Edmonds, Federal Way, Kirkland, Mill Creek, Redmond, Woodinville, and the North East King County Regional Public Safety Communication Agency (NORCOM) (collectively, the Cities). Each entity has its individual plan document, which governs its participation, contributions, and disbursements. Each of the cities withdrew from, or elected not to participate in, coverage under the Federal Old Age, Survivors, Disability and Health Insurance Act (Social Security). In lieu of such coverage, the Cities created the Plans, whereby both the employee and employer make contributions to the Plans to provide retirement, survivor, and disability benefits otherwise provided by Social Security. The Trust is comprised of two levels of Social Security replacement. Regular employees participate in MEBT I with benefits invested primarily in the Pooled Balanced Fund. Those participants nearing retirement may choose to invest in the Money Market Fund. Partially benefiting employees who are not eligible for PERS or LEOFF participate in MEBT II with benefits invested in the Money Market Fund. The Trust and Plans are not subject to the provisions of the Employee Retirement Income Security Act of 1974.

Eligibility - In each entity, all regular (40 hours per week) and part-time (20 hours per week) employees are immediately eligible upon the date of employment. With the exception of Federal Way, Edmonds and NORCOM, all temporary (hourly) employees are also eligible when hired. Bellevue, Redmond, and Kirkland PERS hourly/partially benefited employees are not eligible. Effective October 1, 2009, City of Woodinville hourly employees are no longer eligible to participate in their plan.

Contributions - The Plans generally provide that the employers make contributions equal to those that would be required had the Cities not withdrawn from or elected to not participate in Social Security. Employer contributions to the Plans, which are made according to each entity's Plan, are used to pay administrative expenses, operating costs, and other employee benefits, including disability coverage for employees and survivor benefits to beneficiaries.

The Plans also require that the employees contribute 100% of the amount that would be required for Social Security, except for Bellevue, Redmond, and Kirkland MEBT I employees, whose contributions to the Plans are optional. Depending on the individual entity's Plan, employees may make their contributions on a before or after tax basis. Additionally, depending on the individual entity's Plan, these employees may elect to make additional voluntary contributions to the Plans on a before or after tax basis, subject to certain conditions and restrictions, as defined in the Plans' documents and subject to certain requirements set forth by the Internal Revenue Code.

Participant Accounts - Each participant's account is credited with the participant's contribution and an allocation of (a) the respective entity's contribution, net of expenses and insurance premiums, (b) forfeitures of terminated participants' non-vested accounts, and (c) Trust earnings, participant fees or other listed items. Trust earnings are reflected in each participant's account based on the daily change in the Trust's unit value. The benefit to which a participant is entitled is limited to the participant's vested account balance.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 1 - Continued

The Plans' Administration and Trustee - The Trust is administered by the Cities' Municipal Employees' Benefit Trust Committee (the Committee), which is appointed by the Bellevue City Manager. The Plans' investments are held under a trust agreement with Wilmington Trust (WT). An Investment Advisory Committee (IAC), which consists of a member from each of the Cities, provides advice to the Committee on the Trust's investment activities. All members are voting members of the IAC if their entity has five or more years of membership in the Trust. A minimum of five IAC members need to be present to vote on a recommendation to be adopted by the Trust.

Vesting - Employee contributions to the Trust are fully vested at all times. Employer contributions are vested as follows for each entity:

Mill Creek, Edmonds, and Kirkland - Employer contributions vest at 10% at the end of 12 months of participation and then at 1.25% for each additional month of participation. Employees become fully vested after seven years of participation.

Bellevue - Employer contributions vest at 10% at the end of 12 months of participation and then at 0.83% for each additional month of participation. Employees become fully vested after ten years of participation.

Federal Way - Employer contributions vest at 20% per year and become fully vested after five years of service.

Redmond, Woodinville and NORCOM - Employer contributions vest at 20% after 12 months and at 1.66% for each additional month. Employees become fully vested after five years of service.

Forfeitures - Forfeitures become part of an unallocated account within each Plan, which is allocated to the Plan's respective participants on a periodic basis based on a prescribed formula related to employer contributions. Total forfeitures allocated in 2010 and 2009 were approximately \$295,000 and \$297,000, respectively.

