

REVISED

INTRODUCTION

The 2023-2024 mid-biennial revenue forecast provides an overview of projected General Fund revenues through year-end and into the upcoming 2025-2026 biennium. The revenue forecast is based on fiscal year 2021, 2022, and the first six months of 2023 budget actuals, along with the latest local, regional, and national information available.

The forecast outlines the basis for the 2023 year-end revenue outlook, the underlying assumptions, and the anticipated impacts to revenues for the next biennium.

In 2022, the September revenue forecast anticipated that by most measures, the economy would slow down through the end of 2022 with a gradual return to pre-pandemic growth rates in 2023. Twelve months of new data indicates the local economy has proven more resilient than expected, with strong month-to-month growth in most of the City's large revenues.

While inflation has slightly declined, adjustments to the federal fund target rates have impacted real estate activity on the island. With credit card and auto loan delinquencies ticking up, and banks tightening lending standards, the mid-biennial revenue forecast is cautiously optimistic.

Overall, the mid-biennial revenue forecast projects General Fund revenues will continue along healthy trendlines through the end of the biennium, with the Fund largely stabilized by the City's strategic use of American Rescue Plan Act (ARPA) funds. Also included is a forecast for Real Estate Excise Taxes as well as projected revenue activity in the Youth and Family Services Fund.

2023-2024 MID-BIENNIAL REVENUE FORECAST

GENERAL FUND REVENUES

2023
Amended Budget
\$33.9 million

2023 Forecast
~~\$38.6 million~~
\$39.5 million

2024 Forecast
~~\$38.8 million~~
\$38.9 million

2025 Forecast
~~\$39.0 million~~
\$39.2 million

REVISED

Figure 1 includes General Fund revenue projections for fiscal 2023, 2024, and 2025. A summary of each revenue category listed in the left column is listed below.

MID-BIENNIAL REVENUE FORECAST <i>(\$ in thousands)</i>	2023 Amended Budget	2023 Forecast	Diff. from Amended	2024 Forecast	2025 Forecast
01-PROPERTY TAX	13,509	13,705	196	13,942	14,180
02-GENERAL SALES TAX	5,600	7,225	1,625	7,381	7,652
03-UTILITY TAXES	4,852	5,087	234	4,970	5,027
04-LICENSE, PERMIT, AND ZONING FEES	2,635	3,496	861	3,603	3,709
05-B&O TAXES	706	706	0	706	714
06-PARK AND RECREATION	1,339	1,350	11	1,363	1,378
07-EMS REVENUES	2,088	2,161	73	2,115	2,175
08-COST ALLOCATION	1,056	1,056	0	1,081	1,103
09-INTERFUND TRANSFERS	0	0	0	0	0
10-SHARED REVENUES	1,707	1,702	(5)	1,715	1,744
11-MUNICIPAL COURT	175	231	56	243	250
12-MISCELLANEOUS REVENUES	251	401	150	417	417
13-INTEREST EARNINGS	11	1,438	1,428	1,260	700
TOTAL REVENUES	33,930	38,558	4,628	38,795	39,049
13-INTEREST EARNINGS REVISED	11	2,365	2,354	1,332	888
TOTAL REVENUES	\$33,930	\$39,485	\$5,555	\$38,867	\$39,237

Figure 1 - Revised

PROPERTY TAX

The 2023 Adopted Budget assumed \$13.5 million (M) in property tax revenue, representing 40% of total General Fund revenues. This is a stable revenue source with payments due in April and October of each calendar year.

Revenues through June are tracking slightly higher than the 2023 adopted budget. The current year collections are projected to exceed budget estimates due to receipt of prior year levied amounts. It is common for the City to receive late property tax payments from prior years.

The forecast assumes property tax revenues will slightly exceed budget projections by year-end. For 2024 and 2025, the forecast assumes the City will assess a property tax increase of the statutorily allowed 1% of the previously levied amount (e.g., 2023 actual regular levy) plus new construction each year.

SALES TAX

The 2023 Amended Budget assumed \$5.6 M in total sales tax revenues (general and local criminal justice sales tax revenues), representing 17% of total General Fund revenues. Total sales tax earnings in 2022 were \$6.6 M, a record high for Mercer Island. This strong growth trend in 2022 carried into 2023, up 17% (or \$455,000) for the first six months when compared to the prior year.

For a long-term view of general sales tax activity, figures 2 and 3 illustrate historical revenues and year-over-year trends for the City from 2007-2022, with 2023 and 2024 projections included for reference.

