



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 6839
January 20, 2026
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 6839: 2027-2028 Budget Planning Overview – <i>added 1/16/2026</i>	<input checked="" type="checkbox"/> Discussion Only <input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Receive report. No action necessary.	

DEPARTMENT:	Finance
STAFF:	Matthew Mornick, Finance Director
COUNCIL LIAISON:	
EXHIBITS:	<ol style="list-style-type: none">1. City of Mercer Island Funds by Type and Purpose.2. Tentative 2027-2028 Biennial Budget Development Schedule.4. Focus efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community.
CITY COUNCIL PRIORITY:	

AMOUNT OF EXPENDITURE	\$ n/a
AMOUNT BUDGETED	\$ n/a
APPROPRIATION REQUIRED	\$ n/a

EXECUTIVE SUMMARY

This agenda bill provides background on the City's financial operations, emerging priorities, and a look ahead at the schedule to develop the 2027-2028 Biennial Budget.

- Every two years, the Mercer Island City Council adopts a financial plan that covers a two-year period, known as a biennium. The current 2025-2026 Budget is a balanced \$222 million plan that emphasizes prudent fiscal management while tackling a backlog of infrastructure needs.
- Staff is in the process of closing out fiscal year 2025. Information on the City's financial position at 2025 year-end will be presented to the City Council in April/May 2026. Meanwhile, efforts are also underway to begin drafting the 2027-2028 Preliminary Budget.
- Staff will be engaging with the City Council early in 2026 to inform the budget development process. Discussions over the next several months will address next steps for facility planning replacement and review planned investments underway in the capital improvement program.
- A key focus in 2027 and 2028 will be to prioritize how to fund general government operations within budget limitations and develop a long-term sustainable funding strategy for the General Fund and the Youth and Family Services Fund.
- Staff will return incrementally to the City Council this year to request additional budget authority to address emerging needs and seek policy direction to inform goals and objectives for the 2027-2028 biennium.

BACKGROUND

Every two years, the Mercer Island City Council adopts a financial plan that covers a two-year period, known as a biennium. The current biennial budget includes the 2025 and 2026 fiscal year. Adopted by the City Council on December 3, 2024 ([AB 6585](#)), this budget serves as the primary financial and policy plan, detailing what the City will achieve as outlined in the work plan, and how the City will pay for these operational services and capital improvements.

The 2025-2026 budget is a balanced \$222 million plan that emphasizes prudent fiscal management while tackling a backlog of infrastructure needs.

To track how these resources are invested and prepare for the 2027-2028 biennial budget process this year, it is important to distinguish between the operating and capital components of the budget, how the City uses fund accounting to ensure the use of public funds is transparent and invested as intended, and the differences between restricted versus unrestricted resources.

This information is foundational to maintaining a long-term view of the City's financial position while prioritizing the many immediate needs facing City operations with limited financial resources in the 2027-2028 biennium.

Operating Budget Versus Capital Improvement Program Budget

The operating budget is the central financial planning document that embodies all operating revenue and expenditure decisions. It establishes what programs, projects, and day-to-day operations will be funded in each department within the confines of anticipated municipal revenues.

Different funds pay for different elements of the City's operating budget. However, the General Fund, Youth and Family Services (YFS) Fund, and Development Services Fund finance most of the day-to-day City operations and makeup mostly non-capital related expenses. The City's enterprise funds for the water, sewer, and stormwater utilities as well as the Street Fund include both operating and capital expenses.

In May 2025, the City Council received a six-year forecast of the General and YFS Funds ([AB 6680](#)). At the time, General Fund expenditures were projected to meet budget expectations in the current biennium and outpace revenues by approximately \$1.6 million in 2027. The General Fund's available fund balance is projected to sustain operations until early 2029, when the available fund balance is then projected to go negative.

The YFS Fund's operating balance is projected to be fully spent this biennium. By 2027, projections indicate an \$800,000 annual operating deficit that will grow over time.

The capital budget – also known as the City's Capital Improvement Program (CIP) – is the six-year financial plan to acquire, expand, or rehabilitate land, technology, buildings, and other major public infrastructure. Although the CIP planning horizon spans six years, funding for the plan is allocated every two years as part of the biennial budget process.

The 2025–2026 CIP includes 148 active projects totaling \$105.5 million. The planned capital projects include infrastructure investments in parks, utilities, streets, transportation, technology, and buildings. In October

2025, the City Council received an overview of the capital improvement program including highlights of projects currently underway ([AB 6790](#)).

Consistent with the City's financial management policies, CIP funding through 2026 relies on existing, available fund balances, projected revenues from real estate excise taxes, state shared revenues, and utility rates, along with the prudent use of outside funding including state and federal grants.

