



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 6555
October 15, 2024
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 6555: Public Hearing and 2025-2026 Biennial Budget Workshop to review the Revenue Forecast, Operating Budget, and Budget Proposals.	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input checked="" type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Receive report and provide feedback and questions on the proposed 2025-2026 Operating Budget and Budget Proposals.	

DEPARTMENT:	Finance and Public Works
STAFF:	Jessi Bon, City Manager Jason Kintner, Chief of Operations Matthew Mornick, Finance Director
COUNCIL LIAISON:	n/a
EXHIBITS:	1. Preliminary 2025-2026 Biennial Budget at www.mercerisland.gov/budget 2. 2025-2026 Biennial Budget Revenue Forecast 3. Budget Proposals
CITY COUNCIL PRIORITY:	n/a

EXECUTIVE SUMMARY

In continuation from the October 1 City Council budget workshop ([AB 6550](#)), this agenda bill outlines next steps in the City Council’s 2025-2026 Biennial Budget review process, which is anticipated to conclude with the adoption of the 2025-2026 Biennial Budget on December 3.

- Per Washington State law, the City Manager is required to deliver a balanced preliminary biennial budget to the City Council for review and approval. The City Council received the **Preliminary 2025-2026 Biennial Budget (“Preliminary Budget”)** on September 25, 2024, and a copy was filed with the City Clerk (Exhibit 1).
- The 2025-2026 Preliminary Budget is balanced, maintains current service levels, and is built upon significant progress and a sustained practice to enhance City services and operations with each biennium.
- As proposed, the General Fund expenditure budget is \$36.8 M in 2025 and \$38.6 M in 2026.
- At the October 1 City Council meeting staff introduced overarching budget themes, reviewed the schedule for Council and the community to provide feedback on the budget, and presented the 2025-2030 Capital Improvement Program (CIP).
- At Tuesday’s meeting, the City Council will hold the first of two public hearings on the Preliminary Budget. This is an opportunity for the public to provide comments about any part of the budget.
- The **2025-2026 Biennial Budget Revenue Forecast** (Exhibit 2) provides an update on projected revenues for the City’s primary operating funds. Projections of key revenues that support the CIP are also included.

- General Fund revenues are projected to exceed budget estimates in 2024 by \$5.8 M, largely due to higher-than-expected sales tax revenues, development service revenues, and interest earnings.
- Revenues in the YFS Fund are on track to meet budget expectations. Staff projects the YFS Fund’s operating deficit will be offset with ARPA funds, amounting to 670,000 in 2024. With one-time federal dollars set to expire at year-end, an annual operating structural deficit of nearly \$800,000 begins in 2025. General Fund resources and operating reserves in the Youth and Family Services Fund bridge the next two-year budget gap, bidding time to develop and commit to a sustainable funding plan.
- At 2024 year-end, real estate excise tax (REET) revenues – a major revenue source for the CIP – is projected to be \$288,000 below revenue projections from the 2023-2024 mid-biennial budget review last October. REET revenue is projected to improve over the next two years.
- Staff will present recent work plan achievements that served as the foundation for the goals and objectives proposed for the next two years. The presentation will conclude with a review of Budget Proposals (see Exhibit 3). Staff will be prepared to answer questions from the City Council and community.
- Staff will return to City Council for a second public hearing on November 19 to review changes incorporated into the Preliminary Budget and present for adoption budget related ordinances related to property tax levies and regional policy dispatch services.

BACKGROUND

Per Washington State law, the City Manager is required to deliver a balanced preliminary biennial budget to the City Council for review and approval. The City Council received the Preliminary Budget (Exhibit 1) on September 25, 2024, and a copy was filed with the City Clerk.

By design, the Preliminary Budget is both a spending plan for the City’s available financial resources and the legal authority for departments to spend these resources for public programs and services. The Preliminary Budget aligns with the City’s Financial Management Policies and the City Council’s 2025-2026 priorities, which include:

1. Develop data-driven economic development and retail plans and strategies to activate Town Center and other business areas.
2. Sustain and enhance our natural environment, especially parks and open spaces, to benefit this generation and others that follow.
3. Make once-in-a-generation investments to update and modernize aging infrastructure, capital facilities, and parks.
4. Focus efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community.