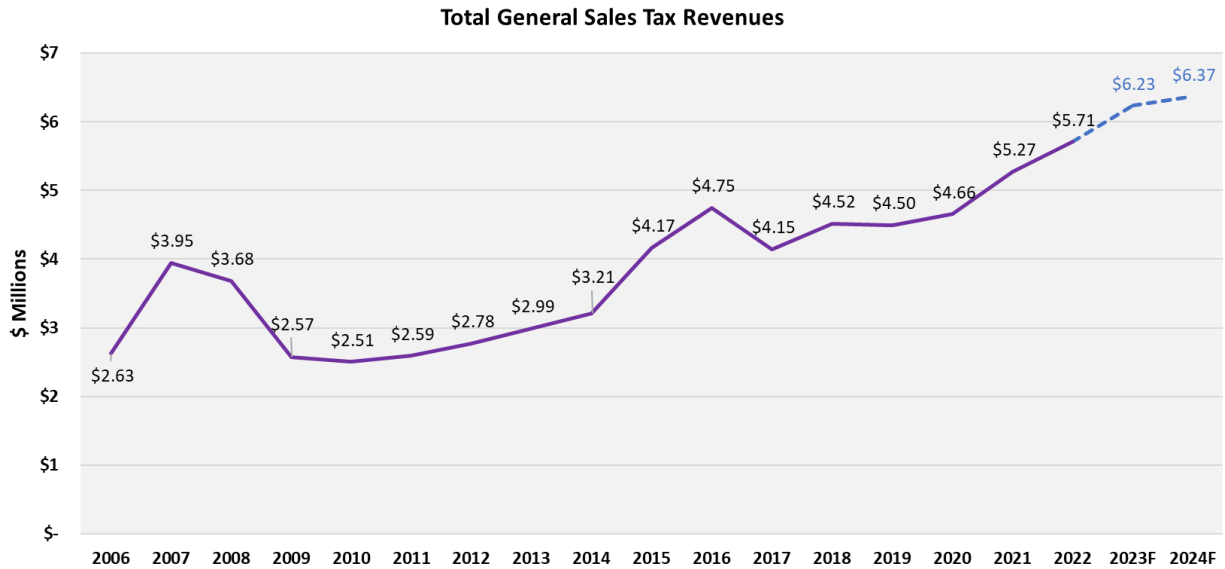


Figure 2

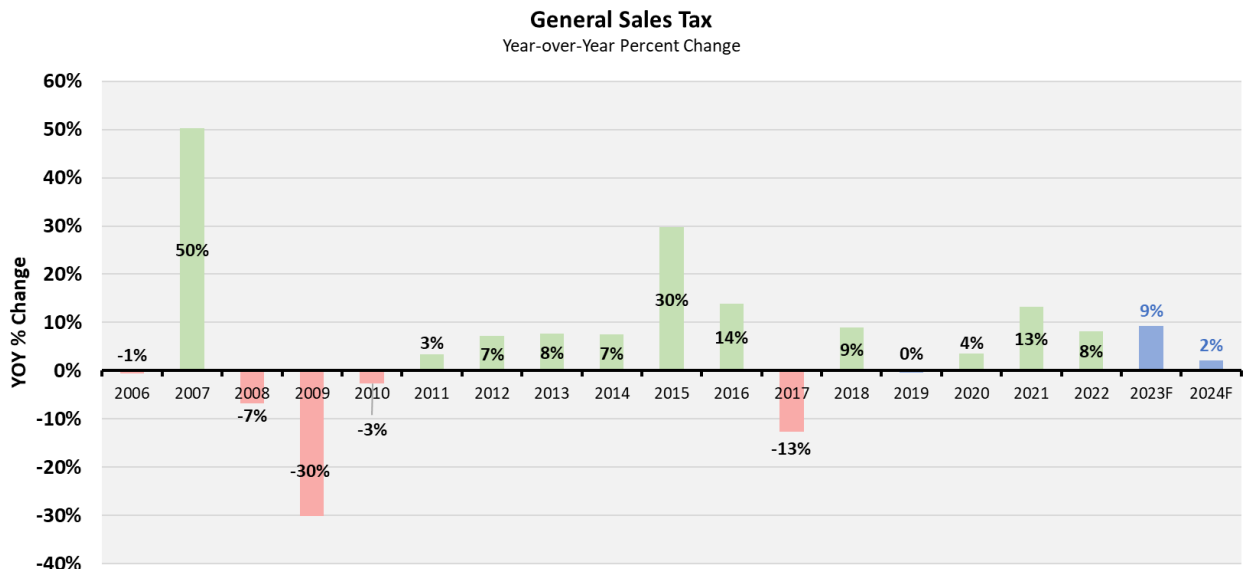


Figure 3

The historical data highlights the sensitivity of the sales tax revenues to the economic environment, but also shows the City has been without a year-over-year (YOY) decrease in sales tax revenues since 2017. This dip in total revenues was due to the construction sector generating \$490,768 less in 2017 than in 2016.

