CITY OF MEDINA

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Date: March 14, 2022

To: Future Finance & HR Director, Staff, Mayor and City Council

From: Julie Ketter, out-going Finance & HR Director

Re: Update report on Levy Lid Lift ballot measure of 2019, new developments

I am taking this opportunity to thank the entire Medina City team and community for the support they gave me over the last 8 years.

In an effort to capture the institutional memory I have amassed regarding the City's levy lid lift ballot measure of November 2019 and property taxes, I have assembled this memo to help the team going forward. The City is currently half-way through their 6-year, voter approved levy lid lift. There are a few updates that I would like to outline. This document is arranged chronologically; the new developments and their implications will be found starting on the bottom of page 4.

Background:

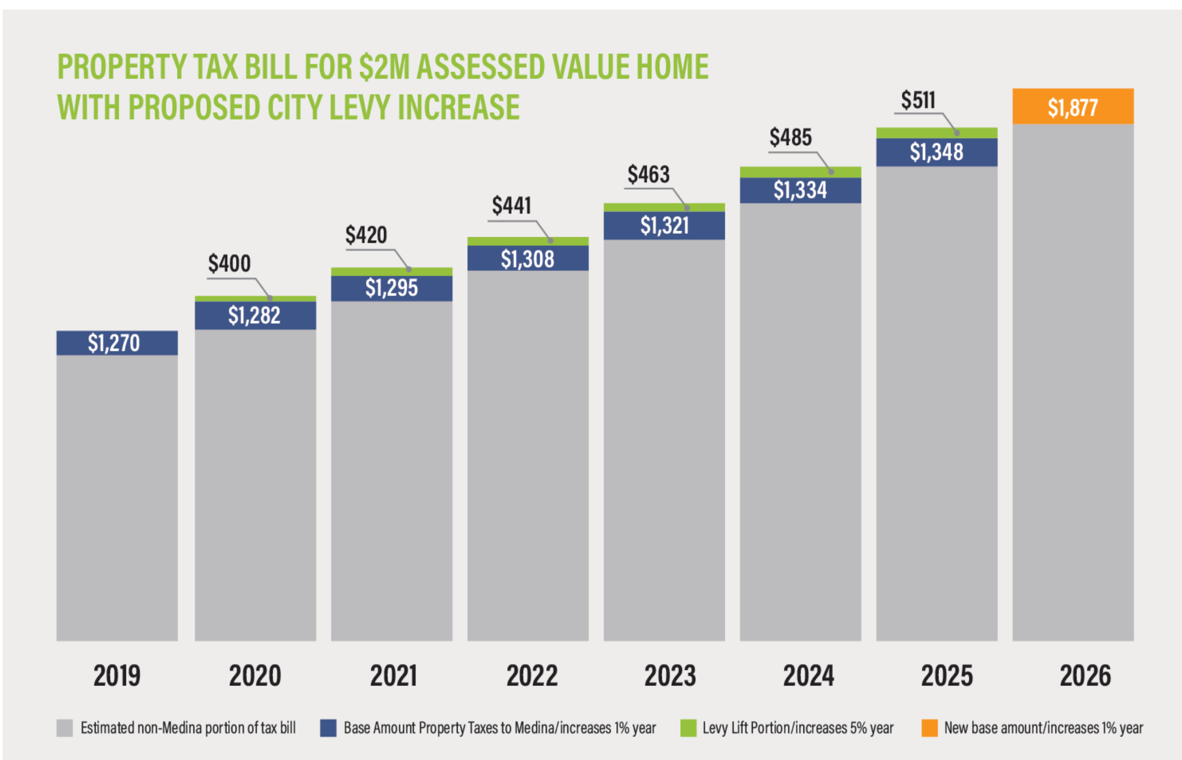
Since the passage of Initiative 747 in 2001 Medina, like many other jurisdictions in the state, struggled to maintain the level of service residents expect with its major source of revenue for these services unable to grow at the same pace of rising costs.
I-747 limited annual increases to property tax levies by local taxing jurisdictions to only 1%. By 2018, the City was at a financial crossroads. The cost of providing basic services had been growing faster than the available revenue streams—expenses had risen an average of 4-5% per year while revenue was only growing at an average of 2.5% per year. The City Council had previously been able to balance the budget through aggressive cost-saving measures, identifying additional revenue sources and dipping into reserves. But the City could no longer find efficiencies without impacting service delivery and its sources of reserves were nearly depleted. The City was projected to have a $500,000 budget deficit by 2020 and a $3.3 million cumulative deficit by 2025.