The City's operating and capital budgets are separate because they pay for different goods and services, use different resources, and plan for different lengths of time. However, the two budgets are codependent. For example, in September 2025 when the City acquired a new building at 9655 SE 36th Street ("9655 Building") in part with capital budget resources, additional operating budget resources were required to begin operating and maintaining the facility.

This distinction between the operating and capital budgets is further shaped by the legal and policy constraints placed on the City's revenue sources. While the operating budget mostly uses unrestricted revenues – such as property taxes that provide flexibility to fund broad community services – the capital budget often relies on restricted revenues that are legally "earmarked" for specific purposes.

Fund Accounting

In Washington State, local governments use fund accounting to ensure public funds are spent exactly as intended via state law, local policy, or as outlined in the biennial budget. Instead of one big "checking account," the City of Mercer Island divides resources into multiple independent "funds," each acting as a separate accounting entity.

The Washington State Auditor's Office publishes and regularly updates the Budgeting, Accounting, and Reporting System (BARS) manual, which governs how cities organize and manage the public's resources in separate funds (RCW 43.09.200).

City Funds are organized into seven different types as outlined by the BARS manual. Exhibit 1 outlines in detail the City's 19 different active funds by type and purpose.

- **General Purpose Funds** account for daily operations like police, fire, and internal service departments. If money doesn't legally have to be anywhere else, it lives here.
- **Special Revenue Funds** account for the proceeds of specific revenue sources that are restricted or committed to expenditures for specified purposes other than debt service or capital projects.
- **Debt Service Funds** account for resources set aside to pay the principal and interest on the City's long-term loans or bonds. Debt is a priority obligation, meaning it cannot be deferred in times of financial difficulty.
- **Capital Project Funds** include financial resources for the acquisition or construction of capital facilities other than those financed by Enterprise or Internal Service Funds.
- **Enterprise Funds** account for government activities that are financed and operated like a private business. Costs of providing services to the community are primarily financed by user fees.
- **Internal Service Funds** account for the financing – on a cost-reimbursement basis – of goods and services provided by one department of the City to another department.
- **Trust Funds** account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, and other governments.

Aside from the General Fund, each of the City's 19 funds among the seven different fund categories are created for a specific purpose. For example, the "Street Fund" is a special revenue fund that organizes the revenues and expenditures associated with investments in the transportation network. Revenues in the Street Fund are largely restricted to transportation. The City cannot legally use Street Fund resources to pay for public safety operations like police or emergency medical services.

Restricted Versus Unrestricted Resources

To comply with state laws and local policies, the City's [financial management policies](#) distinguish between restricted and unrestricted resources. Restricted revenues are funds with enforceable limitations as mandated by state law and local policy set by the City Council. Most often these constraints are imposed by parties outside Mercer Island.

Unrestricted revenues are general purpose revenues. The most common are the City's portion of property tax and sales tax. These are deposited into the General Fund and can be used for any municipal purpose, such as public safety, park maintenance, internal services (e.g., finance, legal, and human resources), and any other general government operation.

This distinction creates transparency with the use of public funds. More specifically, it ensures funding remains tied to the specific purpose for which it was collected.

For example, state laws limit how fuel tax revenues can be used (RCW 46.68). Eligible use is limited to maintaining the City's transportation network (e.g., filling potholes, paving streets, and maintaining traffic lights), which is why this revenue is distributed to the City's Street Fund.

In 2022, the Mercer Island community approved the 2022 parks levy – a property tax lid lift that per state law (RCW 84.55.050) generates resources that are restricted in the budget based on the levy ballot proposition voters approved. The 2022 parks levy funds must go to the operations and maintenance of parks and open spaces, including Luther Burbank Park, and fund playground replacements and forest restoration in Pioneer Park and Engstrom Open Space.

Real estate excise tax (REET) is the 0.5% tax paid by the seller in property transactions. This is the largest source of revenue for capital projects in the Street and Capital Improvement Funds. State law restricts the use of REET revenues. REET-1 (the 1st quarter of 1% of the sale price) may be used for streets, parks, utilities, or facilities. REET-2 (the 2nd quarter of 1% of the sale price) may be used for streets, parks, or utilities, but may not be used for facilities. Neither REET-1 nor REET-2 may be used for equipment or technology.

Per City Council policy established in 2019, the City's financing strategy for the capital budget commits all REET-1 revenues to the Capital Improvement Fund. REET-2 is split – 10% goes to the Capital Improvement Fund and the remaining 90% to the Street Fund for the construction and maintenance of the transportation network.

It is within the City Council's discretion to modify the REET financing strategy during the 2027-2028 biennial budget process based on near and long-term CIP projects and the available resources to fund these infrastructure needs.