Since then, sales tax revenue has continued to increase every year. The increase in sales tax activity at the end of 2022 and through the first half of 2023 is due to higher-than-expected returns across most sectors of business, with the most year-over-year growth in the construction sector.

Staff estimates the recent increase in the construction sector is related to two high-valuation projects: the Riot Games building renovations and construction related to the King County Pump Station and North Mercer Island/ Enatai Sewer Upgrade. The King County Sewer Upgrade Project broke ground last year, and work on the Riot Games facility began January 2023 and is ongoing. Staff is closely monitoring monthly sales tax revenues by sector. This data will inform revenue projections leading into the 2025-2026 biennium.

Overall, general sales tax revenues are projected to end the year ahead of the amended budget by \$1.6 M, increase 2% in 2024 above 2023 projections, with a 4% year-over-year increase in 2025.

UTILITY TAXES

The 2023 Amended Budget assumed \$4.8 M in utility tax revenues, representing 14% of total General Fund revenues. This revenue stream is, for the most part, not subject to economic volatility. The mid-biennial forecast assumes utility tax revenues will remain on track and finish the year 5% above the 2023 amended budget. In 2024 and 2025, staff projects utility tax revenues will hold relatively flat with minor declines in the telephone and cellular sectors.

LICENSE, PERMITS, AND ZONING FEES

The 2023 Amended Budget assumed \$2.6 M in license, permit, and zoning revenues, representing 8% of total General Fund revenues. This revenue category consists of fees related to development services and business licenses.

Revenues in 2022 were at a five-year high due to improved administration of development services, an updated fee schedule, and deferred revenue collections on a handful of commercial and residential projects earlier in the year.

Revenues for the first six months of 2023 are tracking slightly higher than the same period in 2022. This activity stems from the two high-valuation development projects mentioned above (Riot Games and the King County Sewer Upgrade Project).

Staff projects this revenue category will end \$861,000 above the 2023 amended budget and generate \$3.6 M in 2024. These projections track with housing permit activity growth rates for the region from the Puget Sound Economic Forecaster.

BUSINESS AND OCCUPATION (B&O) TAXES

The 2023 Amended Budget assumed \$706,500 in B&O tax revenue, representing 2% of total General Fund revenues. B&O tax is paid annually unless a business earns greater than \$1 M annually in gross receipts, in which case the tax is paid quarterly. Most B&O tax receipts are received on an annual basis, filed before April 15 for the year prior.

Though the Pandemic impacted the business community, B&O tax revenues have trended upward since 2019, when the City transitioned to the Washington State's Business Licensing Service in 2019. This has resulted in better tracking of businesses eligible to pay B&O tax revenues.

Revenues for the first six-months of 2023 are tracking with budget estimates. The mid-biennial revenue forecast assumes 2023 B&O tax revenues will meet budget expectations and remain relatively flat in 2024 and into the next biennium.

PARKS & RECREATION REVENUES

The 2023 Amended Budget assumed \$1.3 M in Parks and Recreation revenues, representing 4% of total General Fund revenues. Revenues include field rental fees, boat launch fees, program fees, and rent payments from the annex building located behind the Community Center.

Though recreation program revenues are mostly expected in the third and fourth quarters of the year, with current bookings scheduled through the end of the year, revenues at year end are projected to meet if not slightly exceed budget expectations. Revenues in 2024 and into the upcoming biennium are projected to incrementally improve year over year as the Recreation Division continues to recover services and fine-tune operations.

EMERGENCY MEDICAL SERVICE (EMS) REVENUES

The 2023 Amended Budget assumed \$1.9 M for EMS revenues, representing 6% of total General Fund revenues.

This revenue stream offsets expenses related to fire and emergency medical services. It includes the annual contribution from the King County EMS levy, the EMS utility charge adopted annually with utility rate adjustments, and revenues from emergency medical transport fees, also known as the ambulance transport fee.