Temporary/Hourly/Partially Benefited Employees - The Plans (except for the Plans of Federal Way, Edmonds, and NORCOM) allow participation by temporary/hourly/partially benefited employees of the Cities. The part of the Plan for the temporary/hourly/partially benefited employees is commonly referred to as MEPT II. Edmonds, Federal Way and NORCOM temporary/hourly employees are covered by Social Security. Additionally, effective October 1, 2009, hourly employees for the City of Woodinville are covered by Social Security. These participants do not share in the distribution of the Plans' earnings or in the risk of any of the Plans' investment losses. Their accounts are credited with earnings at the current money market rate of return.

Benefit Payments - The Plans provide that participants may make withdrawals of any extra after tax contributions and, in the event of hardship (as defined in the Plans' documents), may make withdrawals from their before or after tax contributions, subject to certain limitations and restrictions. In addition, certain Cities allow withdrawals of after-tax contributions without a hardship event. Upon termination of service, death, disability, or retirement, participants or their beneficiaries may elect to receive their vested account balances in a lump-sum distribution, in monthly, quarterly, or annual installments, or in annuity payments as determined by provisions of the Plans.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 1 - Continued

Notes Receivable from Participants - Federal Way allows participants to obtain loans of up to 50% of their vested account balances, not to exceed \$50,000. The interest rate charged on loans is equal to the prime rate. For 2010 and 2009, the interest rate on outstanding participant loans ranged from 3.25% to 8.25%.

Redmond allows participants to obtain loans of up to 50% of their vested account balances, not to exceed \$50,000. The interest rate charged is equal to the prime rate plus 1.0%. For 2010 and 2009, the interest rate on outstanding participant loans ranged from 4.25% to 9.25%.

Effective January 1, 2011, the Bellevue plan document was amended to allow participants to take a loan on their account balance subject to certain limitations.

Insurance Premiums - Most of the Cities have purchased survivor and disability insurance coverage for Plan participants. The insurance carrier, The Standard Insurance Company, provides surviving beneficiaries with coverage in the event of death, and disabled participants with coverage in the event of a disabling condition, as described in such policy. The premiums for these policies, with the exception of life insurance premiums at Edmonds and Woodinville, are deducted from the Entities' overall contributions to the Plans, with the remainder deposited into the Trust. The cities of Edmonds and Woodinville replaced survivor insurance with term life insurance, which is wholly or partially paid by the employees on an after-tax basis.

Plan Termination - Although the Cities have no intent to do so, they have the right to reduce, suspend, or completely discontinue contributions to the Plans. Upon such action by any participating entity, participant accounts related to that entity would become fully vested.

Investment Policy - The Committee has established an Investment Policy Statement that the Trustee, Wilmington Trust, must follow. The approved target asset allocation of the Trust at December 31, 2010, is as follows:

| | |
|--|-------|
| Equities - Domestic | 45.0% |
| Equities - International | 15.0% |
| Fixed Income | 40.0% |
| Cash and Cash Equivalents (kept to a workable minimum for cash flow) | |

For any month-end allocation varying more than 20% from the target percentages, the Chair of the MEBT Trust Committee may instruct the trustee to sell assets from the asset class in question, sufficient to bring that asset class back to within a 10% deviation from its target, and allocate to the other asset classes to bring those asset classes back towards their targets. A rebalance is not required if the allocation returns within the target percentages prior to rebalancing.

Basis of Accounting - The accompanying financial statements are maintained on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP). Revenues are recognized when earned and expenses are recognized when incurred.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 1 - Continued

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events - The Cities have evaluated subsequent events through June 28, 2011, the date on which the financial statements were available to be issued.

Note 2 - Significant Accounting Policies

Benefits - Benefit payments are recorded when paid. Amounts allocated to accounts of participants who had elected to withdraw from the trust as of year-end but had not yet been paid totaled \$167,710 and \$114,381 as of December 31, 2010 and 2009, respectively.

Investment Valuation and Income Recognition - The Trust's investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 3 for discussion of fair value measurements.

Purchases and sales are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Net appreciation in the fair value of investments represents the change in fair value from the beginning to the end of the Trust's fiscal year or from the date of purchase to the end of the Trust's fiscal year, if purchased during the current year, plus realized gains and losses.

