

MONTGOMERY COUNTY MARYLAND

Comprehensive Annual Financial Report



Fiscal Year 2003

July 1, 2002 - June 30, 2003
Rockville, Maryland

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Montgomery County,
Maryland

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

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

MONTGOMERY COUNTY MARYLAND

Comprehensive Annual Financial Report



Prepared by the
DEPARTMENT OF FINANCE

Timothy L. Firestine, Director
101 Monroe Street
Rockville, Maryland 20850
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Fiscal Year 2003
July 1, 2002 - June 30, 2003





Montgomery County Vision Statement

*“Helping to make Montgomery County
the best place to be through efficient, effective and
responsive government that delivers quality services.”*

Guiding Principles

We Will Provide Excellence in Government By:

- Insisting upon customer satisfaction
- Ensuring high value for tax dollars
- Adhering to the highest ethical standards
- Appreciating diversity
- Being open, accessible and responsive
- Empowering and supporting employees
- Striving for continuous improvement
- Working together as a team
- Being accountable

Montgomery County, Maryland
COMPREHENSIVE ANNUAL FINANCIAL REPORT
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INTRODUCTORY SECTION



DEPARTMENT OF FINANCE

Douglas M. Duncan
County Executive

Timothy L. Firestine
Director

December 11, 2003

Honorable County Executive,
Members of the Montgomery County Council, and
Chief Administrative Officer

Ladies and Gentlemen:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of Montgomery County, Maryland (the County), for the fiscal year ended June 30, 2003. This report, presented in conformity with accounting principles generally accepted in the United States of America (GAAP), was prepared by the County's Department of Finance in cooperation with the finance departments of the County's component unit and joint venture organizations.

This report has been prepared pursuant to the provisions of Article 2, Section 214 of the Charter of the County, and includes the independent auditors' opinion, issued by the County Council appointed independent public accounting firm, as provided by Article 3, Section 315 of the County Charter. Responsibility for both the completeness and fairness of the information presented in this report, including the disclosures, rests with the County. We believe the information presented in this report is complete and accurate in all material respects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the County; and that all disclosures necessary to enable the reader to gain the maximum understanding of the County's financial affairs have been included.

Internal Accounting Controls

To provide a reasonable basis for making these representations, management of the County has established a comprehensive internal control framework. Internal accounting controls are designed to provide reasonable assurance regarding (1) the safeguarding of assets against loss from unauthorized use or disposition, and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that the County's internal accounting controls adequately safeguard assets and provide reasonable assurance for the proper recording of financial transactions and for reliance upon the financial records in the preparation of the financial statements.

The County has three significant programs that enhance the internal controls of the government. First, the County maintains auditing staff that reports to the Director of Finance. This staff performs periodic and regular financial and operational audits throughout the County's agencies and departments. The internal auditing effort has been bolstered by the use of contracts with public accounting firms. During the year ended June 30, 2003, audits performed by contract with auditing firms covered fiscal operations, contract compliance, and information technology. Second, the County Council maintains an office responsible for "Legislative Oversight" activities, which include determining the effectiveness of legislation enacted by the County Council, and making findings and recommendations concerning the performance, management, and operation of programs and functions for which funds are appropriated or approved by the Council. Third, the Office of Inspector General is responsible to (1) review the effectiveness and efficiency of programs and operations of County government and independent County agencies, (2) prevent and detect fraud, waste, and abuse in government activities, and (3) propose ways to increase the legal, fiscal, and ethical accountability of County government departments and County-funded agencies.

Office of the Director

101 Monroe Street • Rockville, Maryland 20850 • 240/777-8860

Independent Audit

The County Charter requires that “the Council shall contract with, or otherwise employ, a certified public accountant to make annually an independent post-audit of all financial records and actions of the County, its officials and employees. The complete report of the audit shall be presented to the Council and copies of it shall be made available to the public.”

This requirement has been complied with, as the Montgomery County, Maryland financial statements have been audited by the public accounting firm of KPMG LLP. The goal of the independent audit was to provide reasonable assurance that the financial statements of the County for the year ended June 30, 2003, are free of material misstatement. The independent audit involves 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; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the Montgomery County, Maryland financial statements for the year ended June 30, 2003, are fairly presented in conformity with GAAP. The independent auditors’ report is presented as the first component of the financial section of this report.

This independent audit of the County’s financial statements was part of a broader, federally mandated “Single Audit” designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements, including the Single Audit Act of 1984 and the U.S. Office of Management and Budget Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations,” require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government’s internal controls over financial reporting and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the County’s separately issued Report on Expenditures of Federal Awards.

Overview of the Report

The accompanying report consists of four sections: introductory, financial, statistical, and index.

The introductory section includes this transmittal letter, a copy of our Certificate of Achievement for Excellence in Financial Reporting awarded for the FY2002 report, a list of special acknowledgments, the Montgomery County, Maryland organization chart, and a listing of officials.

The financial section includes the report of the independent auditors, MD&A, the basic financial statements, and the combining and individual fund financial statements and supplementary schedules. GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of MD&A. This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The Montgomery County, Maryland MD&A can be found immediately following the report of the independent auditors.

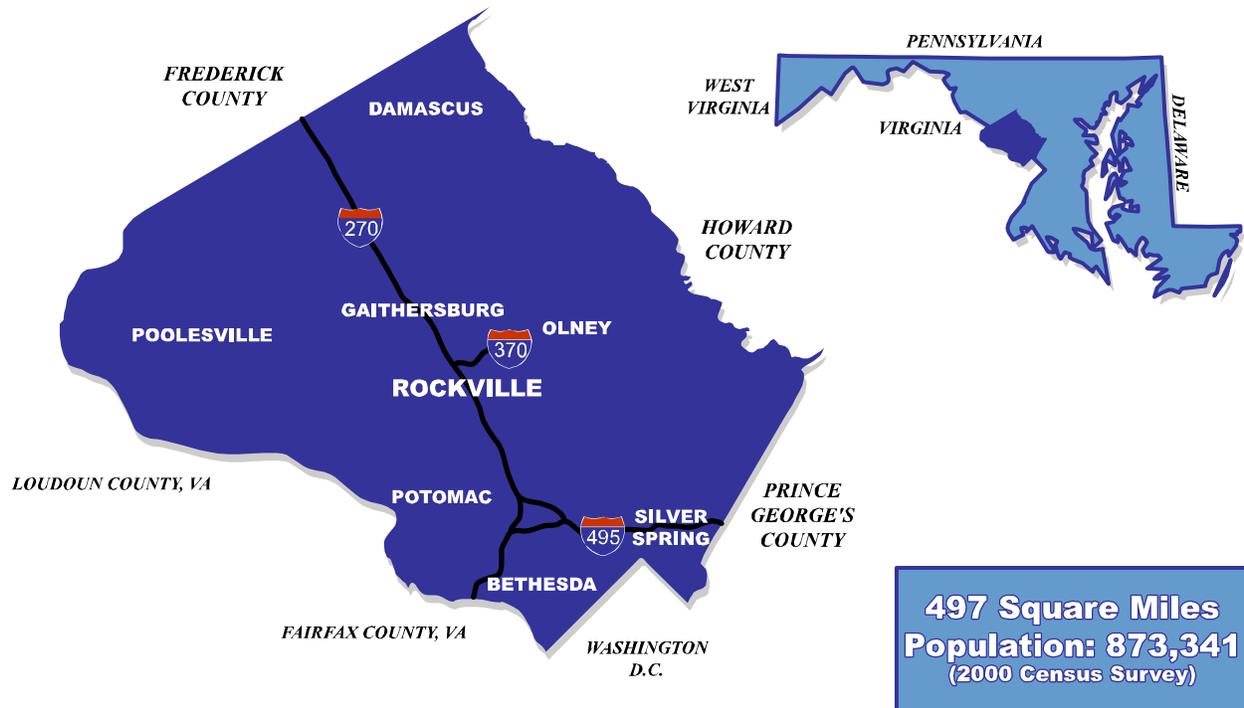
The statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

The index is presented solely to facilitate the identification of financial statements of the individual funds and component units of the County.

PROFILE OF THE GOVERNMENT

Montgomery County, named after the early American general, Richard Montgomery, was established in 1776 by the State Convention. The County government was structured under the County Commission system until 1948, when voters adopted a charter, which gave the County home rule and a council-manager form of government. The governing authority of the County, today, is still the charter, which was fully implemented in 1970, with the election of an executive and a council. Currently, Montgomery County is the most populated and affluent jurisdiction in Maryland and enjoys the distinction of being named an All-American community.

The annual budget provides the basis for coordinating and controlling the County government programs and expenditures, which include education, public safety, public works and transportation, culture and recreation, health and human services, community development and housing, environment, and general government services. The County Executive develops and recommends budget proposals and the Council then authorizes expenditures and sets property tax rates. A budget-to-actual comparison schedule is presented on Exhibit A-7 as part of the basic financial statements for the governmental funds.



THE REPORTING ENTITY

For financial reporting purposes, the County's reporting entity consists of: (1) the primary government, and (2) component unit organizations for which the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The financial statements of all agencies, boards, commissions, and authorities that have been identified as the primary government or a component unit have been included.

Section 2100 of the GASB *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) describes the criteria for determining which organizations should be considered part of the County for financial reporting purposes. The basic criteria include appointing a voting majority of an organization's governing body, as well as the County's ability to impose its will on that organization, or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the County.

Based on evaluation of this criteria, the following organizations are included as component units in the accompanying financial statements: Montgomery County Public Schools (MCPS), Montgomery Community

College (MCC), Housing Opportunities Commission of Montgomery County (HOC), Montgomery County Revenue Authority (MCRA), and Bethesda Urban Partnership, Inc. (BUPI).

The County's participation in the following joint ventures is also disclosed in the Notes to the Financial Statements (see Note IV-D): Maryland-National Capital Park and Planning Commission, Washington Suburban Sanitary Commission, Washington Suburban Transit Commission, Washington Metropolitan Area Transit Authority, Metropolitan Washington Council of Governments, and Northeast Maryland Waste Disposal Authority.

Copies of the respective independently audited annual financial reports required by State or County law are available from the above mentioned component units and joint ventures.

FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which Montgomery County operates.

Overview of National Economic Condition and Outlook

As FY03 began, the nation's economy was entering its third full quarter of recovery with real gross domestic product at \$9.4 trillion after growing 2.2 percent during FY02, payroll employment stood at 130.4 million, the unemployment rate was 5.8 percent, "core" inflation was 2.3 percent, and interest rates on 30-year fixed rate mortgages was 6.55 percent and the effective rate on federal funds was 1.73 percent. At the end of FY03, the nation's economy grew an additional 2.5 percent with real gross domestic product at \$9.6 trillion, "core" inflation increased a meager 1.5 percent, mortgage rates continued to decline to an historic low of 5.24 percent, and, because of an accommodative Federal Reserve policy, the effective rate on federal funds declined to 1.22 percent. However, while most economic indicators suggested a marked economic improvement during FY03, payroll employment declined by 500,000 jobs and the unemployment rate increased to 6.4 percent by June 2003, making this a jobless recovery.