The mid-biennial revenue forecast projects revenues will slightly exceed budget estimates for 2023 due to higher than projected revenue from the City's participation in the Ground Emergency Medical Transportation program and receipt of Mobile Integrated Health funds from King County Emergency Medical Services levy, the latter addressing needs of low-acuity 9-1-1 callers and vulnerable community members. Revenue projections in 2024 and beyond are currently forecasted to remain relatively consistent.

These revenues will continue to be managed by the City of Mercer Island and will offset costs for service resulting from the partnership with Eastside Fire and Rescue for fire and emergency medical service, slated to begin January 1, 2024.

COST ALLOCATION

The cost allocation revenue categories recover overhead costs from the Utility Funds through internal transfers. The 2023 Amended Budget assumed roughly \$1 M in cost allocations, representing 3% of total General Fund revenues.

These revenues are forecasted to meet budget expectations through the end of the year and will increase in 2024 and beyond.

As part of the 2023-2024 work plan, staff is developing a policy guiding how indirect or "overhead" costs as well as direct costs are accounted for when determining the full cost of a government service. Once the City Council Ad Hoc Finance Committee reviews the proposed cost allocation policy, and a recommendation is reviewed and approved by the City Council, the updated cost allocation policy will be put into practice and inform future revenue projections.

SHARED REVENUES

The 2022 Amended Budget assumed \$1.8 M in shared/intergovernmental revenues, representing 5% of total General Fund revenues. This category combines a variety of revenues and includes State shared tax revenues, grants, and the Department of Transportation (WSDOT) funds collected for landscape services agreement for Aubrey Davis Park, among others.

After reviewing revenue actuals for 2022 and the first six months of 2023, revenues are projected to end the year just below budget. This is mainly due to state grant funds for marine patrol services coming in slightly below budget estimates. Revenues in 2024 and beyond are projected to remain consistent relative to 2023 estimates.

MUNICIPAL COURT REVENUES

The 2023 Amended Budget assumed \$157,359 in General Fund revenue collected from fines, forfeitures, fees, costs, and penalties associated with the enforcement of local and State law.

Court revenues depend on caseload. Revenues for the first six months of 2023 are 53% more than the same period in the prior year, indicating case load is notably up and new administrative operations – despite the closure of City Hall in April 2023 – have stabilized. The mid-biennial forecast projects revenues will end the year at \$231,000, 26% greater than actuals from 2022. Staff project revenues will increase in 2024 and 2025.

MISCELLANEOUS REVENUES

The 2023 Amended Budget assumed \$251,000 in miscellaneous General Fund revenues. This category includes judgment settlements, cell tower leases, and disability reimbursements received from the Washington State Department of Labor and Industries.

The mid-biennial forecast assumes miscellaneous revenues will end the year 60% above budget estimates, largely due to disability reimbursements coming in higher-than-anticipated. These reimbursements are a result of the buy-back policy the City has with active employees that qualify for time-loss compensation the Department of Labor and Industries. This revenue category is forecasted to remain flat in 2024 and into the next biennium.

INTEREST EARNINGS

The 2023 Amended Budget assumed \$11,000 in General Fund revenue from interest earned on the City's holdings. To date, interest earnings are markedly exceeding budget expectations.

Aside from the cash on-hand required for paying bills and managing daily operations, the City invests in the WA State Local Government Investment Pool (LGIP). The LGIP saw a continued increase in interest rates through June 2023, ending at 5.21% compared to 1.03% in June 2022.

Increased earnings in the City's investments correspond with changes to the Federal Reserve's federal funds target rates, as illustrated in figure 4. Between March 2022 and June 2023, the Federal Reserve raised the funds target rate by more than five percentage points. 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.