Notes Receivable from Participants - Notes receivable from participants are measured at their unpaid principal balance. Accrued but unpaid interest, if any, would not have a material impact on the Plan's financial statements.

Risks and Uncertainties - Investments are exposed to various risks such as interest rate, market and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is reasonably possible that changes in risks in the near term would materially affect participants' account balances and the amounts reported in the statements of net assets available for benefits and the statements of changes in net assets available for benefits.

New Accounting Pronouncements - In September 2010, the Financial Accounting Standards Board (FASB) issued guidance clarifying the classification and measurement of participant loans by defined contribution pension plans. That guidance requires that participant loans be classified as notes receivable from participants and measured at their unpaid principal balance, plus any accrued but unpaid interest. The plan adopted this new guidance in its December 31, 2010 financial statements and has reclassified participant loans of \$2,640,406 for the year ended December 31, 2009 from investments to notes receivable from participants. Net assets of the plan were not affected by the adoption of the new guidance.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 3 - Fair Value Measurements

FASB provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

The three levels of the fair value hierarchy are described as follows:

Level 1 - Unadjusted quoted prices available in active markets for identical assets or liabilities;

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are significant to the fair value measurement.

A financial instrument's level within the fair value hierarchy is based upon the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2010 and 2009.

Mutual Funds - Valued at quoted market prices in active markets, which represent the net asset value (NAV) of shares held by the Trust at year-end.

Collective Trust Funds - Valued using the NAV provided by the fund's trustee. The NAV is based on the fair value of the underlying assets owned by the funds, minus its liabilities, and then divided by the number of units outstanding at the valuation date. The funds are traded on a private market that is not active; however, the unit price is based on observable market data of the funds' underlying assets.

Mortgage-backed Securities and Corporate Bonds - Valuations incorporate available market information and are primarily based on yields currently available on comparable securities of issuers with similar credit ratings.

Common and Preferred Stock - Valued at the closing price reported on the active market on which the individual securities are traded.

Money Market Funds - Valued at cost plus accrued interest, which approximates fair value.

Interest-Bearing Cash - The carrying amount of cash approximates fair value.

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 3 - Continued

The following tables set forth by level, within the fair value hierarchy, the Trust's assets at fair value as of December 31:

| | <i>Fair Value Measurements as of December 31, 2010</i> | | | |
|--|--|----------------------|------------------|----------------------|
| | <i>(Level 1)</i> | <i>(Level 2)</i> | <i>(Level 3)</i> | <i>Total</i> |
| Mutual funds- | | | | |
| Fixed income | \$185,179,926 | \$ - | \$ - | \$185,179,926 |
| International | 36,291,809 | | | 36,291,809 |
| Total mutual funds | 221,471,735 | | | 221,471,735 |
| Collective trust funds, large cap equity | | 103,280,436 | | 103,280,436 |
| Common and preferred stock- | | | | |
| Large cap growth | 52,220,147 | | | 52,220,147 |
| Large cap value | 49,043,709 | | | 49,043,709 |
| Small cap growth | 13,377,420 | | | 13,377,420 |
| Small cap value | 11,582,178 | | | 11,582,178 |
| International growth | 37,621,148 | | | 37,621,148 |
| International value | 275,600 | | | 275,600 |
| Total common and preferred stock | 164,120,202 | | | 164,120,202 |
| Money market fund | 16,159,992 | | | 16,159,992 |
| Interest-bearing cash | 3,434,149 | | | 3,434,149 |
| | <u>\$405,186,078</u> | <u>\$103,280,436</u> | <u>\$ -</u> | <u>\$508,466,514</u> |
| | | | | |
| | <i>Fair Value Measurements as of December 31, 2009</i> | | | |
| | <i>(Level 1)</i> | <i>(Level 2)</i> | <i>(Level 3)</i> | <i>Total</i> |
| Mutual funds, fixed income | \$157,256,338 | \$ - | \$ - | \$157,256,338 |
| Collective trust funds, large cap equity | | 89,996,231 | | 89,996,231 |
| Mortgage-backed securities | | 2,402,706 | | 2,402,706 |
| Corporate bonds | | 10,376,627 | | 10,376,627 |
| Common and preferred stock- | | | | |
| Large cap growth | 46,274,507 | | | 46,274,507 |
| Large cap value | 44,230,373 | | | 44,230,373 |
| Small cap growth | 10,781,762 | | | 10,781,762 |
| Small cap value | 11,925,785 | | | 11,925,785 |
| International growth | 33,078,237 | | | 33,078,237 |
| International value | 32,099,833 | | | 32,099,833 |
| Total common and preferred stock | 178,390,497 | | | 178,390,497 |
| Money market fund | 15,519,564 | | | 15,519,564 |
| Interest-bearing cash | 3,620,238 | | | 3,620,238 |
| | <u>\$354,786,637</u> | <u>\$102,775,564</u> | <u>\$ -</u> | <u>\$457,562,201</u> |