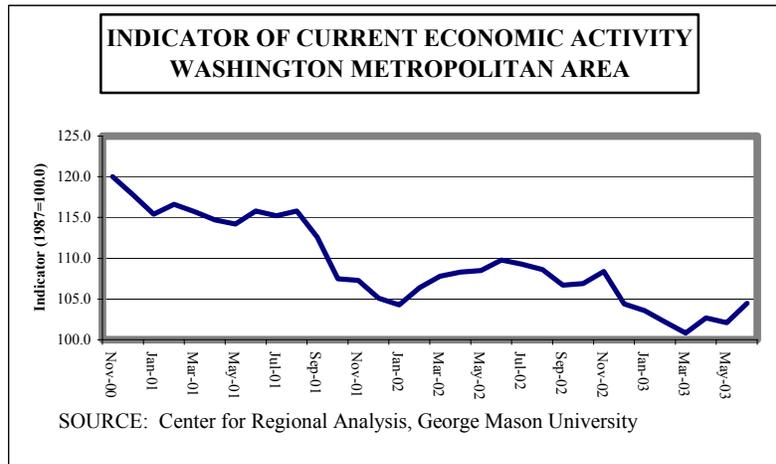
During FY03, significant national and international events took center stage by providing shocks to the economy during the first half of the fiscal year. The major event was the continuing lack of consumer confidence largely attributed to alleged corporate malfeasance especially among Enron and WorldCom executives. Although such activities were limited to a few major corporations, the effects on consumer's confidence were significant such that the stock market continued to decline reaching a bear market low point in October 2002.

The war on terrorism took a significant step during FY03 with U.S. forces along with its coalition partners invading Iraq and removing Saddam Hussein and his regime. The events leading up to the invasion caused instability in the energy markets. Oil prices increased significantly and as such gasoline prices reached all time highs during late winter and early spring. Locally, the sniper incident during the Fall of 2002 affected the local economy during those weeks of terror causing a concerned public to limit its outside activity and as such resulted in a weak economic performance in the retail sector during that troubling period. The blizzard that occurred during the President's Day holiday weekend also significantly affected the local economy with weak retail sales during one of the most advertised periods by retailers.

The Local Economy

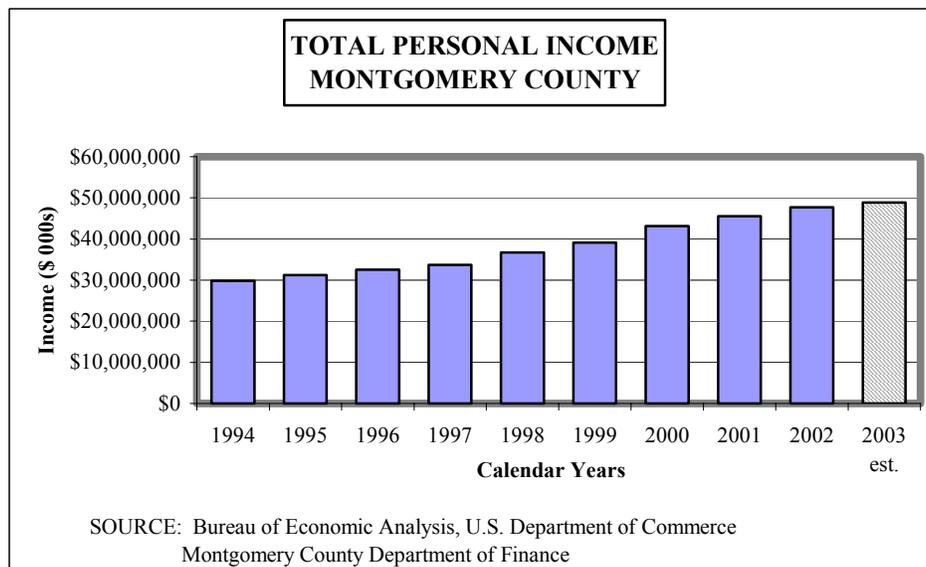
Because the region's economy is significantly dependent on the spending by the federal government, there is a perception that the economy is immune to national recessions. While federal government spending contributes a significant portion to the local economy, the economy slowed considerably during the last three fiscal years. According to data from the Center for Regional Analysis, George Mason University, the Washington Coincident Index, which represents the current state of the region's economy, declined 14.4 percent since its peak in November 2000. The decline is attributed to a drop in three of the four components that comprise the index – a modest decrease in wage and salary employment (-0.3%), a significant decline in consumer confidence (-59.7%), and another significant drop in domestic airport passengers (-25.2%). Only purchases of nondurable goods increased over this period (+7.4% on a seasonally adjusted basis and in constant dollars). With the significant international,

national, and local events of the past two years having a profound effect on the local economy, the index improved in the latter part of FY03, but remained significantly below its value prior to 9/11.



Personal Income

On a calendar year (CY) basis, total personal income in Montgomery County increased from \$29.9 billion in CY94 to an estimated \$48.9 billion in CY03 – an annual average rate of 5.5 percent. However, over the past ten years, the rate of growth in personal income experienced three distinct phases. Between the years 1994 through 1997, income grew at a 4.0 percent annual rate, and between the years 1997 and 2002, it grew at a 7.0 percent annual rate. However, given the lack of new jobs, such an acceleration in the growth in personal income was not sustainable and as such, personal income is expected to grow only 2.5 percent during CY03.



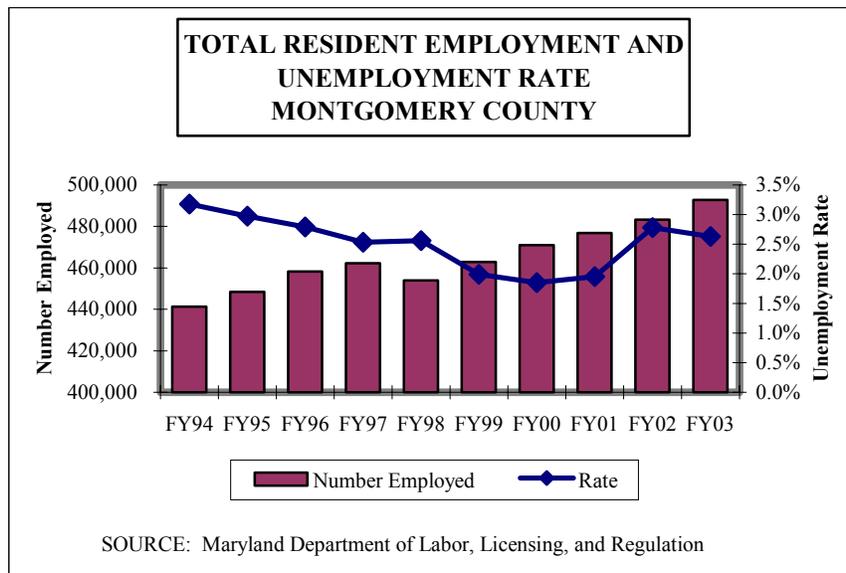
Employment

As FY03 began, the labor force in Montgomery County stood at 508,821, employment for the County residents was 493,291, and the unemployment rate was 3.1 percent. By the end of the fiscal year, the labor force increased by 3,756, or 0.7 percent, the smallest increase since FY98. Employment for County residents increased slightly greater than the labor force at 5,074 or 1.0 percent, thereby resulting in a lower unemployment rate of 2.8 percent by the end of the fiscal year. However, total payroll employment during FY03 presented a much different

picture of the employment situation in Montgomery County. Through the first three quarters of FY03, the number of payroll jobs in the County increased 1,752, or 0.4 percent, compared to the same period in FY02. Payroll employment is a better indicator of the economic activity and employment situation in Montgomery County than employment by place of residence for it provides a measure of the strength of the County's economy.

Labor Force and Resident Employment

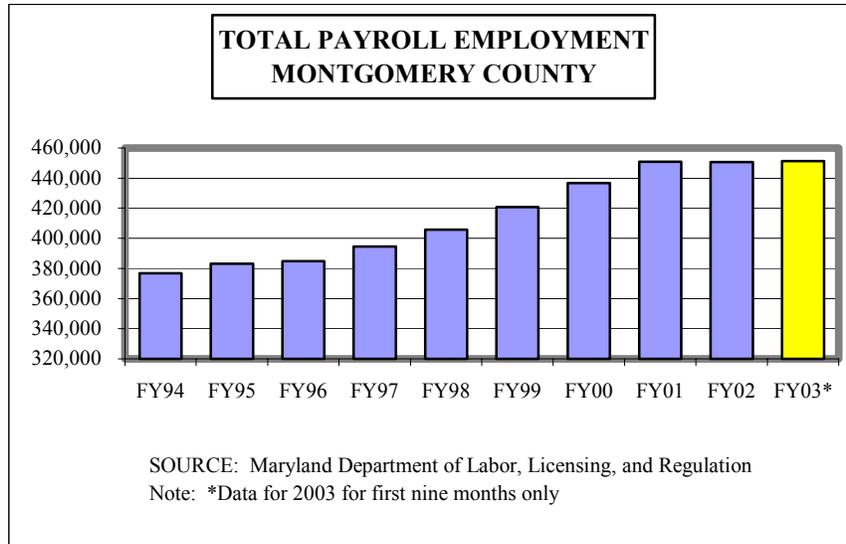
The average total labor force in Montgomery County stood at 506,131 in FY03, which was slightly lower than when the fiscal year began but an increase of 1.8 percent over the average for FY02. Average resident employment also increased during FY03 to 492,804, or 2.0 percent, compared to the average for FY02. Unlike total payroll employment, resident employment experienced significant growth during the fiscal year compared to the previous three fiscal years. Such an increase in resident employment exceeded the growth in the labor force, thereby contributing to the decline in the unemployment rate from an average of 2.8 percent throughout FY02 to 2.6 percent in FY03.



Payroll Employment

Because Montgomery County is a suburb of Washington, D.C., thirty-percent of the County's economy is attributed to the presence of the federal government. Such importance is reflected in payroll employment both in number of jobs created by the federal government and the proportion of total jobs held by federal employees. Over the past two years, the number of federal government jobs increased by over 1,500, while the private-sector added less than 100 jobs. The proportion of employees in the federal government compared to total payroll employment has held steady at almost 9 percent over the past four years.