June 2020 - June 2023

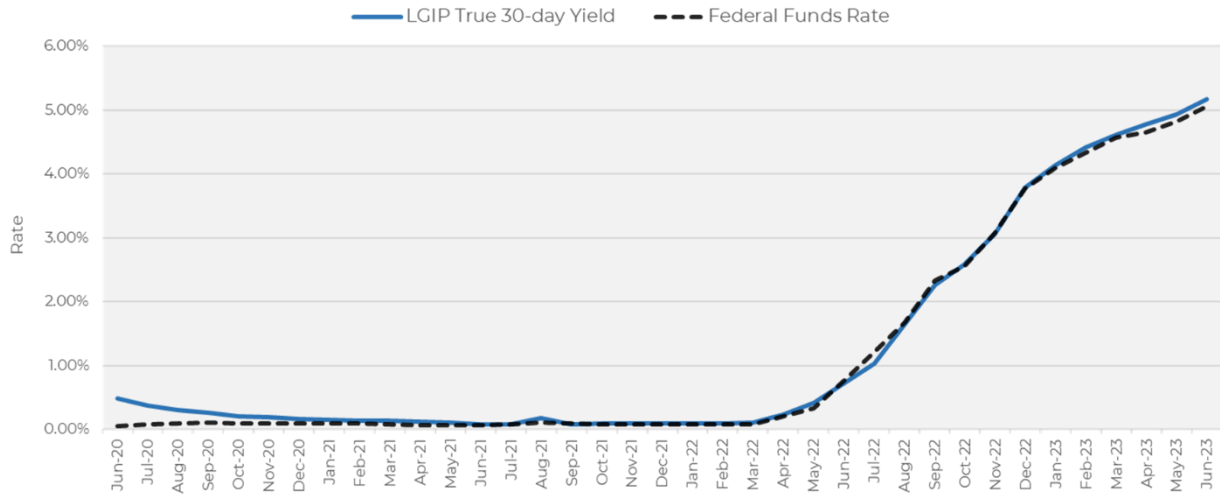


Figure 4

Figure 5 illustrates the average balance of holdings in the LGIP for fiscal 2023 to date. These include:

1. **US Treasuries** are backed by the full faith and credit of the US government and considered to be low risk.
2. **US Government Agencies** are bonds of government-sponsored enterprises or U.S. government agencies. They are independent organizations sponsored by the federal government that are established with a public purpose. Examples include Fannie Mae, Freddie Mac, and the Federal Deposit Insurance Corporation (FDIC).
3. **Certificates of Deposit (CD) & Interest-Bearing Demand Deposit Accounts (IBDDA)** are accounts from which deposited funds can be withdrawn at any time.
4. **Repurchase Agreements** (AKA repo) is the agreement by an authorized dealer to sell to a public fund investor (buyer) authorized investment securities (referred to as collateral) with the agreement to purchase the securities back on an agreed to date and rate of interest (simple interest on 360-day basis), to be paid to the buyer.
5. **Supranationals** are US dollar-denominated bonds of quasi-governmental organizations that exist in multiple countries to promote economic development, such as the World Bank.

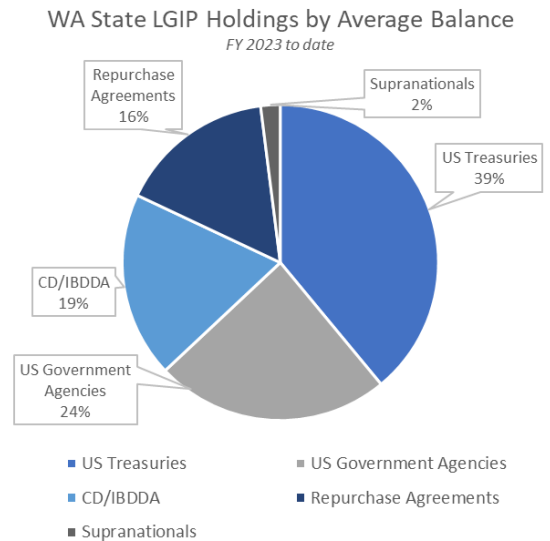


Figure 5

Per current budget policy, interest earnings are distributed quarterly to various Funds based on their relative cash balances at quarter end. The Contingency Fund achieved its funding target at 12.5 percent of budgeted General Fund expenditures in the beginning of the year, as defined in the City Council’s adopted financial management policies. Interest earnings previously transferred to the Contingency Fund now remain in the General Fund.

REVISED

The mid-biennial forecast projects interest earnings in the General Fund will reach \$2.4 M by yearend, which would represent a historic high. The forecast considers the projected principal balance, the annual LGIP 30-day yield, and the General Fund portion of the City’s principal investments. Interest earnings in the outyears are currently projected to stabilize and return to historical averages.

GENERAL FUND FORECAST

Figure 6 projects General Fund revenues and expenditure assumptions as outlined in the mid-biennial forecast. The pro forma includes fiscal years 2020 through 2027.

In general, the forecast assumes there will be no recession, that inflation will not increase further, and interest rates will stabilize. In the near term, General Fund revenues are projected to remain healthy. One-time costs associated with the transition to Eastside Fire & Rescue are included in baseline expenditure estimates. The \$1.8 M in one-time costs will be absorbed in the 2023-2024 biennium, using unassigned General Fund balance.