At the halfway point of the 2025-2026 biennial budget, staff is focused on completing the goals and objectives as outlined in the operating budget work plan and capital improvement program as well as preparing for the 2027-2028 biennium. This requires seeing through significant work within the limitations of the City's

personnel and financial resources while also responding to several emerging needs leading into the 2027-2028 biennium.

Staff is in the process of closing out fiscal year 2025. Information on the City's financial position at 2025 year-end will be presented to Council in April/May 2026.

ISSUE/DISCUSSION

2027-2028 BIENNIAL BUDGET DEVELOPMENT

In 2026, staff will draft the preliminary 2027-2028 Biennial Budget. The biennial budget establishes measurable work plan goals and allows reasonable time to accomplish those goals in the next two years within the confines of anticipated municipal resources.

Prior to its adoption, the City Council will establish priorities for the next two years and provide staff with feedback on the preliminary budget.

A key focus in 2027 and 2028 will be advancing a long-term sustainable funding strategy for the General Fund and the Youth and Family Services Fund. The 2027-2028 budget will be developed during a time when projected revenues received each year may not address the projected annual expenses.

Exhibit 2 outlines the tentative schedule with City Council touchpoints (pink) relative to staff's internal efforts (gray) to develop the 2027-2028 Preliminary Budget and work plan. Budget adoption is estimated for the first City Council meeting in December 2026.

EMERGING NEEDS

Major Investments in Parks, Utility Infrastructure and City Facilities

As mentioned, the 2025-2026 CIP includes 148 active projects totaling \$105.5 million, spanning infrastructure investments in parks, utilities, streets, transportation, and buildings. This represents a significant period of reinvestment in City infrastructure that will continue into the 2027-2028 biennium and beyond.

Clarke and Groveland Park Joint Infrastructure Plan

Clarke and Groveland parks were developed in the 1960's and 1970's, and their waterfront infrastructure and other amenities are aging and in need of replacement (CIP project 90.25.0013). In March 2025 ([AB 6642](#)), the City Council approved the scope of work and community engagement plan for a Joint Infrastructure Plan to begin planning for these significant infrastructure improvements. Given the type of work anticipated, design, permitting and construction is likely to span several budget cycles.

Luther Burbak Park Waterfront Improvement Project

Similar waterfront improvements are required at Luther Burbank Park. For context, the docks were built in 1974. The City began the Luther Burbank Park Waterfront Improvements Project in 2018 and is currently finalizing design and permitting. Like the Clarke and Groveland project, the Luther Burbank project (CIP project 90.25.0020) requires extensive permitting and outside agency coordination and authorization.

Significant outside funding has been secured from the Washington State Recreation and Conservation Funding Board, the U.S. Department of Fish and Wildlife, and the King County Flood Control District and without it, these projects would not be constructed. Staff anticipate going out to bid for the Luther Burbank Project in Q2 2026, with construction anticipated to continue through 2027.

Water & Sewer Projects

Work is ongoing to replace the City's aging water distribution and sewer conveyance systems. Construction of the new Water Supply Pipeline as well as a comprehensive review of the sewer conveyance system infrastructure, specifically the Lakeline Reach 1 segment, is on the horizon. Both projects require significant investment and outside funding support. This work coincides with major facility replacements and repairs, including replacement of the old City Hall and Public Works Facility and a new HVAC system for the community center.

Future of City Facilities

The City took possession of the 9655 Building in September 2025 ([AB 6714](#)). The roughly 22,000 square foot commercial space will eventually house a portion of City staff who are largely working remotely and in temporary spaces due to the permanent closure of City Hall in 2023.

Work is underway to determine the best use of the limited office space in the near- and long-term. Staff is assessing the building, evaluating necessary repairs and upgrades, and conducting a space planning exercise to make the most efficient and effective use of the 9655 Building. This will inform next steps to address public facility needs in the wake of the outcome of the November 2025 Public Safety and Maintenance (PSM) Facility Bond Measure.

Staff is currently designing a statistically valid survey of Mercer Island residents to receive community input on the recent PSM Bond Measure and inform priorities for future City facility planning. The survey will likely be launched by the end of January, with results available by the first City Council meeting in March.

Space planning and potential facility renovations of the 9655 Building, along with the efforts to determine resident priorities, informs the possibility of returning to voters for another bond measure and/or exploring other alternatives to address the City's facility issues. Much of this work is unbudgeted. However, staff will return to the City Council for input and seek direction incrementally as the facility planning work progresses through 2026.

Comprehensive Plan Mandatory Update

In November 2025, the City Council appropriated \$200,000 for professional services to amend the City's Comprehensive Plan by July 31, 2026, due to the Growth Management Hearings Board's Final Decision and Order (FDO). The FDO was issued in August 2025 following the appeal of the City's Comprehensive Plan periodic update, adopted in late 2024.