While employment in almost all of the private-sector industries declined in CY 2002, the health and education services sector experienced a significant increase in jobs that offset most of the decline. Such an increase can also be attributed to government spending in the County both in healthcare and education. Because of the concentration of employment in the service-providing sector of the economy, of which health and education services are a significant part, Montgomery County has not been as susceptible to major contractions in private-sector employment during this jobless recovery period. However, during the first three quarters of FY03, the County lost 1,400 manufacturing and 800 information technology jobs compared to the same period in FY02. The significance of such losses had been offset by the increase in public-sector employment and in the health and education services industry.



Payroll Wages and Salaries

Total payroll wages were \$21.4 billion in CY02, the latest period for which data are available. This amount represents a 3.6 percent increase over CY01 in nominal dollars or 1.3 percent in real dollars, i.e., adjusted for inflation. However, the increase in total payroll wages in the private-sector was only 2.4 percent over CY01, or 0.1 percent in real terms and the average weekly wages per private-sector worker increased only 2.3 percent in CY02, which presents a decline of 0.1 percent in real terms. Those changes in private-sector wages suggest that employers in Montgomery County, excluding the public sector, were reluctant to hire additional workers and to increase wages and salaries.

Real Estate

Construction and real estate activity play a significant role in Montgomery County's economy. First, over 40 percent of the County's General Fund revenues are derived from the property tax base. Second, the construction industry was one of the few private-sector industries that added jobs in CY02. It is in reference to these factors that the condition of the construction and real estate activity is presented in this section. Non-residential construction activity tends to be very volatile from one year to the next, while residential construction exhibits a more medium-term cycle. Such volatile and cyclical trends have had significant effects on the County's economy.

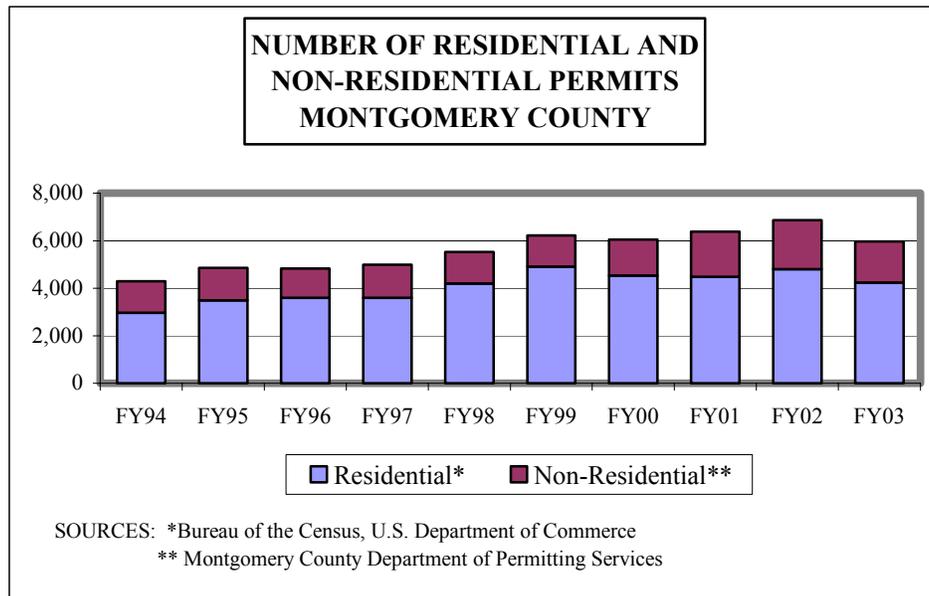
A number of economic indicators provide an assessment of such trends and of supply and demand for non-residential and residential real estate. Such indicators include permit authorizations, new contracts or construction starts for non-residential and residential construction, home sales, and office vacancy. This section provides an analysis of those indicators of construction and real estate activity during FY03 and for previous years.

Permits

Permit authorizations are an indicator of planned construction activity in non-residential and residential real estate sectors and are granted by Montgomery County's Department of Permitting Services (DPS). The total number of non-residential and residential permits for the County for the past ten fiscal years is presented in the figure below and suggests that the cycle for total permits is of a three- to four-year duration with volatile, yet offsetting, annual changes between non-residential and residential permits. The total number of permits authorized in FY03 was 5,970, a decrease of 13.0 percent and the first such decrease in three years. The drop in total permits almost matches the entire two-year increase of 13.6 percent between FY00 and FY02 suggesting that construction has entered a downward cycle in the short-term. A decrease was experienced for both non-residential (-16.3%) and residential (-11.6%). This is the first time since FY94 that both sectors declined during the same year.

The decline in non-residential permits follows a three-year increase in the issuance of permits coupled with the large construction activity that occurred in FY02. Over the previous three-year period (FY99-FY02), the number of non-residential permits issued by DPS increased 57.5 percent suggesting a construction boom.

However, the residential sector did not experience such rapid growth during the earlier period. Over the past four fiscal years beginning with FY00, the number of residential permits issued declined during three of those years. Since reaching a peak of 4,915 permits in FY99, the number of residential permits issued by DPS has declined 13.6 percent suggesting that construction of residential property has dropped dramatically during the early part of this decade. The percentage of residential permits to total permits issued remains above its 70 percent level, however, that ratio declined significantly over the past three fiscal years (FY01-FY03) to proportions experienced between FY93-FY95.



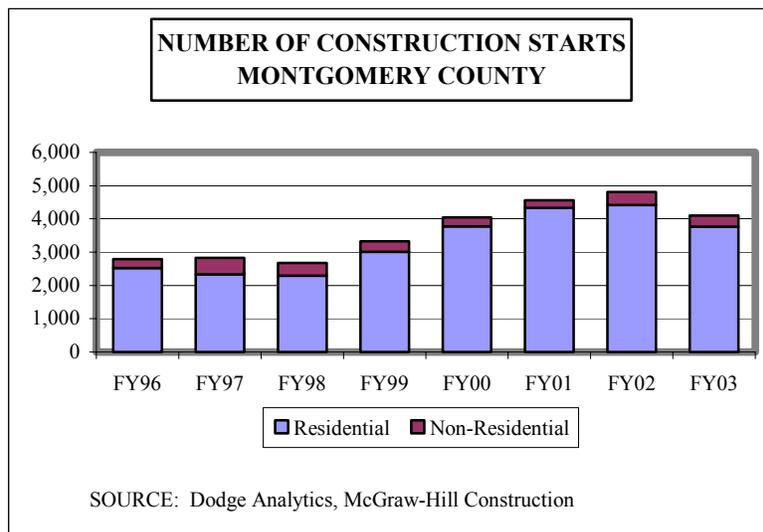
Construction Starts

Along with permit authorizations, construction starts measure the potential level of the supply of real estate property in the near term. The number of construction projects or starts in the County for non-residential and residential properties was 4,099 in FY03 – a decrease of 703 starts or 14.7 percent from FY02. As the chart below illustrates, that decline follows four years of growth in total construction in Montgomery County. Such a drop suggests that construction activity has reached a pause after double-digit growth in three of the four previous fiscal years. As with the issuance of permits, both non-residential and residential construction starts declined in FY03, the first time both sectors declined the same fiscal year since FY98. Since both permit authorizations and construction starts declined sharply in FY03, such decreases suggest that the boom experienced in prior years has halted temporarily. The value of total construction declined to \$1.1 billion in FY03 after achieving a record high of \$1.7 billion in FY02. While comparing FY03 to a record high in FY02 may not provide a reasonable historical trend, a comparison of FY03 to recent years, FY00 and FY01, may reveal a better perspective of construction activity during FY03. The average value of total construction in the County during FY00 and FY01 was \$1.2 billion, which was 9.0 percent above the FY03 level. While the number of construction projects declined 14.7 percent in FY03, the value of construction put in place experienced less of a decline measured by historical standards.

Because of the close association between the issuance of permits and the start of construction, one would expect that the construction cycle for both non-residential and residential starts would follow a similar pattern as the permitting cycle. While such correlation was evident during FY03, it was not the pattern for previous years. For example, while DPS’s issuance of non-residential permits during the FY00-FY02 period suggested a construction boom in this sector, it did not occur. Non-residential construction starts only increased in FY02 (+72.8%) after declining the previous two years. While the number of starts increased dramatically in FY02, such an indication

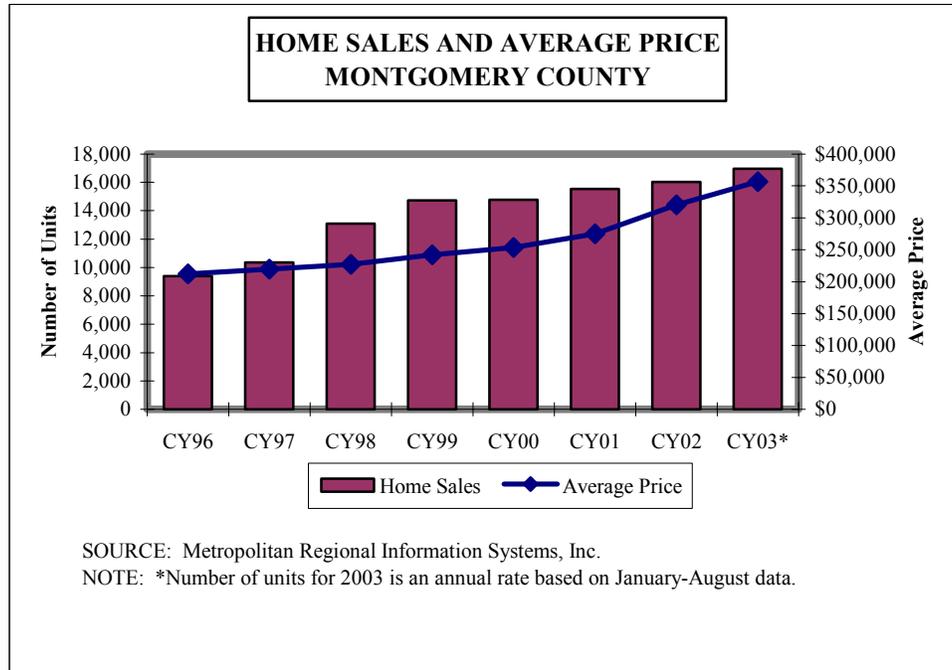
suggests that a contemporaneous correlation between the issuance of non-residential permits and construction starts is weak in the short term, which is due to a difference in the long lead time between authorization and construction. The value of non-residential construction also declined 42.3 percent in FY03 to \$538.7 million. This is the largest yearly drop in the past seven years and is the lowest value in five years.