It is not until the 2025-2026 biennium that expenditure growth is projected to outpace General Fund revenues. The forecast as presented shows annual revenues and expenditures and does not include reserves or prior-year accumulated fund balance.

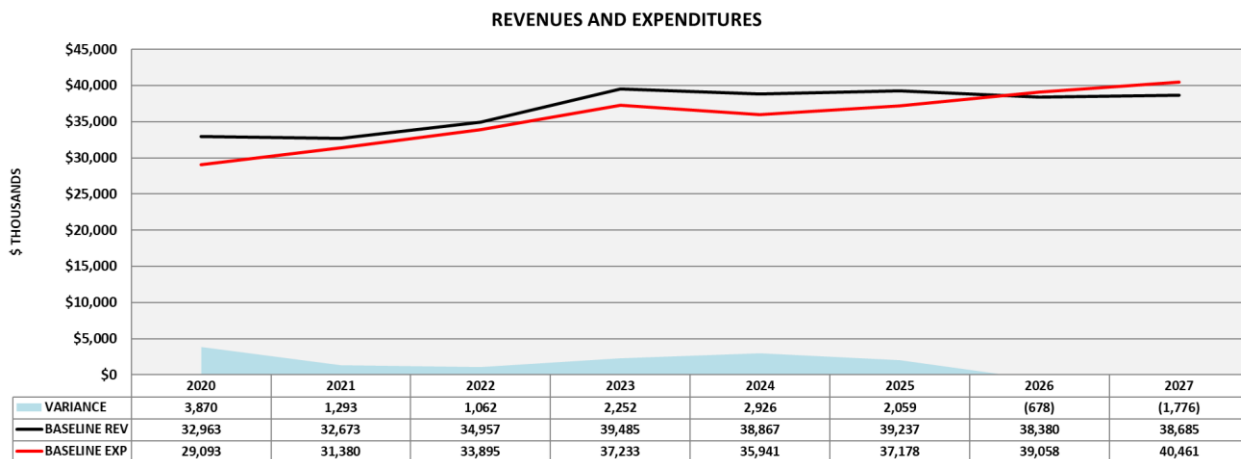


Figure 6 – Revised

It is important to note the near- and long-term budgetary impacts of City Hall’s closure are not yet reflected in the General Fund. Emergency expenditures to assess the condition of City Hall and evaluate near- and long-term investments associated with the building have been paid for with American Rescue Plan Act (ARPA) funds. At the time of the mid-biennial forecast, staff is working closely with the City Council to stabilize government operations and provide temporary workspace while long-term plans are developed.

ARPA FUNDS

A significant influence that is stabilizing the General Fund through the current biennium is the City’s strategic disposition of the American Rescue Plan Act (ARPA) funds. The City is required to encumber these funds by December 2024, and fully expend them no later than December 2026. With budget amending Ordinance [No. 23-12](#) adopted in September 2023, about \$1 M of the \$7.2 M original allocation remains available.

These one-time resources helped respond to immediate community needs and stabilize government operations. Most of the ARPA funds have gone to critical investments in the City’s public facilities, the water distribution system, and the sewer conveyance infrastructure. During the May 2023 planning session, the City Council authorized \$885,500 of ARPA funds to support a variety of work items for completion this biennium ([AB 6255](#)).

The remaining ARPA funds are not included in the General Fund balance. For audit and tracking purposes, staff account for them separately.

NON-GENERAL FUND REVENUE SOURCES

The following details additional revenue streams and underlying assumptions through year-end and into 2024 and beyond.

REAL ESTATE EXCISE TAX (REET)

REET revenues support the City’s Street and Capital Improvement Funds. This revenue stream results from a 0.5% tax levied on all sales of real estate, measured by the full selling price, including the amount of any liens, mortgages, and other debts given to secure the purchase.

Figure 7 illustrates the number of property sales each year and the resulting REET revenues from 2006 through 2022, with revenue projections in 2023-2025. REET revenues in 2021 were the highest on record, due to a historically high volume of homes sold and two commercial property sales that generated a combined \$1.8 M in revenue. The total number of property sales in 2021 were 530.

By comparison, total property sales were 303 in 2022, a 42% decrease. Revenues for the first six months of 2023 are down by nearly \$340,000, relative to the prior year. This is largely tied to the current market conditions, the lower volume of property sales, and the nearly 10% reduction in the average sale price for most property sales (excludes properties that sell for over \$5 M).

