



**BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND**

**AB 6451
May 7, 2024
Regular Business**

AGENDA BILL INFORMATION

TITLE:	AB 6451: Fiscal Year 2023 Year-End Financial Status Update and Budget Amending Ordinance	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input checked="" type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Receive the Fiscal Year 2023 Year-end Financial Status Update and Adopt Ordinance No. 24-04, Amending the 2023-2024 Biennial Budget.	

DEPARTMENT:	Finance
STAFF:	Matt Mornick, Finance Director LaJuan Tuttle, Deputy Finance Director Ben Schumacher, Financial Analyst
COUNCIL LIAISON:	n/a
EXHIBITS:	1. FY 2023 Year-End Financial Status Update 2. Ordinance No. 24-04 2023-2024 Budget Amendments
CITY COUNCIL PRIORITY:	4. Focus efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community.

EXECUTIVE SUMMARY

This agenda bill summarizes the City’s financial position at the end of fiscal year 2023.

- The City’s General Fund balance at year-end is \$15.7 million (M). Of this amount, \$11.5 M is committed to prior City Council actions, including restricted uses and appropriations based on established financial policies.
- The remaining \$4.2 M represents the available unassigned fund balance in the General Fund. This revenue surplus is the result of better than anticipated sales tax revenues, interest earnings, and strategic use of the American Rescue Plan Act (ARPA) funds.
- General Fund expenditures were 97.5% of the amended budget. After carrying over 2023 resources to complete work in 2024, 99% of the 2023 expenditure budget was used.
- For 2023, total REET revenues were \$3.51 M, \$0.9 M below budget expectations and down from \$4.04 M in 2022. The drop in REET revenues in 2022 and 2023 below budget expectations comes during a time of significant capital investment within the Mercer Island community.
- Detailed analysis across all funds is provided in the FY 2023 year-end Financial Status Update (Exhibit 1). This includes revenue and expenditure actuals along with budget amendments adopted by the City Council from January 1 through December 31, 2023.
- Ordinance No. 24-04 (Exhibit 2) formalizes budget adjustments previously approved by the City Council.
- Staff recommends the City Council appropriate \$2.7 M of the unassigned fund balance to support emerging needs in the current biennium.

ISSUE/DISCUSSION

During the 2023-2024 mid-biennial budget workshops last fall, the City Council received a revenue forecast ([AB 6357](#)) as well as the third quarter financial status update for FY 2023 ([AB 6377](#)). At the time, General Fund expenditures were tracking within budget expectations. Revenues were forecasted to exceed budget estimates and continue along healthy trendlines. This proved to be the case through year-end.

General Fund Revenues

At the end of 2023, the General Fund posted \$39.0 M in revenues, roughly \$4.9 M more than the amended budget due to better than anticipated revenues from sales tax, license, permit, and zoning fees, and interest earnings (see Exhibit 1).

The City received \$6.4 M in general sales tax revenues, a record high for Mercer Island, previously set in 2022. The increase in 2023 sales tax activity is due to higher-than-expected returns largely in the construction sector. Overall, general sales tax revenues were \$689,000 more than in 2022.

License, permit, and zoning fees outperformed budget expectations due to high permit activity and revenues collected from three high valuation projects. Overall, net operating revenue tied to development services amounted to just over \$420,000. This surplus is restricted fund balance in the General Fund, set aside strictly for permit-related services.

Increased earnings in the City's investments reached a historic high in 2023, amounting to \$1.8 M, which is \$1.7 M more than the prior year. In 2022, the City earned an average 1.33% earnings rate with the Washington State Local Government Investment Pool (LGIP). The average earnings rate in 2023 was 5.02%. This exponential increase corresponded with changes to the Federal Reserve's federal funds target rates.

For context, changes in the federal funds target rates are the Federal Reserve's primary tool to implement monetary policy. While increases to the federal funds target rates helped slow the pace of inflation, it also increased the LGIP's earnings rate.