While one would expect a long lead time between authorization and construction to exist in non-residential construction, the lead time with residential property is much shorter. There is an average of four months from the issuance of a residential permit to the start of construction for residential projects. Therefore, the trend between the number of permits issued and the number of construction starts is almost contemporaneous. The number of residential permits authorized in FY03 declined 11.6 percent while the number of construction starts declined 14.6 percent. The value of new residential construction also declined 19.9 percent in FY03 to \$610.8 million. While the percentage decline appears dramatic, the value of new residential construction was the second highest during the last eight years and was only exceeded by the previous year's \$762.6 million.



Home Sales

With the increase in construction of residential property over three of the past four years and the current level of 30-year fixed mortgage interest rates at historic lows, one would expect dramatic growth in home sales in the County. As the accompanying chart illustrates, home sales in CY03 are expected to increase 5.8 percent, which is above the recent three-year average (CY01-CY03) of 4.7 percent and a significant rebound from last year's disappointing 3.1 percent, which was one of the lowest increases in seven years. While home sales are expected to rebound this calendar year, average prices have continued their dramatic acceleration during CY03 outpacing the percentage increase in sales. Prior to CY02, the sales of existing homes averaged almost 11.0 percent per year, while the average annual increase in home prices was only 5.4 percent. Because of the dramatic decline in the stock market between CY00 and CY02 and the significant decline in mortgage rates, some individuals appear to have shifted their investment in corporate equities and mutual funds to real estate. That shift created a significant demand for housing in the County such that average home prices increased 16.5 percent in CY02 and an expected 13.8 percent in CY03, while percentage sales were much lower, which is just opposite prior to CY02. Therefore the dramatic increase in home prices in the County may be attributed to two factors: an investment portfolio shift by individuals and households from corporate equities and mutual funds to real estate, and the demand for real estate exceeding supply. The dramatic increase in home prices over the past two years also has had an effect on reassessments in the County. In FY99, total reassessments for residential property including homes, apartments, and condominiums were \$338.5 million and by FY03 reached \$2,723.9 million – an eightfold increase. That increase was the highest since the early 1990s.



Retail Sales

Retail sales are the most closely watched indicator for judging the strength of consumer confidence and demand. The Bureau of the Census, U.S. Department of Commerce, provides monthly retail sales at the national level that reflect sales of merchandise either for cash or credit by establishments selling primarily to the public. However, retail sales data are not available at the County level. Sales tax receipts provide a proxy for the strength of consumer spending in Montgomery County.

Sales tax receipts are divided into nondurable and durable goods. The sale of nondurable goods is an indicator of consumer's confidence about the current economic condition in the County while the sale of durable goods is an indicator of consumer's expectations about future economic activity. Sales tax receipts experienced four cycles over the past ten fiscal years, a period (FY94-FY96) of 5.3 percent growth in tax receipts, a period (FY97-FY98) of 0.5 percent growth, a period (FY99-FY01) of 5.9 percent growth, and finally a period of identical annual growth of 1.3 percent in FY02 and FY03. Sales tax receipts stood at \$378.5 million in FY03. Sales of nondurable goods grew 3.4 percent while sales of durable goods fell 0.9 percent. Energy consumption comprised the largest increase (+18.4%) of nondurable goods, which was primarily attributed to the harsh winter and the rapid increase in gasoline prices during the late fall and early winter. Automotive products also increased (+2.4%) in FY03 which helped offset the decline in sales of furniture (-0.3%) and building supplies (-4.7%).

Consumer Prices

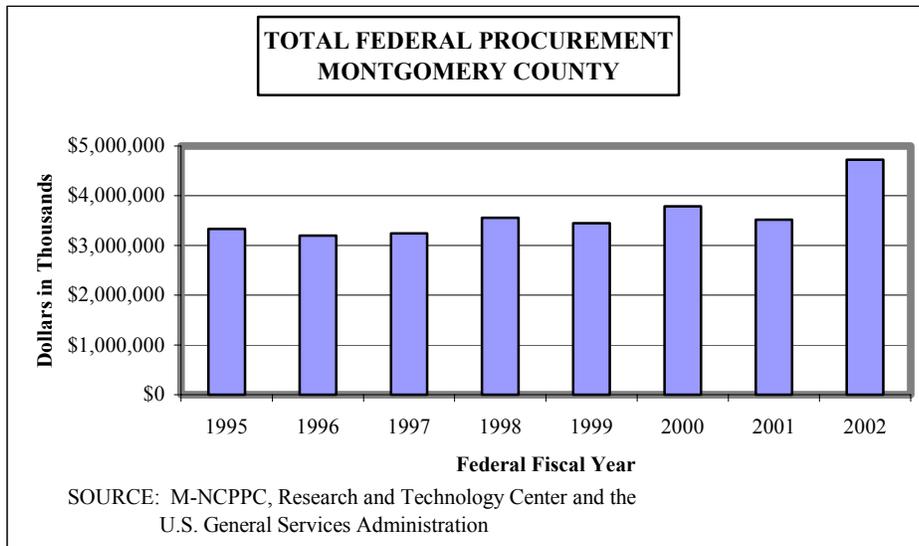
The consumer price index for all items less food and energy for the Washington-Baltimore Consolidated Metropolitan Statistical Area (CMSA) increased 2.6 percent in FY03 which was lower than in FY02 (3.3%) but higher than the nation (1.5%). Since the U.S. Bureau of Labor Statistics began reporting the index for the region, the increases in the regional core consumer price index exceeded the national rate in FY02 and FY03 by over 1 percentage point largely attributed to increases in the cost of housing and medical care. Although the region's core inflation rate exceeded the national rate in FY03, it declined after four consecutive years of growth.

Federal Procurement Spending

According to data provided by the Planning Department of the Maryland-National Capital Park and Planning Commission and the U.S. General Services Administration (GSA), businesses in Montgomery County received \$4.7 billion in procurement contracts from the federal government for federal fiscal year (FFY) 2002 (October 1, 2001 through September 30, 2002). This represents an increase of 34.5 percent over the previous FFY and is the highest in the County's history. Between 1995 and 2002, federal procurement averaged approximately \$3.4 billion per year.

The dramatic increase in procurement during FFY02 represents the federal government's response to geopolitical events since 9/11. Both defense (+18.5%) and nondefense (+30.8%) increased significantly in FFY02. Along with the Department of Defense, other defense procurements were from the Departments of the Army, Navy, and Air Force, and the U.S. Army Corps of Engineers, all of which amounted to \$1.3 billion. Procurement from the National Institutes of Health, which represents the largest federal agency in the County, amounted to \$1.1 billion. The individual private sectors that benefited from the increase in federal procurement were the professional, scientific, and technical services sector, the information sector, and the manufacturing sector.

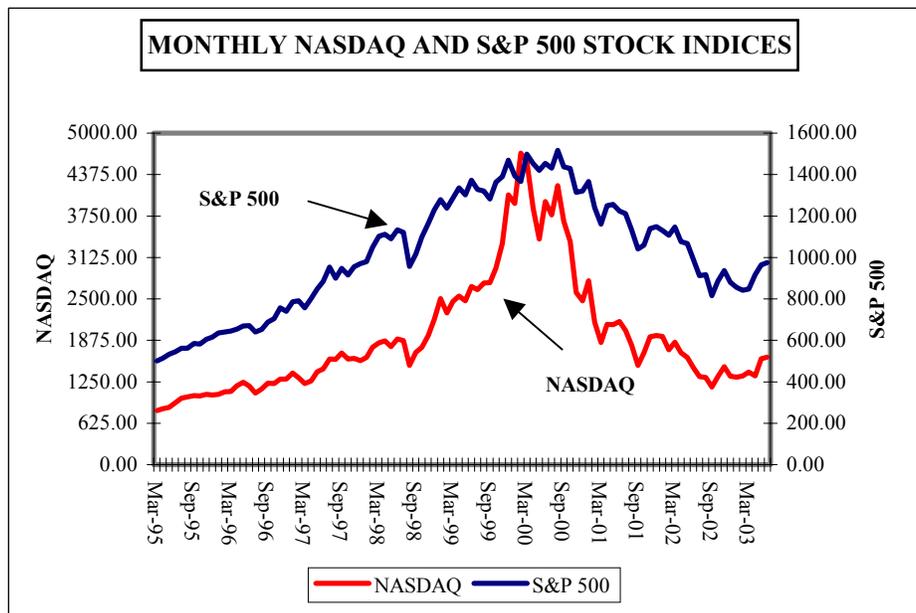
While the procurement dollars grew dramatically in FFY02, the effect of federal largess in the County's economy did not provide complete immunization from a sluggish economy. Such growth did not immediately increase payroll employment in some sectors. Based on payroll data for the first three quarters of 2002, most of the job growth occurred in the local government, construction, and education and health services sectors. The presence of NIH in the County's economy continues to contribute to the growth in education and health service employment. However, employment in the information, manufacturing, and professional and business services sectors declined during that period. However, these sectors experienced the largest gains in federal procurement. The explanation for such a discrepancy is attributed to the timing when the federal government makes the procurement awards and when activity or production begins. Because of such lags, increases in County employment may not occur until the last quarter of the County's fiscal year (FY) 2003 or the first half of FY04.



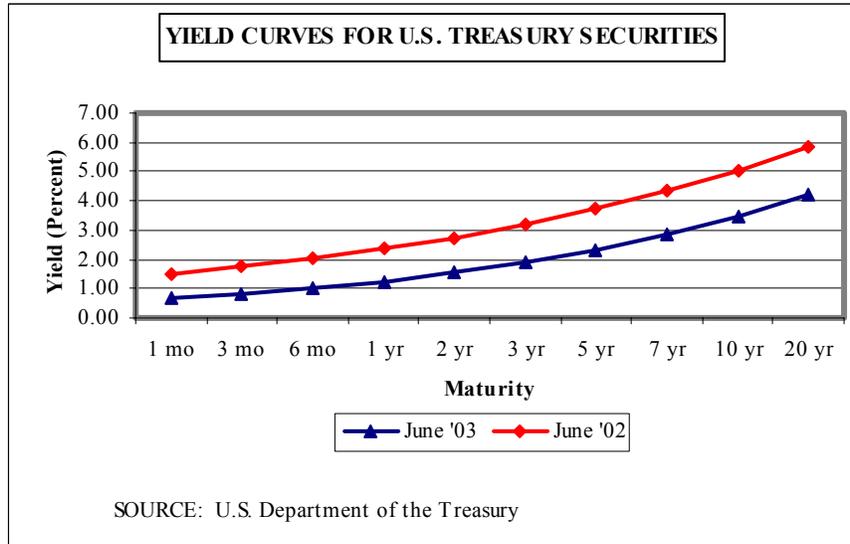
Future Economic Outlook

Following a year in which the County's economy experienced little growth in employment and consumer spending, and a decline in both residential and nonresidential construction, the outlook for FY04 is expected to see modest increases in employment and consumer spending, but little growth in construction. Other key economic variables are expected to improve during FY04. Such variables include both the national and regional stock markets. Home sales are expected to increase and excess capacity of office space is expected to decline gradually from its high of 10 percent in FY03. Private-sector payroll employment is expected to improve due to the increase in federal procurement.