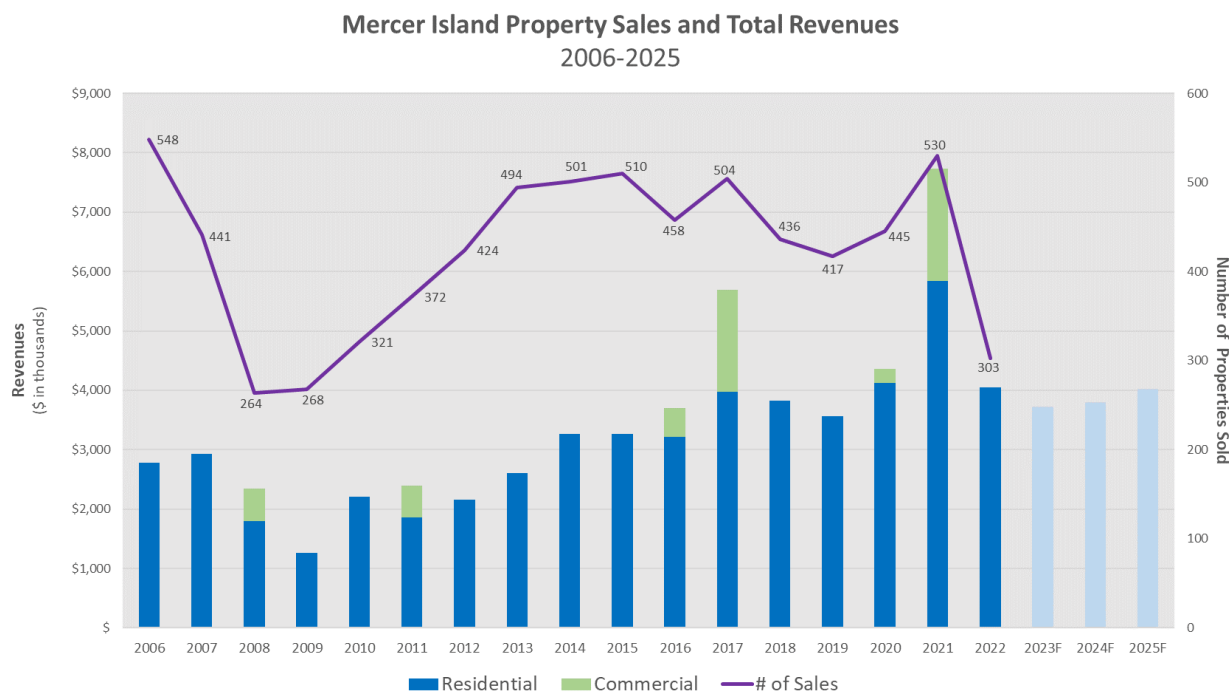


Figure 7

The slowing of real estate activity on the island mirrored the Federal Reserve’s increases to the federal funds rate, which has simultaneously slowed the pace of inflation and increased borrowing costs.

At year-end, 2023 REET revenues are projected to come in \$624,000 below FY 2023 amended budget estimates. Despite further interest rate hikes by the Federal Reserve, staff estimates REET revenues will increase in 2024 and 2025 as illustrated in figure 8.

(\$ in thousands)	2023B	2023F	Diff.	2024F	2025F
REET	\$ 4,344	\$ 3,720	\$ (624)	\$ 3,794	\$ 4,022

Figure 8

This projection is informed by the average price of homes sold in 2023 to date, the number of homes in the past two years, and the estimated number of homes that will sell based on historic seasonal trends.

YOUTH & FAMILY SERVICES (YFS) FUND

Figure 9 shows revenue and expenditure projections for the City’s Youth and Family Services (YFS) Fund.

YFS FUND FORECAST (\$ in thousands)	2023 Amended Budget	2023 Forecast	Diff. from Amended	2024 Forecast	2025 Forecast
REVENUE					
01-CHARGES FOR SERVICES	150	158	8	156	155
02-MIYFS CONTRIBUTIONS	300	515	215	515	515
03-THRIFT SHOP	1,566	1,566	0	1,723	1,787
04-FEDERAL GRANTS	350	350	0	260	0
05-STATE & COUNTY GRANTS	38	38	0	38	38
06-EMERGENCY ASSISTANCE	62	62	0	62	62
07-FOOD PANTRY	100	100	0	100	100
08-ARPA SUPPORT	671	555	(117)	618	0
09-MISCELLANEOUS REVENUES	47	47	0	47	47
TOTAL REVENUES	\$3,284	\$3,390	\$106	\$3,518	\$2,703

