



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 6856
February 3, 2026
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 6856: Capital Improvement Program Overview	<input checked="" type="checkbox"/> Discussion Only
RECOMMENDED ACTION:	Receive report and provide staff direction.	<input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution

DEPARTMENTS:	Public Works and Finance
STAFF:	Jason Kintner, Chief of Operations Matthew Mornick, Finance Director
COUNCIL LIAISON:	n/a
EXHIBITS:	1. 2025-2026 Capital Project List
CITY COUNCIL PRIORITY:	4. Focus efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community.

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

EXECUTIVE SUMMARY

This agenda item provides information about the current Capital Improvement Program to better understand what projects could be delayed or canceled to free up funds for other projects – specifically facility projects.

- On January 6, 2026, the City Council directed staff to conduct a statistically valid survey of Mercer Island residents to collect community input on the recent Public Safety and Maintenance Facility Bond Measure. Survey results will inform priorities for future City facility planning ([AB 6844](#)).
- At the January 20, 2026 meeting, the City Council received an overview of the City's financial operations, emerging needs, and the schedule to develop the 2027-2028 Biennial Budget ([AB 6839](#)).
- At the same meeting, Council reallocated resources to support facility planning, including initial planning work required for occupancy of the newly acquired building at 9655 SE 36th Street, known as the 9655 Building ([AB 6850](#)).
- Exhibit 1 provides a detailed list of capital projects by category within the 2025-2026 CIP, as amended through Ordinance No. 25-33.
- Given the breadth of infrastructure investments needed to meet current and future demands on Mercer Island, the City has reached the practical limits of what can be accomplished within the 2025-2026 Capital Improvement Program using existing financial resources.
- If the City Council wishes to advance facility projects using current City resources, policy direction will be required to reprioritize capital investments.

- Staff are seeking initial feedback and policy direction from the City Council on how it wishes to proceed. This input will inform the scope, focus, and approach to capital planning discussions later this year.

BACKGROUND

CITY COUNCIL ACTIONS IN 2026

During the January 6, 2026 meeting, the City Council directed staff to conduct a statically valid survey of Mercer Island residents following the failure of Proposition No. 1 related to the Public Safety and Maintenance Facility ([AB 6844](#)). This data-informed approach will help gather community feedback to inform future facility planning work, capital projects, and next steps.

On January 20, 2026 the City Council received an overview of the City's financial operations, emerging priorities, and a look ahead at the schedule to develop the 2027-2028 Biennial Budget ([AB 6839](#)). Staff distinguished 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.

At the same meeting, the City Council reallocated \$587,594 to fund facility planning needs, including initial planning work required for occupancy of the newly acquired building at the 9655 Building ([AB 6850](#)).

Together, this work represents the incremental decisions about near- and long-term facility needs during a period of significant capital reinvestment in City of Mercer Island infrastructure.

This agenda item represents the first of many discussions about the City's current financing strategy to complete critical improvements to public infrastructure on Mercer Island. Staff seeks to address City Council questions and receive input to inform policy that will help prioritize immediate facility needs and the use of the City's limited financial resources to develop the 2027-2032 Capital Improvement Program.

LONG-RANGE PLANNING FOR PUBLIC INFRASTRUCTURE

The City of Mercer Island is responsible for providing day-to-day public goods and services as well as making considerable long-term investments to operate, maintain, and improve public infrastructure. The operating component of the City's two-year budget sets the goals and objectives for each of the City's twelve Departments as well as the financial resources required to achieve these investments and service deliverables.

For the preservation, qualified maintenance, and future improvement of public infrastructure, several plans work in tandem to complete near-term infrastructure improvements in line with long-term community need.

The City's Comprehensive Plan is the high-level blueprint that establishes goals and policies affecting changes to land uses, natural resource protection, City facilities and services over a twenty-year period. Within that plan is the Capital Facilities Element, which acts as a master list of all the big-ticket infrastructure – like parks, water distribution and sewer conveyance systems, and transportation systems, among others – required to support that future vision.

The Capital Improvement Program (CIP) is the six-year financial road map that turns this long-term vision into reality. It identifies which projects will be prioritized, when they are constructed, and how the City will pay for

them. Together, these plans ensure the City tactically prepares for and completes infrastructure improvements that keep pace with the community's needs. Figure 1 outlines key differences between the two plans.