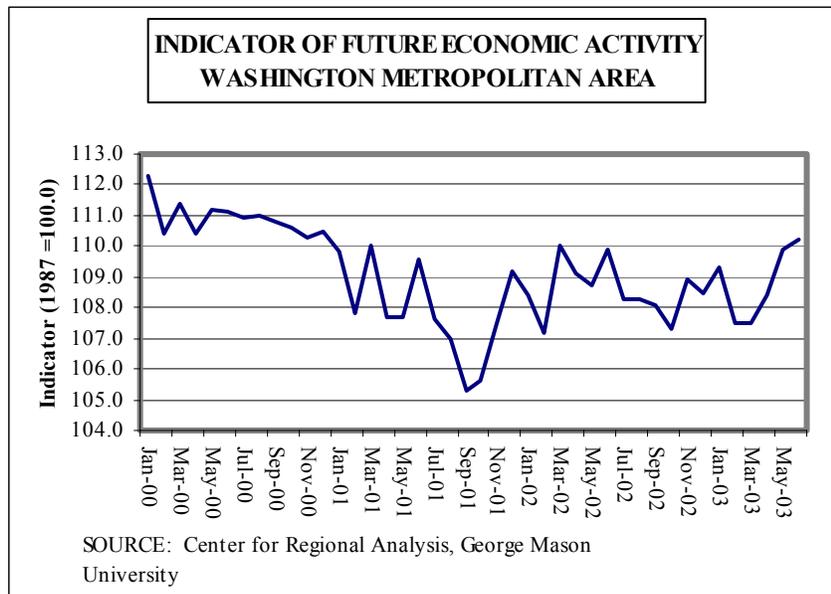
The weak performance of the stock market over the past three years has had a negative effect on both business and consumer confidence. As the accompanying chart illustrates, the three-year bear market that began in March 2000 recovered in March 2003. While the volatility in the stock market has been the result of both psychological and economic factors such as corporate malfeasance and the war on terror, it is a measure for assessing future corporate earnings. Since the economic recession ended in November 2001 and the stock market began its recovery in March 2003, business profits have improved, but companies have been reluctant to hire new workers. Most of their efforts to improve corporate earnings have been in reducing excess capacity and increasing worker productivity. Based on the most recent data from the Bureau of Labor Statistics, U.S. Department of Labor, productivity increased 4.3 percent during FY03. With the growth rate of the population increasing one percent per year, real gross domestic product must increase at least four to five percent per year before employment increases and the current unemployment rate decreases. Given that the real GDP growth rate in FY03 was 2.5 percent, the economy must expand at a rate that is almost twice the current rate for payroll employment to improve.



The stock market is not the only financial indicator of the economy. Because of the accommodative policy of the Federal Open Market Committee (FOMC) of the Federal Reserve, the yield curve on U.S. Treasury securities has remained strongly positive during FY03. Because of the slope in the yield curve and improvement in the stock market, both indicate continued economic growth through FY04. With inflation remaining subdued and corporations trimming most of the excess capacity during FY03, both indicators suggest that businesses will begin hiring workers, albeit at a modest rate.



With the positive economic outlook for the national economy in FY04, the regional economy is also expected to grow during FY04. Since March 2003, the index of leading indicators developed by CRA for the Washington metropolitan area suggests a scenario of improved economic activity during FY04. Data from the CRA show that the index increased steadily between March and June of 2003. Such an increase is the first three-month increase since the end of 2001 when the national recession was declared to have ended. With the coincident and leading indices showing improvement during the final quarter of FY03, the outlook for the region's and Montgomery County's economy suggests a marked improvement compared to the last three fiscal years.



The assumptions underlying an improvement in the County's economy during FY04 are the continuation of low interest rates, especially home mortgage rates, a decline in the "core" inflation rate, consistent consumer confidence, and growth in payroll employment largely attributed to the increase in federal procurement and a rebound in the national economy. With the FOMC pronouncement on September 16, 2003 stating that "the Committee believes that policy accommodation can be maintained for a considerable period," interest rates, especially short-term money market rates will remain at current low levels throughout FY04. The FOMC statement

also stated that inflation “becoming undesirably low remains the predominant concern for the foreseeable future.” As such, there is a remote possibility that short-term rates may increase during the latter part of FY04.

Cash Management

The County maintains an active cash and investment management program. The primary objectives of this program are the preservation of capital, providing liquidity to meet financial obligations, and maximization of the investment yield on short-term working capital.

Working capital is managed pursuant to the Annotated Code of Maryland, the County Code, and the County’s investment policies as approved by the County Council. The County is authorized to invest in: a) obligations for which the United States has pledged its full faith and credit for the payment of principal and interest, b) obligations that a federal agency or instrumentality issues in accordance with an act of Congress, or c) repurchase agreements that any of the foregoing listed obligations secures. Cited statutes also authorize investments in bankers’ acceptances, secured certificates of deposit issued by Maryland banks, commercial paper of the highest investment grade and in money market funds whose portfolio is operated consistent with the Securities and Exchange Commission rule 2a-7. The County requires that these money market funds invest only in obligations that a federal agency or instrumentality issues in accordance with an act of Congress and repurchase agreements collateralized by an obligation of the United States, its agencies, or instrumentalities. The average maturity of the County’s working capital portfolio is generally less than six months. At June 30, 2003, the investment balance of the County’s portion of the consolidated portfolios was \$588.7 million and had earned investment income of \$12.7 million for FY03.

Risk Management

Montgomery County is self-insured for most claims filed by third parties. Property exposures are commercially insured above a high dollar retention. Potential losses are mitigated by a strong safety program, contractual transfer of exposure to others, and ongoing analysis of risk associated with County activities. In addition to the component units covered by this financial report, the following agencies are also members of the risk management program: Maryland-National Capital Park and Planning Commission, City of Rockville, Rockville Housing Enterprises, City of Gaithersburg, the Town of Somerset, the Village of Martin’s Additions, the Village of Drummond, and the City of Takoma Park.

Pension and Other Postemployment Benefits

The County sponsors two cost-sharing multiple-employer pension plans, in which other agencies and political subdivisions have the right to elect participation. The Employees’ Retirement System of Montgomery County is a defined benefit pension plan. The plan is closed to employees hired on or after October 1, 1994 (except public safety bargaining unit employees). The plan’s assets are exclusively managed by the Board of Investment Trustees, which consists of nine trustees and functions as part of the County. The annual contribution required for this plan is based on an actuarial valuation. The Retirement Savings Plan, a defined contribution plan, covers all non-public safety and certain public safety (non-bargaining unit) employees hired on or after October 1, 1994. The Board of Investment Trustees oversees the investment options offered to the participating employees.

All component units participate in various pension plans, either directly in their own plan or through participation in pension systems of Montgomery County or the State of Maryland. HOC and MCRA participate in the Employees’ Retirement System and Employees’ Retirement Savings Plan of Montgomery County, and their data is included in that of the retirement system.

Financial data relative to the pension plans administered by the County is as follows:

| Plan Name | Covered Payroll | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL |
|---|-----------------|---------------------------|-----------------------------------|----------------|
| Employees' Retirement System of Montgomery County | \$ 312,057,363 | \$ 2,029,314,438 | \$ 2,411,492,724 | \$ 382,178,286 |
| Retirement Savings Plan of Montgomery County | 112,790,167 | 40,214,719 | N/A | N/A |

| Plan Name | Employer Contributions | Employee Contributions | Number of Members | # of Persons Receiving or Entitled to Benefits |
|---|------------------------|------------------------|-------------------|--|
| Employees' Retirement System of Montgomery County | \$ 55,205,855 | \$ 14,769,579 | 6,250 | 4,370 |
| Retirement Savings Plan of Montgomery County | 6,798,553 | 3,750,518 | 3,206 | 3,206 |

The County sponsors the Montgomery County Deferred Compensation Plan pursuant to Section 457 of the Internal Revenue Code. The assets are held in trust for the sole benefit of participants and their beneficiaries. Trust responsibilities are assigned to the Board of Investment Trustees.

Net assets of the County's pension plans and deferred compensation plan are as follows at June 30, 2003:

| | |
|----------------------------|-------------------------|
| Retirement System | \$ 1,726,543,279 |
| Retirement Savings Plan | 40,214,719 |
| Deferred Compensation Plan | 199,590,622 |
| | <u>\$ 1,966,348,620</u> |

In addition to the pension benefits described above, the County provides certain postemployment health and life insurance benefits to all employees who retire under the Employees' Retirement System or Retirement Savings Plan. These benefits, which are financed on a pay-as-you-go basis by the General Fund and employee contributions, are accounted for in the Employee Health Benefits Self-Insurance Internal Service Fund. GAAP do not require governments to report a liability in the financial statements in connection with an employer's obligation to provide these benefits.

Additional information on the County's pension plans, deferred compensation plan, and postemployment benefits can be found in Notes IV-E and IV-F in the Notes to the Financial Statements.

MAJOR INITIATIVES

Major initiatives of the County during FY03, including certain initiatives of its component units, presented by functional area, include the following:

Community Development and Housing

Economic and Business Development: The County successfully broke ground on a 19,000 square foot Information Technology (IT) incubator in Silver Spring that will be ready for occupancy in April 2004. The incubator will nurture 25 to 35 early stage IT companies every 3 year cycle. The County also secured 40 acres in Germantown, and 115 acres in East County (Northern Silver Spring) to develop the second and third Life Sciences and Technology Centers in the County. Both centers, with development periods of 3 to 5 years, will provide approximately 2 million square feet of high-tech and research and development space to attract and retain globally competitive businesses. The County, by committing to fund \$6 million by 2004 to build a 700 space parking garage (to be owned by the County later), enabled Macy's to break ground on 180,000 square foot new store construction in Silver Spring. Macy's will be open for business in early 2005.

Silver Spring Redevelopment: A major transformation is underway to revitalize the southern portion of the Silver Spring Central Business District with a significant focus on housing. The County is collaborating with the developers of seven different housing projects that will produce over 1,000 new housing units in the South Silver Spring area. The end result will be a combination of rental apartment units, condominium units and co-housing units including a mix of unit sizes and income ranges. Some projects will include loft units for artists. Several of these projects involve the adaptive re-use of large, vacant, deteriorated buildings that have had a significant blighting influence on the area for years. Combined with the Discovery Communications Creative Technology Center, the Silver Spring Innovation Center, the expansion of the down county campus of Montgomery College and related investments such as restaurants, this new housing will create a dynamic “hip,” smart growth community in downtown Silver Spring. The County is providing financial assistance to several housing projects and has committed over \$6,000,000 to streetscaping and improved pedestrian circulation in the form of interior block linkages throughout the area.