At the October 1 City Council meeting staff introduced areas of focus in the Preliminary Budget, the budget development schedule, and the six-year CIP. During the meeting, Council requested staff evaluate options and trade-offs to potentially accelerate the removal and replacement of asbestos cement (AC) pipes in the water distribution system.

ISSUE/DISCUSSION

Budget workshops over the next two months are intended to be interactive. Staff will address City Council questions while seeking consensus on key policy decisions and priorities for the upcoming biennium. Department Directors and other budget staff will attend and participate in the discussions.

AC Water Mains Follow-up

The AC main replacements focus on the systematic replacement of antiquated AC water mains with ductile iron water mains. AC pipe was a widely used material for water mains in the 1940's, 50's and 60's. Unfortunately, as the AC mains age, they become prone to deterioration and catastrophic failure, typically requiring full pipe segment replacements and large service impacts. Since 2020, the City has had 10 water main breaks on AC pipe alone. The replacement program reduces the potential for catastrophic system failure, unexpected service disruptions, and large damage claims to the City. The 2025-2030 CIP proposed the complete removal and replacement of antiquated AC water mains via a staggered approach of design in year one and construction in year two through 2030.

At the City Council's request, staff reevaluated the proposed capital work in the water utility and whether AC main replacements could be accelerated. The current CIP calls for all the remaining AC pipe to be replaced by the end of 2028, with the exception of the "clean-up" project in 2029-2030. Specifically, the 2029-2030 AC Main Replacement project (90.40.0026) is intended as a final "clean-up" project to identify and replace remaining AC main "odds and ends" within the distribution system.

Although staff appreciate the opportunity to evaluate potential project acceleration, the only way to move ahead the 2027-2028 AC main projects would be to postpone other water projects. Water system improvement projects are prioritized and rely on a combination of data to inform project timing including age, material type, condition, fire flow, service history, and water quality. These capital improvements take place in coordination with other scheduled capital improvement projects and are well sequenced. Therefore, staff do not recommend changing the proposed timing of the water utility CIP projects.

There will be opportunities, however, to accelerate the work planned in 2029-2030. The 2029-2030 AC Main Replacement project (90.40.0026) is intended as a final "clean-up" project to identify and replace remaining AC pipe within the distribution system. Although the City's Geographic Information System (GIS) is very comprehensive, there are some remaining data omissions from as-builts submitted from the late 1960's. This remaining AC Water Main project requires completing the City's data set via GIS analysis and field confirmations (e.g., via minor excavations known as "potholing") to identify, confirm, and design the replacement plan for the remaining AC pipes.

The 2025-2026 budget proposal list (see Exhibit 3) includes funding for two LTE positions in the water utility. Funding for these positions ensures we will have enough staff resources to complete the water improvement projects in the CIP. The addition of these staff positions also ensures our other team water utility team members will have the time to do the AC pipe field investigations described previously, among a long list of other priorities.

Staff recommends the City Council fund these two positions as this is the best strategy to ensure AC main replacement stays on track. The addition of these two positions also allows for the AC main field investigation work to begin in 2025. As field investigations are confirmed, the project team will continue to identify opportunities to accelerate the remaining AC water main replacements.

Revenue Forecast

The 2025-2026 Biennial Budget Revenue Forecast ("Revenue Forecast") (Exhibit 2) is an integral part of the two-year budget process. Each year, the Revenue Forecast evaluates the City's current and future fiscal conditions to inform the City's policies, strategic decisions, or changes to service levels. In the second year of the biennium, the Revenue Forecast establishes baseline budget figures for the Preliminary Budget. It is based

on past, current, and projected financial conditions unique to City operations while considering socio-economic factors at the local, regional, and national level.

The Revenue Forecast details General Fund revenue projections through the end of 2026 with an outlook through 2028. It also includes a five-year projection for the Youth and Family Services Fund and REET, a primary revenue that supports the CIP.

Staff will provide a presentation on the Revenue Forecast at the City Council meeting. Overall, General Fund revenue year-over-year growth is projected to slow yet remain healthy in 2025 and 2026. It is not until the 2027-2028 biennium that expenditure growth is projected to outpace General Fund revenues.