In 2018, Council & Staff began studying solutions for a long-term financial plan. While many ideas for additional revenue sources, cost-recovery directions and expense trimming were discussed; they were small. Cumulatively they lacked the impact to correct the City's financial trajectory without also a significant reduction of core service levels, an idea which the Council was uncertain the community would embrace. A more impactful solution, sale of public property was also discussed but Council felt it was also an idea which the community wouldn't embrace. I-747 does allow for an increase to property tax levies beyond the 1% limit, if proposed to the voters and it is approved by a majority. March 11th, 2019, the Council approved Ordinance 970 which directed a measure to be placed on the November 5th ballot.

The ballot measure (Proposition 1) was crafted around the following goals:

- Maintain the same service levels provided in 2019
- Create a 10-year solution for financial stability

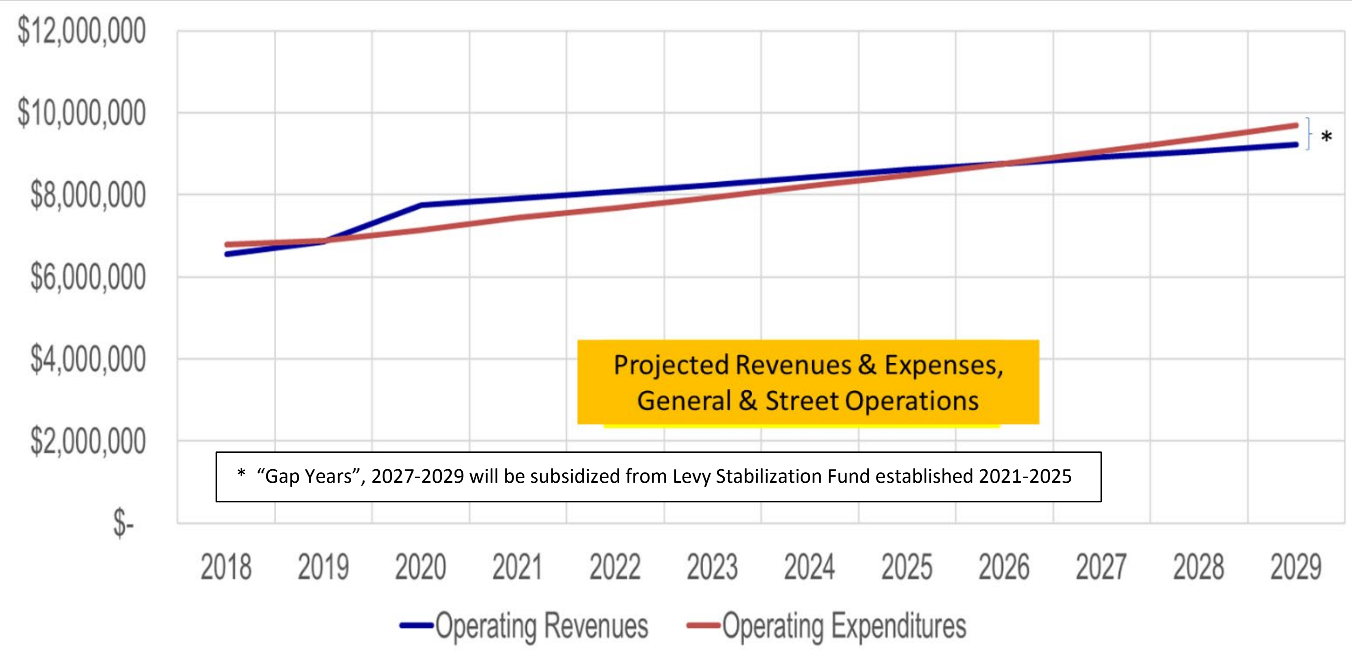
The City decided on a multi-year, permanent levy. The initial "bump" would add $0.20 per $1000 AV in 2020; increasing the tax bill on a $2M tax assessed home, for example, by $400. The additional overall amount generated from this would be approximately $900K, would turn the City away from deficit spending and start restoring financial health. Years 2-6 of the levy period would see this amount increased by 5% each year (approximately $945K, $992K, etc.). This would keep revenues moving with expense inflation, plus an additional amount to transfer to a Levy Stabilization Fund. This would fill the budget gaps that would arise once the term of the levy measure expired, allowing the City to continue balancing its budget through its goal of 10 years (2029). Once the 6-year levy period was over, the amount collected its final year (2025) would roll into the City's regular (statutory) levy to create a new base that would then only increase by 1% each year as allowed by law.