The FDO adds to the work plan for the Community Planning and Development Department and many of the City's other operating departments. Staff is developing a land capacity model, analyzing potential development scenarios, developing graphics and visualizations, drafting policies and regulations, modeling impacts to transportation, sewer and water infrastructure, reviewing utility system connection charges, and conducting environmental review.

Additional unbudgeted resources will be required to complete the required scope of work by the July 2026 deadline.

Police Technology

In December 2025, the City Council appropriated just over \$100,000 to procure a new police in-car digital video recording (DVR) system and a digital evidence management system. The City executed a contract for these technology systems with Axon Enterprise, Inc. Coordination to install the new DVR system in the new patrol vehicles is underway and expected to be completed by spring 2026.

In early 2026, the City Council will receive an appropriation request for a new parking enforcement system that will include one-time and ongoing budgetary impacts. Procurement of a new parking enforcement system is a priority for the Police Department because the current parking enforcement system has failed. Additionally, the opening of the Sound Transit Light Rail Station in spring 2026, and the FIFA World Cup in summer 2026 are expected to increase demand for parking (and parking enforcement) in Town Center.

The appropriation request for the parking enforcement system is expected to be between \$150,000-\$200,000. The recent funds the City received from the Eastside Public Safety Communications Agency (EPSCA) in 2025 represent a potential funding source for this technology. Staff will also apply for grant funding through the Washington Byrne Justice Assistance Grant Innovation Fund. A request for proposals for a new parking enforcement system will be published in early 2026.

The City Council discussion on procurement of a body-worn camera system is anticipated to take place in fall 2026 as part of the biennial budget process. Body-worn cameras will require a larger appropriation compared to the police technology systems referenced above. Specifically, body-worn cameras will require a one-time investment in the equipment and ongoing resources to support the staff position(s) needed to administer the public records component of this program. Procurement of this technology is a high priority for the City and staff are exploring all options to fund and sustain this equipment and the program.

Type-2 Fire Apparatus Acquisition

The City's type-2 fire apparatus is due for replacement in 2026. The mid-size apparatus – known as a “midi” – was purchased in 2008 and has reached the end of its useful life. It is a custom build, ideal for the unique geography of Mercer Island due to its ability to effectively maneuver on smaller streets and in tighter neighborhood spaces.

Staff estimate the cost of the new apparatus will be between \$750,000 to \$800,000. To support this apparatus replacement, staff are planning to submit a funding request to the State Capital Budget during the 2026 State Legislative Session. The request proposes a 50 – 50 split of fire apparatus costs between state and local funds. The State Capital Budget will not be finalized until March of this year.

The City's Equipment Rental Fund will cover the debt service for the acquisition of the new fire apparatus. Similar to what the City is experiencing with the acquisition of large equipment, the funding mechanisms in place to cover the debt service for this fire apparatus are not keeping pace with the cost of these engines, which continue to steeply increase in price. Even with potential state funding support, the apparatus acquisition in 2026 will result in financial impacts being absorbed in the 2027-2028 biennium, when staff anticipate the City will receive the new fire truck.

Rising Costs of Vehicles and Heavy Equipment

The Equipment Rental Fund (510) accounts for the cost of maintaining, operating, and replacing City owned vehicles, heavy equipment, and radios. This equipment is funded through internal user charges developed for

each class of vehicle, heavy equipment, and radio system. The financial modeling and assumptions that provide the basis for appropriation to the fund have not kept pace with the increasing cost of equipment in recent years.

For example, the City purchased a type 1 fire apparatus for \$733,000 in 2018. At that time, the City's replacement schedule forecasted a 35% increase to the price by 2025. The City purchased a new type 1 fire apparatus at the end of 2025 for \$1.27 million – which represents a 73% increase since 2018 – double the original forecasted increase. The delivery time for several types of specialized vehicles and equipment has significantly increased. Tariffs and supply challenges further complicate efforts to manage and replace vehicles and equipment.

Staff will discuss updated funding strategies for the Equipment Rental Fund with the City Council as part of the 2027-2028 biennial budget process to ensure budgeted funds keep pace with equipment replacement forecasts.

NEXT STEPS

Exhibit 2 outlines the tentative schedule to develop the 2027-2028 Preliminary Budget. Staff will return to the City Council in February with an overview of the Capital Improvement Program and potential trade-offs to address emerging facility needs with the City's limited capital resources. This discussion will inform the City's financing strategy and priorities for the 2027-2032 Capital Improvement Program.

In April/ May staff will present a financial status update to summarize the City's financial position across all City funds at 2025 year-end. Staff will seek the City Council's input and direction in the year ahead to address emerging needs and inform the service goals and objectives for the 2027-2028 biennium.

RECOMMENDED ACTION

Receive report. No action necessary.