The operating deficit between expenditures and revenues that is projected in the General Fund is already underway in the YFS Fund. Staff projects the operating deficit in the YFS Fund will be offset with ARPA funds in 2024, amounting to 670,000. However, with one-time federal dollars set to expire at year-end, an annual operating structural deficit of nearly \$800,000 begins in 2025. General Fund resources and operating reserves in the Youth and Family Services Fund bridge the next two-year budget gap, bidding time to develop and commit to a sustainable funding plan.

Real estate excise tax (REET) revenues – a major revenue source for the CIP – is a 0.5% tax on property sales. In 2024, property sales are tracking with lows last seen in 2008-2009. However, indications point to REET revenues improving over the next two years. The Federal Reserve reduced the federal funds rate 0.50% in September, while signaling more rate cuts ahead while median home sale prices on Mercer Island remain high.

2023-2024 Work Plan Accomplishments

Most of the work in the upcoming biennium is built upon recent efforts to achieve the goals and objectives outlined in the 2023-2024 biennial budget work plan. Staff has maintained service levels and completed critical improvements to the City's public infrastructure. Many of these capital improvements were discussed during the October 1, 2024 budget workshop.

On the operations side, staff and the City Council have delivered on a multitude of programs, projects, and services. A detailed review of the 2023-2024 work plan accomplishments is included in the October 15 City Council meeting materials (see AB 6539). Beyond day-to-day service delivery, notable work completed in the current operating budget is briefly summarized below:

- Completion of numerous capital projects including the Booster Chlorination Station (paid for with a low-interest Public Works Trust Board loan), the West Mercer Way Roadside Shoulders Phase 4, and the opening of the new Bike Skills Area in Deane's Children's Park, to name just a few.
- The Comprehensive Plan Periodic Update will guide land use, transportation, housing, economic development, and environmental decisions in the decade ahead. This community-wide effort to update the City's long-term vision for growth and development will be completed November this year, following four years of focused work with the staff and City Council.
- Work is underway to implement the City's new financial management software, Enterprise ERP. This suite of new software tools will streamline business operations and improve financial reporting capabilities. The initial phase of software implementation is in the final stages of testing and configuration. It will go live in January 2025, with additional phases scheduled to rollout over the next biennium.
- A new special revenue fund was established for the Community Planning and Development department. All revenues and expenditures tied to development services will be tracked to the

Development Services Fund, which is incorporated into the Preliminary Budget and the City’s new financial management software. The fund has a \$1.3 M projected operating reserve going into January 2025 (see Exhibit 2).

- Secured a long-term partnership with Eastside Fire and Rescue for enhanced fire and emergency medical services, thereby reducing the administrative burdens on the City.
- Maintained access to mental health services for all Mercer Island School District students and the Mercer Island community.
- Per the 2022 PROS Plan, new infield turf was installed at Island Crest Park North Field Turf and new turf, backstops, and lighting improvements were completed at South Mercer Playfields. Both projects were on schedule and within budget.
- Stewarded by the Finance Ad Hoc Committee, the Cost Allocation Policy was adopted by the City Council and is already allowing the City to more effectively recover the cost of services provided to partner jurisdictions.
- The City Council Finance Ad Hoc Committee worked closely with staff to establish a new compensation plan and the first-ever position classification system and salary schedule for non-represented employees. The City Council adopted this new policy in June, and it went into effect July 1, 2024.
- Completed the Town Center parking study and updates to the City’s construction codes in accordance with state requirements; adopted the Climate Action Plan, and the Transportation Improvement Program

Departmental Work Plans

The operating budget proposes staffing and financial resources to deliver the 2025-2026 work plan.

Figure 1 below compares proposed staffing levels in 2025 with those adopted in 2024. Staffing levels remain on par with prior years to tackle the proposed work plan. Emphasis is to sustain current service levels while clearly laying out future facility needs and identifying fiscally prudent ways in the near- and long-term to meet them.