EXPENDITURES BY DEPARTMENT GROUP					
01-YOUTH & FAMILY SERVICES DIVISION	2,276	2,276	0	2,346	2,087
02-THRIFT SHOP DIVISION	1,114	1,114	0	1,172	1,238
TOTAL EXPENDITURES	\$3,390	\$3,390	\$0	\$3,518	\$3,324

Figure 9

CHARGES FOR SERVICES

The 2023 Amended Budget included \$150,000 in revenues from additional YFS services, representing 6% of YFS Fund revenues. These revenues include fees from family counseling services as well as the Mercer Island School District’s \$60,000 contribution to support the school counseling program.

Family counseling service fees are tracking slightly higher than budget estimates through the first six months of the year. This trend is projected to continue through year-end, exceeding budget expectations in 2023 with revenues projected to hold constant in 2024 and 2025.

YOUTH & FAMILY SERVICES FOUNDATION

The Youth and Family Services Foundation (MIYFS) provides critical funding to support human services provided through the Youth & Family Services division. In 2023, the City and MIYFS entered a new four-year funding agreement that formalized the Foundation's annual contribution to the Youth and Family Services Department at \$515,000.

The new funding level goes towards funding the second Mental Health Counselor position at the Middle School, extending the position through June 2026. It will also support rental assistance and food security programs through the Emergency Assistance Program and provide general YFS budget support for Community-Based and School-Based programs.

The mid-biennial forecast assumes the 2023 and 2024 funding levels will remain at \$515,000.

MERCER ISLAND THRIFT SHOP

During the 2021-2022 mid-biennial budget process, the City Council amended the Thrift Shop's 2022 expenditure budget to facilitate the shop's rebuilding phase after operations were heavily impacted by the Pandemic. In 2022, the Thrift Shop generated \$1.35 M in revenue, a 122% increase over the prior year and \$340,000 in net profits.

Revenues in the first six months of 2023 are on track with budget expectations. With new management, staff and volunteer training initiatives, and store improvements, the Thrift Shop is forecasted to meet budget expectations, generating \$1.6 M in gross revenues and over \$450,000 in net profits by year-end. Gross revenues are projected to increase 10% in 2024.

STATE AND FEDERAL GRANTS

The 2023 Amended Budget assumed \$350,000 in intergovernmental grants, representing 13% of YFS Fund revenues. The Sober Truth on Preventing Underage Drinking Act ("STOP") grant is \$48,600 annually for four years to reduce underage drinking. The Partnership for Success, Strategic Prevention Framework ("SPF") grant provides \$300,000 annually for five years for broader drug and alcohol prevention and mental health promotion efforts. These restricted grant revenues are reimbursement-based. Any unspent funds carry-over to the next fiscal year for the life of the grant.

The mid-biennial forecast assumes no change to this revenue stream and projects all federal grant funds will be exhausted at the end of 2024.

ARPA SUPPORT

A significant factor that is stabilizing the Youth and Family Services Fund through the current biennium is the use of American Rescue Plan Act (ARPA) funds. The 2023-2024 biennial budget committed up to \$1.4 million in ARPA resources in support of YFS programs.

The mid-biennial forecast projects a total of \$550,000 in 2023 and \$618,000 in 2024 to fund the projected operating deficit through the end of this biennium.

YFS FUND – MISCELLANEOUS REVENUES

The 2023 Amended Budget assumed \$47,000 in miscellaneous revenues, representing 2% of YFS Fund revenues. Most of the revenues result from [HB 1406](#). During the 2021-2022 biennium, the City Council directed these funds to MIYFS Emergency Rental Assistance.

The mid-biennial forecast assumes the City will receive HB 1406 funding in both 2023 and 2024, and this revenue category will meet budget expectations at year-end.

CONTINGENCY FUND

At the end of 2022, the Contingency Fund balance was \$4.6 M, \$217,725 above the target funding level as outlined in the City's financial management policies.

During the May 2023 planning session, the City Council appropriated this unassigned surplus and \$82,275 of General Fund unassigned surplus to the YFS Fund operating balance. This incremental contribution positions the YFS Fund closer to reaching its target operating balance, equal to six months of operating expenditures.

The current balance of the City's Contingency Fund is \$4.3 M. The current balance in the Contingency Fund is 12.5% of the adopted expenditure budget. Per the City's financial management policies, this figure will be adjusted at the end of the current fiscal year.