While this structure created challenges in explaining how it would work to residents, it was important to the City not to create a 10-year solution that required a bigger increase all in one year, just to sit on a large amount of taxpayer money for nearly a decade; but rather to ease in the need over the longest period allowed.

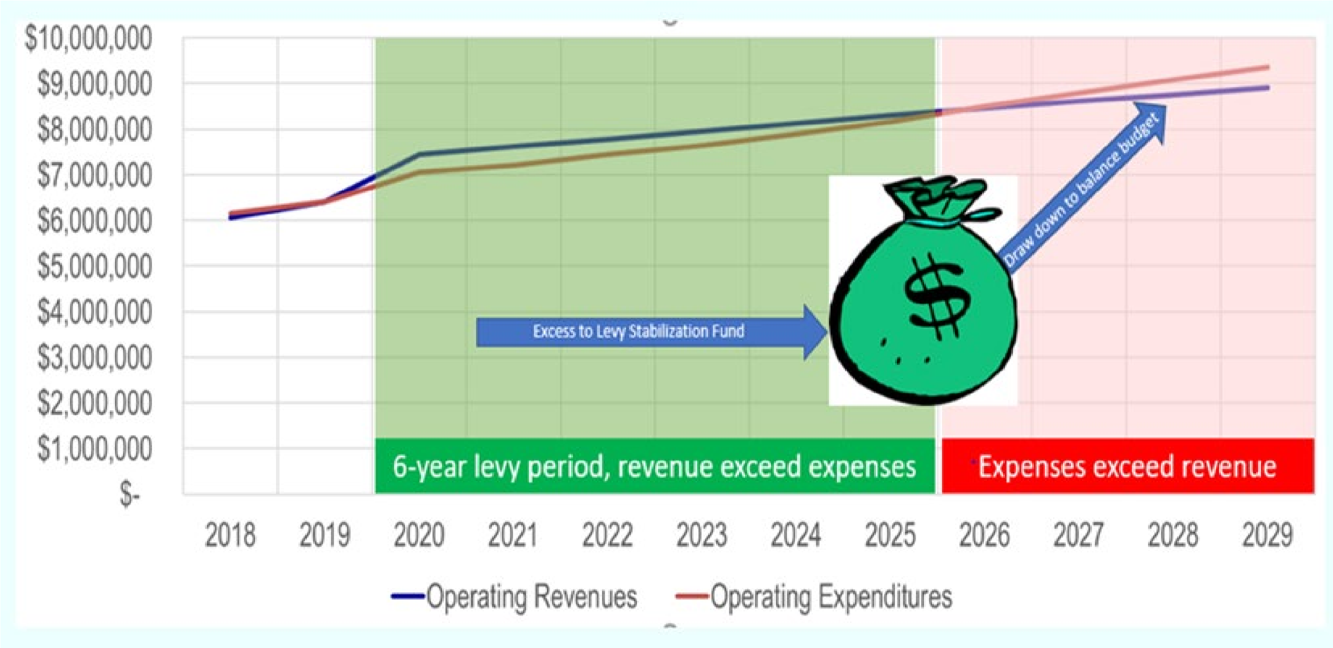
A record voter turnout for an off-season election, nearly 60% was received. During the 3-week period the vote was being counted, from election day to when the results were required to be finalized, the measure remained too close to call. Ultimately the measure passed, 51% to 49%.

<u>Revenues Compared to Expenses Reflecting Passing of Levy Lid Lift:</u>



Making the "bump" from the 6-year levy last at least 10-years.

Levy year 1 (2020) filled the gap from the impact of deficit spending years as well as allowed services to continue without reduction. Years 2-6 (2021-25) will have budgeted transfers to a *Levy Stabilization Fund* in amounts that will build an operating reserve to draw on for at least another 4 years. 2021's budget reflects a $500K transfer into this fund. See illustration on following page.