Wheaton Redevelopment: The Wheaton Redevelopment Program office has worked to bring two well known developers, Eakin/Youngentoub and Bozzuto to Wheaton. They are developing the highly visible “entry” to the Wheaton triangle along Georgia Avenue with a combination of townhomes and apartments to provide Wheaton with its first homeowners within the Central Business District. The County also worked with Westfield Shoppingtown Wheaton in their negotiations with Federated Department Stores, Inc. to open a new Macy’s Department store. The location of Macy’s at Westfield Shoppingtown Wheaton marks a major milestone in Wheaton’s continuing revitalization and provides another pivotal anchor for Westfield Shoppingtown Wheaton.

Special Needs Housing: As part of the implementation of the County’s Housing Policy, Montgomery County – A Place to Call Home, the Department of Housing and Community Affairs, in conjunction with the Department of Health and Human Services, the Montgomery County Coalition for the Homeless and the Housing Opportunities Commission, purchased a 99-unit Econo-Lodge motel. This motel will be converted into 40 efficiency apartments that will provide permanent supportive housing for single men and women and 17 two bedroom apartments for previously homeless families. The homeless families will reside at this County owned facility for a period of three to six months. During this time period, they will receive supportive services to enable them to successfully transition to self-sufficiency and occupancy of subsidized permanent housing.

Culture and Recreation

Facility Development: The Bethesda Outdoor Pool received a major rehabilitation to existing features, and a stand-alone lap pool, water slide, and snack bar were added. A 1,500 foot all-purpose room was added to the Holiday Park Senior Center through a grant from the State of Maryland. The Department of Recreation constructed its first spray park at the Good Hope Neighborhood Center. Construction has begun on the Damascus Community Center.

Recreational Programs: The Department of Recreation established a partnership with the National Recreation and Parks Association for “Hearts ‘N’ Parks,” an educational/fitness program. A grant was received from the Robert Wood Johnson Foundation for a fitness program for seniors. Montgomery County Public Schools awarded a grant for a partnership summer program to serve 550 youth at six low-income school sites

Education

Higher Education:

- At Montgomery College's Takoma Park Campus, the new 98,000 square foot Health Sciences Center is scheduled to open for classes in January 2004. The College's Workforce Development and Continuing Education Program will open a new down-county business center in the facility. A new 95,000 square foot Student Services Center is currently under design with construction expected to start in August 2004. The design for a pedestrian bridge over the railroad tracks linking the two halves of the campus is currently under construction and is anticipated to be completed in June 2004.
- At the Germantown Campus, which celebrates its 25th anniversary in October 2003, plans call for the development of a biotechnology and information business park in close proximity to the College's planned 127,000 square foot Biotech Education Center. With the County and State's support, the College has acquired additional land for the new biotech complex for both education and business.
- At the Rockville Campus, the new Marriott Hospitality Center will be ready soon for its dedication, which was funded by a grant from the Marriott Corporation. The Gudelsky Institute for Technical Education is now 10 years old and the College is making future plans for the expansion of the facility.
- The merger of the Maryland College of Art and Design (MCAD) with Montgomery College has been approved by the College's Board of Trustees and is scheduled to be completed on September 1, 2004.

Secondary Education: Montgomery County Public Schools (MCPS) continues to experience significant enrollment growth. MCPS enrollment was 138,891 students in FY03, 2,059 more than in FY02. The September 30, 2003, enrollment is projected to be 140,861. To relieve overcrowding, accommodate more full day kindergarten classes, and provide for increased enrollment, MCPS will open one new high school in 2005 and add 52 classrooms to six schools in 2004 and another 38 classrooms to three schools in 2005. In addition, four school modernizations will be completed in 2004 with an additional two modernizations scheduled for completion in 2005.

Environment

Stormwater Facility Maintenance Program: The County is required under its National Pollutant Discharge Elimination System (NPDES) permit to conduct the physical inspection of 3,000 public and private stormwater facilities, as well as provide routine structural maintenance on residential and associated nonresidential structures. These critical facilities provide both stormwater quality and quantity control of stormwater runoff. The passage of Bill 28-00 sponsored by the County Executive established the county's first Water Quality Protection Charge (WQPC) to fund this program. The WQPC first appeared on the property tax bills in July of 2002, and \$2.9 million was raised by the charge.

Groundwater Protection Program: The County completed the development of the Groundwater Protection Strategy Baseline Monitoring Plan. The plan development involved the evaluation of 50 hydrogeologic watersheds to determine representative characteristics such as demographics, geology, development, impervious surface etc. Once these characteristics were established, 10 watersheds were identified as representing the entire County. Preferred sampling locations were located in each watershed and 900 letters were mailed to owners of wells within these sampling locations with the hope of attracting volunteers to the sampling program. The volunteers will be screened and 70 will be selected for sampling in FY04.

Radon Survey Program: An extensive, while inexpensive, public and education campaign was launched to educate county residents about radon potential health considerations and radon mitigation, since approximately 35 percent of the homes in Montgomery County exceed the EPA suggested action level. To encourage participation in the program, free radon test kits were offered to all eligible residents. As a result 2,284 residents participated in the program. Requests and laboratory analysis results were tracked to illustrate present radon levels, the need for further testing, the effectiveness of mitigation systems, and the need for further public outreach. The program received a National Association of Counties (NACo) award in recognition of an innovative program which enhances county government in the United States.

Recycling and Refuse Collection: In FY03, the County upgraded to the use of new vehicles with mechanical lifts for providing recycling collection to 90,100 homes and refuse collection to 30,600 homes. The equipment will significantly reduce vehicle emissions from the collection vehicles and improve collection of recyclable paper. Large scale distribution of paper recycling carts, to be used in conjunction with the new vehicles, will begin in early FY04.

General Government

Solid Waste System Bonds Refinancing: In a cooperative effort, the Department of Finance and Northeast Maryland Waste Disposal Authority (NEMWDA) refunded two 1993 series of solid waste revenue bonds totaling \$238,404,583, one of which (\$31,075,000) was issued by the County and the other was issued by NEMWDA. The County series is a direct obligation of the County's Solid Waste Enterprise Fund. NEMWDA net debt service, under a long-term service agreement with the County, is a calculated component of the service fees payable by the County to NEMWDA, also supported by the Solid Waste Fund. Agencies rating both refunding bonds upgraded the underlying credit: Fitch from AA- to AA, and Moody's from A2 to Aa3. The Fitch rating is the highest Fitch has assigned to solid waste bonds. The Moody's rating is the highest Moody's has ever issued solid waste bonds. Based on an AMBAC bond insurance policy, all the series 2003 refunding bonds, for both the County and NEMWDA, carry an AAA/Aaa rating. The refundings yielded a net present value savings for the County and NEMWDA of \$1.9 million and \$15.2 million, respectively. The savings achieved by NEMWDA will ultimately inure to the County through reduced waste disposal fees paid to NEMWDA.

Finance Electronic Transfer Tax Application: The Department of Finance, in conjunction with the Department of Technology Services, designed and developed the Finance Electronic Transfer Tax Application as a re-engineering of the simple deeds and deeds of trust business process. This financial management application created a new processing environment for real estate closing. The new system expedites the present transfer process and enables settlement companies to accomplish County transfer office processing of simple deeds and deeds of trust online, rather than utilizing the traditional "walk through" method. The faster processing resulting from the system benefits the County through faster deposit of tax receipts and increased investment income, and benefits the settlement company through expedited customer service to its clients. The County was awarded a 2003 National Association of Counties (NACo) Achievement Award for the program.

Touchscreen Voting System: The Board of Elections implemented a complete change from a punchcard voting system, with approximately 5,000 voting units, to a touchscreen voting system with approximately 2,700 voting units plus an optical scan voting system for absentee voting. The ratio of voting units per voter increased from 1 unit per 125 voters for the punchcard system to 1 unit per 200 voters for the Touchscreen system. In addition, the Board added Spanish to voting related information by reconfiguring and redesigning documents. The newly configured and translated English and Spanish voting information included a specimen ballot sent to all 500,000+ voters, all legally required voting information postings for all 237 polling places, and numerous other informational documents used for public distribution.

Document Imaging: The Department of Permitting Services (DPS) and the Department of Corrections and Rehabilitation (DOCR) developed an Electronic Document Management Program ("EDMP") at the Montgomery County Correctional Facility ("MCCF"), based on a similar system in use at the Liberty Correctional Facility in Tallahassee, Florida, where inmates perform many advanced automation functions. Inmates, under the supervision of a DOCR supervisor, will convert applications, permits, construction drawings and related documents into electronic format (imaging) for all documents collected each day.

Health and Human Services

Center for Biodefense: The Biodefense Center was established to provide a mechanism that would allow direct communications with the five Montgomery County hospitals, the state of Maryland's Emergency Command Center and the County's Emergency Operations Center. Based on experience with anthrax and many drills, the center was designed to serve as the incident command center in the event of a biological attack. Team members have drilled with colleagues in Fire and Rescue Services to assume incident command roles and responsibilities consistent with the County's Emergency Operations Plan. The Biodefense Center enhances communication lines to allow for rapid GIS visualization of syndromic surveillance, immediate establishment of information lines, and TV/Cable access, incorporating use of the Public Safety Communication System to all hospital command centers. This initiative was funded by the Centers for Disease Control and Prevention bioterrorism grants administered through the Maryland Department of Health and Mental Hygiene.

Learning Parties: During FY03, over 240 parents and other caregivers attended 76 Learning Parties held in easily accessible community locations such as schools, libraries, community centers, and apartment complexes. The Literacy Learning Parties, facilitated by trained, bi-lingual community members, are designed to enhance the skills of parents and other adult caregivers to serve as young children's first teachers. Over 280 children in these communities received high quality books in English, Spanish, and Vietnamese. Parents that participated reported an increase in those behaviors and attitudes that improve children's readiness for school, including obtaining a library card, talking and reading to their children more frequently, and using the activities learned in the Parties at home.

ChildLink: ChildLink was designed as one telephone number where parents or caregivers can speak to a bilingual counselor who can triage calls, determining if a simple referral, parenting information, or linkage to a more intensive program is needed to connect them to services and supports. The ChildLink number is advertised in childbirth education classes, local supermarkets, hospitals, libraries, regional centers, health fairs, and other gatherings targeted to families with young children. ChildLink is a part of the County's overall Help Me Grow campaign to make sure that all 60,000 young children in the County obtain the services and support they need to succeed once they start kindergarten.