General Fund Expenditures

At the end of 2023, General Fund expenditures were 97.5% of the amended budget, ending the year \$0.9 M under budget. Most of this unspent budget was tied to professional and contractual services. Of this amount, \$602,408 is being carried over from 2023 into 2024. This includes resources funding work on the Climate Action Plan and completing scheduled updates to the City's comprehensive plan, among other work items. Including budget carryovers from 2023 into 2024, General Fund expenditures amount to \$36.9 M, or 99% of the \$37.2 M expenditure budget.

Budget carryovers relate to incomplete projects, programs, contracts, or purchases that were authorized in the 2023 budget, but not spent by the end of the fiscal year. Within a biennium, funding and the expenditure authority are automatically "carried over" to the second year of the budget. These include resources such as cash and grants that were obligated but unspent. A list of the operating carryover requests in the General Fund is included in figure 1.

GENERAL FUND	TOTAL
CARRYOVERS FROM 2023 TO 2024	
Election expenses	\$ 141,000
Municipal Court audio-visual grant	34,991
Comprehensive Plan update	129,000
Financial Software implementation	35,000
Mobile Integrated Health resources for EFR	213,517
Climate Action Plan funding	48,900
TOTAL	\$ 602,408

Figure 1

Fund Balance

Per the City’s financial management policies, the five categories of fund balance in the General Fund include:

1. **Non-spendable** fund balance which cannot be spent, such as the principle of an endowment or inventories.
2. **Restricted** fund balance, which has externally enforceable limitations on the use imposed by creditors, grantors, laws, or regulations from other governments.
3. **Committed** fund balance that encompasses long-term limitations imposed by the City Council. For example, the City Council has committed a portion of fund balance to offset the long-term liability from the Washington Law Enforcement Officers' and Firefighters' System (LEOFF I) retirement plan.
4. **Assigned** fund balance, which the City Council earmarks for an intended use that may be temporary or short-term in nature.
5. **Unassigned** fund balance comprises what is left after considering the other four categories. The use is least constrained.

The fund balance in the General Fund at the end of fiscal year 2023 is \$15.7 M. Of this, \$11.5 M is reserved based on prior City Council actions. The remaining \$4.2 M unassigned fund balance represents the year-end surplus in the General Fund. Figure 2 outlines in detail by category the General Fund balance.

GENERAL FUND BALANCE FOR 2023 <i>(\$ in thousands)</i>	TOTAL
RESERVED	
NON-SPENDABLE	
Petty cash	\$1
Inventory of supplies	121
RESTRICTED	
Law enforcement restricted	82
Development services technology reserve	8
Development services customer deposits	58
Deferred development fee revenue	554
Permit fee revenue surplus	723
COMMITTED	
LEOFF I long-term care reserve	2,536
Compensated absences reserve	675
WSDOT lease deposit	711
Emerging innovations reserve	0
Unearned recreation revenue	385
ASSIGNED	
Sound Transit settlement agreement	1,525
Expenditure carryovers to 2024 budget	602
Budgeted fund balance 2024 budget	3,531
Expenditure control budgeting reserve	35
RESERVED SUBTOTAL	\$11,548
UNASSIGNED - AVAILABLE BALANCE	\$4,201
TOTAL FUND BALANCE	\$15,749

Figure 2

REET Revenues

Real Estate Excise Tax (REET) is the primary revenue source for both the Steet Fund and Capital Improvement Fund. It is currently split into two revenue streams – REET-1 and REET-2 – each with restricted uses per State law.

The slowing of real estate activity on the Island in the latter part of 2022 and through 2023 mirrored the Federal Reserve’s increases to the federal funds rate. Although the increased federal funds rate slowed the pace of inflation, it simultaneously increased borrowing costs and reduced the number of property transactions on the island.

For 2023, total REET revenues were \$3.51 M, \$0.9 M below budget expectations and down from \$4.04 M in 2022. By comparison, REET revenues in 2021 were \$7.7 M, the highest on record. The lower-than-expected returns are due to 290 property sales in 2023, a markedly low number compared to 303 in 2022, let alone 530 in 2021.