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 4 - Investments

The fair market values of individual investments representing 5% or more of the Trust's total net assets as of December 31 are as follows:

| | <u>2010</u> | <u>2009</u> |
|------------------------------------|----------------|----------------|
| PIMCO Total Return Institutional | \$ 127,833,914 | \$ 103,294,390 |
| State Street S&P 500 Flagship Fund | 103,280,436 | 89,996,231 |
| Calamos High Yield A Fund | 57,346,012 | 53,961,947 |
| Allianz NFJ International | 36,291,809 | * |

* Does not represent 5% or more of plan's assets for the respective plan year.

During 2010 and 2009, the Trust's investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value as follows:

| | <u>2010</u> | <u>2009</u> |
|--|----------------------|----------------------|
| Mutual funds | \$ 2,765,327 | \$ 13,460,018 |
| Collective trust funds | 13,509,227 | 19,722,387 |
| Government obligations, mortgage backed securities, and corporate bonds | 305,301 | 4,236,746 |
| Common and preferred stock | 19,377,623 | 40,008,498 |
| | <u>\$ 35,957,478</u> | <u>\$ 77,427,649</u> |

Note 5 - Relative Share of the Trust Assets

The relative share of the Trust's assets for each entity is as follows at December 31:

| | <u>2010</u> | <u>2009</u> |
|-------------|---------------|---------------|
| Bellevue | 50.8% | 51.7% |
| Redmond | 19.8% | 19.1% |
| Kirkland | 13.0% | 12.6% |
| Edmonds | 7.9% | 8.9% |
| Federal Way | 6.0% | 5.6% |
| Mill Creek | 0.9% | 0.9% |
| Woodinville | 0.8% | 0.7% |
| NORCOM | 0.8% | 0.5% |
| | <u>100.0%</u> | <u>100.0%</u> |

MUNICIPAL EMPLOYEES' BENEFIT TRUST

Notes to Financial Statements

Note 6 - Administrative Expenses

The administrative expenses charged directly to the Trust consist of the following for the years ended December 31:

| | <u>2010</u> | <u>2009</u> |
|----------------------------|---------------------|---------------------|
| Trustee and recordkeeper | \$ 392,771 | \$ 297,840 |
| Legal and accounting | 196,885 | 290,218 |
| Asset management and other | <u>1,720,398</u> | <u>1,261,232</u> |
| | <u>\$ 2,310,054</u> | <u>\$ 1,849,290</u> |

Administrative expenses as a percentage of average net assets are as follows for the years ended December 31:

| | <u>2010</u> | <u>2009</u> |
|----------------------------|--------------|--------------|
| Trustee and recordkeeper | 0.08% | 0.07% |
| Legal and accounting | 0.04% | 0.07% |
| Asset management and other | <u>0.35%</u> | <u>0.31%</u> |
| | <u>0.47%</u> | <u>0.45%</u> |

Note 7 - Federal Income Taxes

With the exception of NORCOM, each entity has received a determination letter from the Internal Revenue Service stating that its Plan qualifies for exemption from taxation. The Plans have been amended since receiving the latest determination letters; however, the Plans' administrators believe the Plans are designed in compliance with the applicable requirements of the Internal Revenue Code and are being operated as designed. Therefore, no provision for income taxes has been made in the accompanying financial statements. NORCOM has applied for but has not received a determination letter from the Internal Revenue Service.

The Plans are subject to audits by the Internal Revenue Service for certain tax periods based on applicable laws and regulations; however, there are currently no audits for any tax periods in progress.