Public Safety

Sniper Shootings: On October 2, 2002, a shooting spree, like no other known to law enforcement, began in Montgomery County, Maryland. The first victim was shot from a distance by a high-powered rifle, in broad daylight, in a crowded parking lot, for no apparent reason. The next morning four more innocent people carrying out everyday chores, such as pumping gas, vacuuming the inside of a car, waiting for a bus, and mowing a lawn, were shot dead by a sniper within a two-hour period. On the same day, later that evening, an elderly man was shot in Washington, D.C., as he stepped off the curb to cross the road. The next afternoon, a woman loading shopping bags into her car was shot in Spotsylvania, Virginia, in the same cruel, cowardly fashion. Those incidents were followed by the wounding of a Benjamin Tasker Middle School student in Bowie, Maryland, on October 7; a man killed at a Sunoco station in Prince William County, Virginia, on October 9; a man killed at an Exxon station in Spotsylvania County, Virginia, on October 11; a woman killed in the parking lot of a Home Depot store in Seven Corners in Fairfax County, Virginia, on October 14; a man wounded in the parking lot of a Ponderosa steakhouse in Ashland, Virginia, on October 19; and a Montgomery County Ride-On bus driver was killed on October 22, in Aspen Hill, Maryland.

As a result, Montgomery County Police became the lead law enforcement organization in a multi-jurisdictional/Agency Taskforce responsible for investigating the homicides and bringing the shooter(s) to justice. There were 12 primary agencies and 37 assisting agencies. From October 2 through October 24, when the two sniper suspects were arrested without incident, the Montgomery County Police directed all necessary resources towards the goal of stopping the shootings and apprehending those responsible. At the same time, every effort was made to continue the regular duties of police personnel to include: maintaining rapid response to 911 calls, patrolling neighborhoods, and investigating major crimes as they occurred. The costs associated with this incident exceeded \$1.6 million dollars. A federal grant totaling \$600,111 and a County Council supplemental appropriation restored funds to the department's FY03 budget.

Homeland Security: The County's Emergency Preparedness Initiative (EPI), established in FY02, continues to be a top priority in FY03 for the police and fire departments and other county agencies. Plans and protocols for first responders, local government, businesses and schools were developed for the Homeland Security's threat alert announcements. Exercises involving incidents involving bio-terrorism, dirty bombs and terrorists' attacks on infrastructure were conducted by the Emergency Management Group to improve the County's readiness as well as the County's coordination with other federal, state and local agencies. Training was conducted with hospitals on decontamination by the Fire and Rescue Service HAZMAT team to improve medical readiness for bio-terrorist incidents. Several federal grants have enhanced the County Executive and County Council's initial General Fund investment. The Police Department has secured a new command bus, Field Com 1 (FC1) and will take delivery of the vehicle in mid-July 2003 at a cost of close to \$1 million dollars. This state of the art response vehicle will greatly enhance the ability to respond to emergencies and major incidents. The Educational Facility Officer (EFO) Program was implemented with the assistance of a \$4 million dollar grant from the Community Oriented Policing Services office. In a unique partnership with the Police Department and MCPS, thirty-two police officers will be assigned to school clusters in the County with the goal of maintaining and enhancing a safe and secure learning environment for students, staff, and school community. Prophylactic medicine was distributed to all first responders (fire and police) to be available in the event of a bacterial release of an agent. Each household in the County received, through distribution from local newspapers, an emergency and disaster preparations guide providing information to residents regarding sheltering in place and evacuations.

Public Safety Communications System: Montgomery County Fire and Rescue Service (MCFRS) continued to prepare for the implementation of the voice communication and mobile data terminals components of the new 800 MHz radio system and computer aided dispatch. Over 1,400 career and volunteer members of MCFRS were trained on the operation of the new voice and mobile data emergency communications system. Actual cutover from the current system to the new system is planned for mid-July 2003.

New Facility for Public Safety Communications System and Emergency Operations Center: Planning, design and construction activities have occurred to provide a new Public Safety Communications Center for fire and police emergency 911 call taking and dispatch. The automated transportation management center (ATMC) will be co-located with public safety dispatch to facilitate coordinated responses to incidents. The Public Safety Communication Center will be occupied in mid-July 2003 for the implementation of the new public safety communications system. The ATMS is scheduled for occupancy in late fall of 2003. In addition, design and construction of the new emergency operations center for emergency management has continued. The occupancy of the new center is scheduled for late fall of 2003.

Correctional Facility: On March 22, 2003, the first prisoners were received at the new Montgomery County Correctional Facility (MCCF) located in Boyds. This state of the art, 305,000 square feet, 90 million dollar facility is responsible for the custody and care of male and female offenders who are either in a pre-trial status or serving sentences of up to 18 months. The facility's capacity is 1,029 inmates. The mission of MCCF is to protect and serve the citizens of the County and the general public by providing progressive and comprehensive correctional services to all inmates.

Public Works and Transportation

Go Montgomery!: In July 2002, after an assessment of the County's transportation needs, the County Executive announced the Go Montgomery! program. The program is a ten year, \$1 billion initiative to address the traffic congestion problems of the County. The County Council supported the program with an \$11.2 million supplemental appropriation to the operating and capital budgets.

Shady Grove Metrorail Station: One of the most highly used rail stations in the area was given a major boost when a new garage was opened at the Shady Grove Metrorail Station. This garage will provide additional parking for a station that, prior to this opening, had no vacant parking spaces very early on weekday mornings. This new garage has provided many more transit opportunities to county residents.

Transit Services: The Division of Transit Services placed an order for 15 additional Ride On buses, fueled by compressed natural gas (CNG), in FY03 as a part of the County's Go Montgomery! effort to reduce traffic congestion. These buses will be used to increase bus service in the County effective January 2004. In addition, 18 replacement buses, also CNG, were ordered and will retire 18 older diesel fueled buses. The purchase of CNG buses is part of the County's continuing effort to reduce air pollution.

CNG Fueling Station: The Department of Public Works and Transportation began planning for a state of the art CNG fueling station at a cost of \$3.8 million. The station will convert standard pressure natural gas to CNG and will provide fast-fill capability for a total of 79 CNG buses. This CNG fueling station, which is expected to be completed by December 2003, will replace the temporary slow-fill capability CNG station currently used to fuel 24 CNG buses.

Public Access Ethanol (E-85) Fuel Site: Public access to the County's Ethanol (E-85) fuel site located at 16640 Crabbs Branch Way in Rockville was opened in April 2003. E-85 is an ideal transportation fuel, which is better for the environment than petroleum, it is domestically produced, and its use supports farmers and rural economies. Montgomery County is the first local government in the State of Maryland to host this product and allow the public access. The County received the NACo award for the "Best of Category in Transportation" for the E-85 project in 2003.

AWARDS AND RECOGNITION

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Montgomery County, Maryland, for its CAFR for the fiscal year-ended June 30, 2002. Montgomery County has received the Certificate of Achievement more times than any other county in the nation – thirty-three times – as early as 1951 and consecutively for thirty-one years, since 1972.

The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The Department of Finance believes its current report continues to meet the Certificate of Achievement Program's requirements and is submitting it to GFOA to determine its eligibility for another certificate.

Distinguished Budget Presentation

GFOA presented an award of Distinguished Presentation to Montgomery County, Maryland, for its annual budget for the fiscal year beginning July 1, 2002. In order to receive this award, a governmental unit must publish a document that meets program criteria as a policy document, as an operations guide, as a financial plan, and as a communications device. The award is valid for a period of one year only. Montgomery County has received this award consecutively since 1984, the year the program was established. The Office of Management and Budget believes the current budget continues to conform to program requirements and is submitting it to GFOA to determine its eligibility for another award.

USE OF THIS REPORT

The Government Finance Officers Association of the United States and Canada reports a growing awareness that the CAFR should be management's report to its governing body, constituents, oversight bodies, resource providers, investors and creditors. I agree with this direction, and I continue to send copies of this report to elected officials, County management personnel, bond rating agencies, nationally recognized municipal securities information repositories, the State information depository, if any, and other agencies such as financial institutions and government agencies that have expressed an interest in the financial affairs of Montgomery County, Maryland.

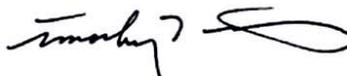
In addition to the vast amount of financial information presented, there is included herein a Statistical Section containing comprehensive data which relates to the financial condition of the entire governmental structure of Montgomery County. Use of this report by the elected officials and department heads of the County is encouraged when furnishing information to interested parties. Considerable effort is being made to present financial information on a uniform and consistent basis nationwide, which will make this report all the more valuable to those desiring to secure information regarding the financial activities of the County.

This report, and other financial information prepared by the Montgomery County Department of Finance, can be accessed on the World Wide Web at www.montgomerycountymd.gov/countyservices/finance/financial. Copies of this report are also being placed in the County Library System for use by the general public.

ACKNOWLEDGMENTS

The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated services of the staff of the County's Department of Finance. I express my appreciation to all participants who assisted and contributed to its preparation. I particularly express my sincerest appreciation to Karen Q. Hawkins, CPA/CGFM, Controller, and her staff, particularly the General Accounting and Administration Sections, for their outstanding performance in the preparation of this report. A list of individuals whose dedicated efforts produced this report is provided separately after this letter. A special appreciation is extended to the finance and accounting managers of the component units whose cooperation greatly facilitated the preparation of this report. I express my appreciation to the County Executive, the members of the County Council and the Chief Administrative Officer and their staffs for their continuing interest and support in planning and conducting the financial operations of the County in a responsible and progressive manner.