Other promises made to the voters:

-**Maintain the same LEVEL of services as before the levy lid lift.** Remember, these were already trimmed service levels. This dictates a service level, status-quo budget. So, no additions or reductions from the 2019 picture.

-**Restore the City's measures of financial health**:
*Start each new year with the full General Fund required balance to cover first quarter expenses. This is something the State Auditor looks for, as well as creditors. It allows us to continue to pay the bills while waiting for our major source of funding (property taxes) that only get paid to the City in portions every 6 months.
*Engaged Finance Committee.
*Continual long-term financial planning, always looking ahead 10 years.
*Contingency Fund rebuilt.
*Develop community friendly financial statements.

AFTER THE BALLOT MEASURE PASSED, WHAT HAPPENED NEXT?

Late November prior to a tax year, the King County Assessor's office requires taxing districts to submit the amounts of their requested levy, up to the maximum available. Typically, the amount requested is the maximum, which is calculated by the Assessor reflecting ***the prior*** *year's total amount + the 1% increase as allowed by law and adjustments made for new construction, utility value & prior year refunds*. A taxing district is not required to request the full amount if they do not need it all to meet their budget's needs. Any amount deferred will be available in future years and is called "banked capacity". Since banked capacity are amounts the taxing district is already entitled to, it can be drawn partially or in full by the entity's governing board (Council) as part of the annual budgeting process, despite the fact it makes a total tax levy increase that year exceed 1%. It should not be a surprise that in this era of a 1% increase cap on cities major source of funding, property taxes, it is rare to find a City with banked capacity.

Year 1 (2020):

November 25th, 2019, Staff submitted the required documents to the KC Assessor's office to receive in 2020 the maximum levy available based on last year's amount (see italicized in above paragraph). Also, the additional $0.20 per assessed $1K valuation outlined in the approved levy lid lift measure was included. That generated an additional $942,833 of revenue for the City. This is the permanent bump described in the levy materials that would increase each of the remaining years (2-6), by 5% and then roll into the original base levy to go forward with the same 1% increase limitations. See chart at the bottom of page 3. The large gray part of the bars represents all the other taxing districts homeowners pay---schools, county, transit, etc. The small colored sections go to Medina, the only part they can control. The blue is the City's regular, legacy levy amount that is limited to only the 1% increase. The green is the new addition approved by the voters that increases 5% each year until the end of the measures' term. Once it is over, starting in 2026 they comingle (orange on the chart) and become the City's regular levy, limited to 1% increases each year unless voted on (again) by the people.

The additional amounts to be added to the budget as a result of the levy lid lift measure, during the period of 2020-25 are:

How Much Extra Funds is the Levy Lid Lift Creating Each Year?

	Amount of Increase	Total	
2020	$ 942,833	$ 942,833	Initial "bump"
2021	$ 47,142	$ 989,975	
2022	$ 49,499	$1,039,473	
2023	$ 51,974	$1,091,447	+5% each year
2024	$ 54,572	$1,146,019	
2025	$ 57,301	$1,203,320	

Year 2 (2021):

Autumn of 2020, staff & Council prepared the 2021 budget and set the property tax amount to request, as outlined above. The KC Assessor's office responded to our submission, wanting to know where the additional $989,975 came from. They didn't have in their records any indication that the "bump" was permanent and also did have that in levy years 2-6 the original base levy would be able to increase 5%. This effectively, would erase most of the intent of the original ballot measure as explained to the public.

I'd like to digress for a paragraph at this point to add in some details that will give context to what happened next. December 2017, staff launched a long-term financial planning process to help educate the Council and community as to the problems the City was facing. Since nobody on staff or Council had ever been involved in something like this before, especially when it became obvious that the Levy Lid Lift option was the only solution that would repair the damage done with nearly two decades of revenues held below inflation; consultants & experts were brought in at key steps along the way. FCS Group verified in-house calculations and Lund Faucett helped create educational materials for the community to clearly explain the problem and a rather complex solution. As required by law, the City Attorney drafted the ballot title and measure, both of which require precise language that is tightly restricted by challenging word count limits. We had discussions along the way with the State Auditor's Office, MRSC, AWC and fellow cities who had experience. *A key piece of advice we had gotten from multiple sources was followed: before finalizing the ballot title and measure, run it through the* ***KC Assessor's office*** *and the* ***WA Dept of Revenue****. They came back to us with an OK, looks good*. Now fast-forward to after the measure passed and sometime in the first half of 2020: a key-contact, long-time employee with the KC Assessors office retired. Like most agencies during COVID, they had difficulties filling the void caused by the loss.