Figure 1: Staffing Proposal

POSITION TYPES <i>Fiscal Year</i>	BUDGETED FY 2024	PROPOSED FY 2025	CHANGE YOY
Full-time Equivalent (FTE)	175.08	176.28	1.20
Limited-term Equivalent (LTE)	17.53	16.08	(1.45)
TOTAL	192.61	192.36	(0.25)

Section D “Operating Budget by Department” in the Preliminary Budget introduces each City department’s work plan for the next two years. As mentioned, several initiatives staff will be executing during the 2025-2026 budget period, listed below, build on recent work completed and are reiterated throughout department work plan goals and objectives. The initiatives outlined below are among the City’s highest priorities over the next two years:

- In response to the closure of City Hall and functional obsolescence of the existing Public Works building, manage the design of a new Public Safety and Maintenance Building (PSM), prepare for a ballot measure to fund its construction, and re-house other displaced City services. This work will be informed by a thorough community engagement process related to the design and future operations of the PSM building and the City Council’s long-term vision for the next generation of City facilities.

- Work with City Council leadership and community partners to develop and commit to a financial plan that sustainably funds Youth and Family Services beyond 2026.
- Renew all interlocal agreements with neighboring jurisdictions (e.g., municipal court services and marine patrol services, among others) to ensure they align with the City Council’s new cost allocation policy.
- Complete a comprehensive needs assessment to identify areas of City operations where Artificial Intelligence can drive efficiency (e.g., data analysis, project tracking, report generation, language translation, and customer service) and enhance service delivery.
- Draft a new Parks Zone for consideration by the Parks and Recreation Commission, the Planning Commission, and the City Council to include a community outreach and engagement process.
- Develop informed policies to ensure the safe and responsible usage of e-bikes and e-scooters with new regulations proposed for City Council consideration while also working with the State legislature to advocate for statewide regulations.
- Continue succession planning to address upcoming retirements, nurture rising talent, and cross-train staff to ensure continuity of services across all lines of business throughout the organization.

New Work Items

Following the publication of the 2025-2026 Preliminary Budget, staff identified several work items that were omitted from the draft. These items will be included in the final budget document.

- Develop informed policies to ensure the safe and responsible usage of e-bikes and e-scooters with new regulations proposed for City Council consideration while also working with the State legislature to advocate for enhanced statewide regulations.
- Update the Comprehensive Arts & Culture Plan (CACP) with practicable goals and strategies to support arts and culture on Mercer Island. The CACP serves as a roadmap to invest in and promote arts and culture initiatives.
- Upon completion of the new Parks Zone, begin a review of the Parks Code (MICC 9.30.010) and recommend updates. This work is tentatively scheduled to begin in 2026 with adoption later that year, or early 2027.

At the October 15 City Council meeting, staff will provide an overview of the high-level initiatives from department work plans.

Budget Proposals

Exhibit 3 identifies seven budget proposals under consideration for 2025-2026, including the estimated costs for each fiscal year, specifying whether the costs are one-time or ongoing, identifying the funding source, the department responsible, and any additional staff notes for each proposal. The City Council will be asked to review each budget proposal, and if desired, provide a motion directing staff to include the budget proposal in the final 2025-2026 budget.

A total of \$501,273 remains from the 2023 fiscal year for City Council consideration and appropriation for items on the budget proposal list or for other purposes as directed by the Council.

NEXT STEPS

The Preliminary Budget development schedule is summarized below.

Date	Topic
10/15/2024 <i>Public hearing*</i>	Revenue Forecast Operating Budget Review Receive Direction on Budget Proposals
11/19/2024 <i>Public hearing*</i>	Review changes incorporated into Preliminary Budget Adopt 2025 rates for Regional Police Dispatch Services Adopt 2025 Property Tax Levies
12/3/2024	Adopt 2025 Master Fee Schedule and Final 2025-2026 Biennial Budget

Community Outreach and Public Hearings

The public is encouraged to provide feedback on the Preliminary Budget and Capital Improvement Program at two scheduled Public Hearings on [October 15 and November 19](#). Public comment is also invited at all City Council meetings.

RECOMMENDED ACTION

Approve budget proposal(s) [Insert # here] and direct staff to include the associated funding in the final 2025-2026 Biennial Budget.

Additional motion if budget proposals 6 & 7 are approved:

Authorize the City Manager to open recruitment for two Water Utility Capital Team Members (budget proposals 6 & 7) ahead of the final budget adoption.