Respectfully submitted,



Timothy L. Firestine
Director of Finance

ACKNOWLEDGMENTS

The following individuals' efforts were instrumental in closing the County's funds, and in preparing this Comprehensive Annual Financial Report:

Department of Finance

| | |
|------------------------|---------------------|
| Wayne Johnson | Stephen M. O'Malley |
| Joyce E. Boyd | Catherine Patterson |
| Lisa C. Yang | Nora A. Ravarra |
| Michelle S. Hwang | Danielle R. Snowden |
| Jay Narang | Claudia L. Stalker |
| Christine V. Ullmann | Vasili Stavrakas |
| Michael E. Edelin, Sr. | Alicia L. Thomas |
| Nancy C. Foster | Darane Tiev |
| Timothy D. Hughes | Jan Clagett |
| Karen J. Jackson | Josephine Gilbert |
| Susan Kaplan | Michael Lawton |
| Felix O. A. Ogunba | Denise E. Siegel |

Department of Public Works and Transportation

| | |
|------------------|--------------|
| Richard D. Hands | Jo Ann Byrum |
| Florence Okolo | |

Department of Liquor Control

| | |
|------------|-------------------|
| Andy Brown | Richard J. Duthoy |
|------------|-------------------|

The following individuals provided data and information for inclusion in this report:

County Government

Department of Finance

| | |
|------------------|-----------------|
| Jennifer Barrett | Nancy Moseley |
| Phavann Chhuan | David Platt |
| Michael Coveyou | Wayne Hsin |
| Terry Fleming | Marty Utermohle |
| Ray Gulhar | Glenn Wyman |
| Robert Hagedoorn | |

Department of Public Works and Transportation

| | |
|-----------------------------------|---------------|
| Rick Siebert | Bill Davidson |
| Edna McGraw | Tom Kusterer |
| Richard Taylor and the Print Shop | |

Office of Management and Budget

| | |
|-----------------------|---------------|
| Beverley Swaim-Staley | Heidi Metzger |
| Joseph Beach | |

Office of Public Information

| |
|----------------|
| Thomas Whorton |
|----------------|

Component Units

Montgomery County Public Schools

| | |
|-----------------|--------------------|
| Larry A. Bowers | Susanne G. DeGraba |
| Robert J. Doody | Jack Dodson |

Housing Opportunities Commission

| | |
|----------------|-----------------|
| Linda Mansouri | Eugenia Pascual |
| Micky Hall | |

Montgomery Community College

| | |
|------------------|--------------|
| Marshall Moore | Linda Hickey |
| Kenneth Mullinex | |

Montgomery County Revenue Authority

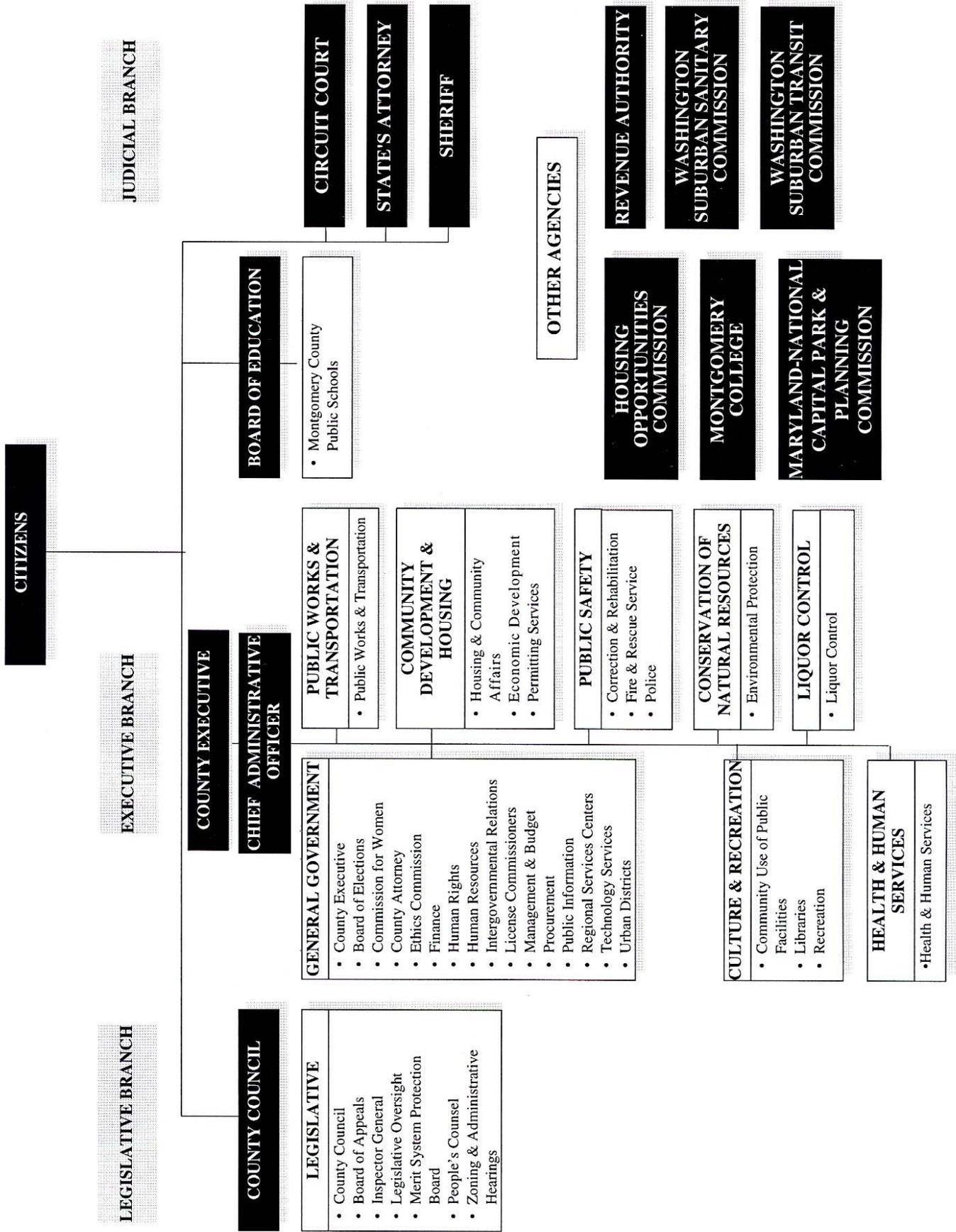
| | |
|-----------|--------------|
| John Luke | Linda Decker |
|-----------|--------------|

Bethesda Urban Partnership, Inc.

| |
|------------------|
| Deborah Williams |
|------------------|

Appreciation is extended to all those in the County Government who take a leadership role in the year-end closing processes and the audit process, including staff in the Department of Finance (Accounts Payable, Information Technology, Payroll, and Internal Audit), Office of Management and Budget, Office of Procurement, Department of Technology Services, and Board of Investment Trustees. Appreciation is also extended to employees in all County departments and agencies who participate in the year-end process.

MONTGOMERY COUNTY, MARYLAND FUNCTIONAL ORGANIZATION CHART



MONTGOMERY COUNTY, MARYLAND

ELECTED OFFICIALS

June 30, 2003

COUNTY EXECUTIVE

Douglas M. Duncan

COUNTY COUNCIL

Michael L. Subin
Steven Silverman

President
Vice President

Phil Andrews
Howard A. Denis
Nancy Floreen
Michael Knapp

George Leventhal
Tom Perez
Marilyn Praisner

Other Elected Officials

Administrative Judge Circuit Court
Clerk of the Circuit Court
Register of Wills
Sheriff
State's Attorney

Ann S. Harrington
Molly Q. Ruhl
Joseph M. Griffin
Raymond M. Kight
Douglas F. Gansler

APPOINTED OFFICIALS

Chief Administrative Officer

Board of Appeals

Correction and Rehabilitation

County Attorney

County Council

Economic Development

Environmental Protection

Finance

Fire and Rescue Service

Health and Human Services

Housing and Community Affairs

Human Resources

Inspector General

Intergovernmental Relations

Legislative Oversight

Liquor Control

Management and Budget

Merit System Protection Board

People's Counsel

Permitting Services

Police

Procurement

Public Information

Public Libraries

Public Works and Transportation

Recreation

Technology Services

Zoning and Administrative Hearings

Bruce Romer

Katherine Freeman

Arthur M. Wallenstein

Charles W. Thompson, Jr.

Stephen B. Farber

David W. Edgerley

James A. Caldwell

Timothy L. Firestine

Gordon A. Aoyagi

Carolyn W. Colvin

Elizabeth B. Davison

Joseph Adler

Norman D. Butts

Melanie L. Wenger

Karen Orlansky

George Griffin

Beverly Swaim-Staley

Waddell Longus

Martin Klauber

Robert Hubbard

Charles A. Moose

Beatrice P. Tignor

David S. Weaver

Harriet Henderson

Albert J. Genetti, Jr.

Gregory A. Bayor

Alisoun K. Moore

Franciose Carrier

Montgomery County Officials, Concluded

COMPONENT UNIT OFFICIALS

Montgomery County Public Schools

Board of Education:

Patricia B. O'Neill, President
Sharon Cox, Vice-President

| | |
|--------------------|------------------|
| Kermit V. Burnett | Gabriel Romero |
| Reginald M. Felton | Mihyar Alnifaigy |
| Charles Haughey | Student Member |
| Walter N. Lange | |

Jerry D. Weast, Superintendent of Schools

Montgomery County Revenue Authority

Board of Directors:

Stephen Edwards, Chair
Carol McGarry, Secretary-Treasurer

| | |
|------------------|--------------------------|
| Peter L. Gray | John Lane |
| Herbert L. Tyson | Scott Reilly, Ex-Officio |

Marc D. Atz, Executive Director

Bethesda Urban Partnership, Inc.

Board of Directors:

Jason Hoffman, Chair
Carol Trawick, Vice Chair

Elliot Schnitzer, Treasurer
Jack D. Hayes, Secretary

| | |
|-------------------|--------------------|
| Edward Hall Asher | Patricia A. Harris |
| Robert E. Hebda | Benjamin W. King |
| Page Lansdale | Deborah Snead |

W. David Dabney, Executive Director

Montgomery Community College

Board of Trustees:

Owen D. Nichols, Chair
Gene W. Counihan, First Vice Chair
Sylvia W. Crowder, Second Vice Chair

| | |
|--------------------|-----------------------|
| Mary E. Cothran | Robert E. Shoenberg |
| Jong-on Hahm | Roberta F. Shulman |
| Stephen Z. Kaufman | Fatema Malik, Student |
| Michael C. Lin | |

Charlene R. Nunley, President and Secretary/Treasurer

Housing Opportunities Commission of Montgomery County

Commissioners:

Richard Nelson, Chair
Norman Cohen, Vice Chair

| | |
|---------------------------------|-------------------|
| Monroe Galloway, Chair, Pro Tem | Michael Kator |
| Ralph D. Bennett | Roberto R. Pinero |
| Lakeyia L. Thompson | |

D. Scott Minton, Executive Director and Secretary Treasurer

INDEPENDENT AUDITORS

KPMG LLP
2001 M Street, N.W.
Washington, DC 20036

Elected Officials

Montgomery County, Maryland



Douglas M. Duncan
County Executive



Michael L. Subin
Council President



Steven Silverman
Council Vice-President



Phil Andrews
Council Member



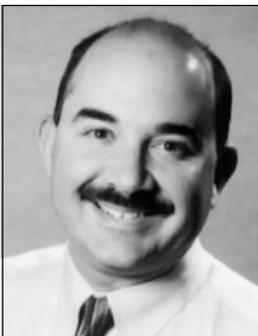
Howard Denis
Council Member



Nancy Floreen
Council Member



Michael Knapp
Council Member



George Leventhal
Council Member



Tom Perez
Council Member



Marilyn Praisner
Council Member



**Prepared by the:
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Division of the Controller
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Rockville, Maryland 20850
240-777-8860**