So, while the issue with the KC Assessor's office was distressing it was not terribly surprising. The City Attorney drafted a letter stating the City's position. KC stepped back from their initial response, referred to themselves as just an Administrator to property taxes and passed the issue to the WA Dept of Revenue as the Interpreter they defer to. Eventually, the State's ruling came back with an unexpected twist. In addition to reinstating the 2020 increase to permanent status, they now said that they interpret the language of the ballot, which voters approved, to mean that the 5% increase allowance for years 2-6 extends to the *entire* City's levy, both the "bump" portion and legacy portion! (New Finance Director: There is a more detailed, colorful account of all this saved in the I:drive and a hard copy in the "King County-Tax Roll" binder in your office.)

Since the 2021 budget was already set based on the originally anticipated revenue from the property tax levy determined well before all this drama, the City went ahead with its submission as planned. The City ignored the newly increased maximum levy allowed, letting the difference become banked capacity. Although the WA Dept of Revenue indicated the determination was final, it happened so suddenly and felt somewhat capricious, so staff felt it best to wait until the cycle came around again before addressing the long-term picture of what this might mean for the City's future finances.

<u>Year 3 (2022)</u>:

Autumn of 2021 arrived and along with it the worksheets from the KC Assessor's office outlining the City's maximum property tax levy allowed. Aside from a significant transposition error in their internal calculations, which was easy to point out to them and get corrected, the effect of reinterpretation of the ballot measure by the WA Dept of Revenue remained. Final was, indeed, final. As with the previous year, Staff and Council had worked up the 2022 budget prior to receiving the Assessor's materials. The budget and property tax levy amount required fell in line with the City's original intention for the Levy Lid Lift. It has been stated often in recent years that the City's budget was essentially written for the next ten years when the levy measure passed. Those budgets are guided by a basic framework or promises made to the voters:

-No change in service levels compared to 2019.
-Apply the 2020 increase to maintain those levels, absorbing impacts of inflation and filling the hole left from years of deficit spending.
-Amounts received 2021-25 in excess of funds needed to continue same service levels would be held in a separate fund. Once the 6-year levy period is over, inflation will begin to out-pace revenues. This fund will be used to fill revenue gaps for a minimum of 4 years, the last of part of the "ten years of financial stability" promise. Although current projections indicate that the fund could possibly fill revenue gaps for a bit longer than that.

With this in mind, staff went forward as they did in the prior year; the status-quo budget was adopted and the excess amount of available property tax levy was ignored, letting it sit as banked capacity.

<u>Year 4-6 (2023-25) and the future</u>:

Currently the City has $317,755 of banked capacity available that can be drawn on in future years to increase revenues. By the end of the 6-year levy lid lift period, if the City continues to bank this excess in the same manner, the total banked capacity available going into 2026 will be approximately $800K. While that sounds significant, keep in mind that it is less that the 2020 bump of $943K which only increased, for example, the median valued home in the City tax bill by approximately $400 a year. Also keep in mind going into 2026, this begins the period outlined in the long-term financial planning when the City would be drawing on the Levy Stabilization Fund to fill budget gaps caused by revenues not being able to keep up with inflation's effect on expenses. It would likely be unnecessary to address the banked capacity until at least 2030, or later depending on how long it takes to deplete the Levy Stabilization Fund. After that, would be the point in the long-term financial plan that was identified as when the City would need to talk about the newly evolving difficulties balancing the budget within revenue restraints. Déjà vu, December 2017, only with that lingering banked capacity likely still hanging out there.

Ultimately, what the City wants to do with its banked capacity falls entirely within the discretion of the Council; even if they want to draw it all in next year, ignore until the end of days, or something in between. As mentioned earlier, banked capacity is looked upon by the law as deferred revenue the City is entitled to. While it may sit awkwardly based on how it came about versus the initial intention, it isn't going to go away. A part of me is disappointed to be retiring and missing out on the fun of helping Council tackle this interesting quandary.