The drop in REET revenues in 2022 and 2023 below budget expectations comes during a time of significant capital investment within the Mercer Island community. Staff is closely tracking cash flow needs to support ongoing capital project work. Should a funding gap in the Capital Improvement Fund or the Street Fund result in a substantial impact on planned construction projects, staff will return to City Council to discuss funding alternatives including using unassigned year end surplus, project delays, or adjustments to project scopes.

Emerging Needs and Disposition of Fund Balance

The \$4.2 M General Fund year-end surplus represents one-time savings in-line with recent prior year-end financial outcomes. Adequate fund balance is a key element of the City's long-term fiscal management strategy. In times when economic health yields a year-end surplus, the City's financial policies ([Resolution No. 1602](#)) provide guidance on how to use unassigned fund balance. Examples include replenishing operating reserves to target levels and investing in one-time work items.

Per Council's direction, the City has created and maintains different reserves and fund balances, which provide the City with options to proactively manage cash flow based on specific needs, respond to unexpected issues, or buffer services and operations against different forms of risk. At the end of 2023, two fund balances are not at target funding levels – the Youth and Family Services Operating Fund Balance and the Municipal Facility Replacement Fund.

Staff recommends the following one-time investments to contribute towards meeting target funding levels and to address emerging needs related to the closure of City Hall, as outlined in figure three.

PROPOSED USES OF GENERAL FUND BALANCE	TOTAL
2023 UNASSIGNED BALANCE	\$ 4,201,273
1. YFS Operating Fund Balance contribution	150,000
2. Municipal Facility Replacement Fund	2,400,000
3. Long-term Facility Support	150,000
SUBTOTAL	\$ 2,700,000
REMAINING UNASSIGNED FUND BALANCE	\$ 1,501,273

Figure 3

1. The **YFS Operating Fund balance** was established with the adoption of the financial management policies in 2021. By design, the fund balance is meant to address temporary revenue losses and ensure adequate reserves given the asynchronous nature between the City's biennial budget and the school district's academic year. The target funding level is six-months of average YFS monthly expenditures. At the end of 2023, the YFS operating fund balance is \$903,114, below the \$1.4 M target funding level.

Staff recommends the City Council appropriate \$150,000 of unassigned General Fund balance, which follows in-line with prior City Council actions of making incremental contributions each biennium to reach the target funding level.

2. In November 2023, the City Council established the **Municipal Facility Replacement Fund** to set aside critical resources to help fund short and long-term needs following the closure of City Hall. The City Council appropriated interest earnings tied to the General and Contingency Funds for the third quarter of 2023, amounting to \$579,808. Between the two funds, fourth quarter 2023 interest earnings amounted to

\$631,980. Staff recommends the City Council appropriate an additional \$2,400,000 of unassigned General Fund balance to further efforts towards reaching the established funding target of \$10 M.

3. **Long-term Facility Support.** In partnership with outside consulting firms, the City has been exploring opportunities to relocate city staff in temporary workspaces in response to the closure of City Hall, while working closely with the City Council on a longer-term solution. Staff is requesting an additional \$150,000 appropriation to support this work.

NEXT STEPS

During the 2025-2026 biennial budget workshops this fall, staff will preview the departmental work plans for the next two years along with the resources required to see them through. Staff will also review policies related to the disposition of year-end surplus and project economic conditions in the near term to inform the City Council of potential uses – both within the operating and capital budgets – of the remaining \$1.5 M of General Fund unassigned fund balance.

RECOMMENDED ACTION

1. Adopt Ordinance No. 24-04, amending the 2023-2024 Biennial Budget.
2. Appropriate unassigned General Fund balance and direct the City Manager to include in a subsequent budget amending ordinance that includes:
 - a. \$150,000 to the YFS Operating Fund Balance.
 - b. \$2,400,000 to the Municipal Facility Replacement Fund.
 - c. \$150,000 to long-term support for facility-related work.