Figure 1

Feature	Capital Facilities Element	Capital Improvement Program (CIP)
Purpose	Long-range policy and growth management.	Tactical project scheduling and funding.
Horizon	20 years (visionary)	6 years (action-oriented)
Focus	Levels of service, future needs, and land use consistent with state laws.	Project costs, funding sources, and construction timing.
Legal Basis	Required by the Growth Management Act.	Legally binds spending every two years.
Components	Inventories assets. Forecasts demand for 20-yr.	List of projects, purpose, and financing plan.

Because of the City's biennial budget, the City Council updates the CIP every two years to adjust for inflation, review priorities, and pursue new grant opportunities while maintaining a financial strategy that plans for infrastructure improvements over a six-year horizon. The City organizes capital improvement projects within the CIP into two distinct categories:

- The **Capital Reinvestment Plan (CRP)** focuses on maintenance and rehabilitation of what the City already owns (e.g., repaving a road or replacing old water mains).
- The **Capital Facilities Plan (CFP)** focuses on new facilities (e.g., adding a new building or constructing an entirely new park). This portion of the capital budget is what directly implements the Capital Facilities Element in the Comprehensive Plan.

The CIP and the Capital Facilities Element of the Comprehensive Plan are co-dependent. While they share a common goal – to manage public infrastructure – they operate on different timelines and serve distinct legal purposes under the Washington State Growth Management Act.

CAPITAL FINANCING STRATEGY

Current Capital Funding

The 2025–2026 CIP matches specific infrastructure improvements to dedicated restricted revenues. This strategy ensures residents who use a specific service – like water or sewer – pay for those improvements through their utility rates; growth-related costs for adding capacity to the City's infrastructure is paid for by new development; and broader community assets are funded by taxes.

The 2025-2026 amended capital budget is \$111 million (as amended through Ordinance No. 25-33) as illustrated in Figure 2 on the following page.

Figure 2

FUND (\$ in millions)	AMENDED BUDGET		TOTAL
	2025	2026	
Special Revenue Fund			
110 Street Fund	\$ 6.4	\$ 7.3	\$ 13.7
Enterprise Funds			
410 Water Utilities Fund	24.7	15.1	39.8
420 Sewer Utilities Fund	7.8	5.1	12.9
430 Storm Water Utilities Fund	2.6	2.0	4.7
Internal Service Funds			
510 Equipment Rental Fund	2.2	2.4	4.7
520 Computer Equipment Fund	0.2	0.2	0.5
Capital Project Funds			
320 Capital Improvement Fund	14.2	9.6	23.8
330 Technology and Equipment Fund	0.7	0.4	1.1
350 Municipal Facility Replacement Fund	9.9	-	9.9
TOTAL	\$ 68.9	\$ 42.1	\$ 111.0

The City's Street Fund is a **Special Revenue Fund** that tracks all revenues and expenditures related to transportation. Examples include road overlays, bicycle facilities, and pedestrian accessibility improvements.

Revenues and expenditures for water, sewer, and storm water utilities are each accounted for in separate **Enterprise Funds** because these government activities are financed and operated like a private business. The revenues generated from each utility is restricted to the maintenance, operation, and investment for that respective utility.

Together the Water, Sewer, and Storm Water Funds make up the largest portion of the CIP, largely supported by utility rates and connection charges, along with outside financing in the form of state grants, low-interest public works trust fund (PWTF) loans, and the sale of limited tax general obligation (LTGO) bonds.

The City of Mercer Island has two **Internal Service Funds**: Equipment Rental Fund and Computer Equipment Fund. They account for the financing of vehicles, heavy equipment, public safety radios, and computer-related hardware and equipment. Their primary goal is to centralize common needs – like the vehicle fleet or computer network – and fund their operation, maintenance, and eventual replacement via internal user fees over time. This creates economies of scale and a stable funding mechanism for critical equipment.

Capital Project Funds include financial resources for the acquisition, maintenance, and construction of capital facilities other than those financed by Enterprise or Internal Service Funds. The Capital Improvement Fund accounts for revenues that can be spent on parks, open spaces, and facility-related capital projects. All investments related to technology software, furnishings, and equipment are paid for by the Technology and Equipment Fund. This fund is mostly supported by an annual contribution of general revenues from the General Fund. General revenues are unrestricted revenues – revenues that can be used for any municipal service.

Established in the wake of City Hall's permanent closure, the Municipal Facility Replacement Fund accounts for resources accumulated to address short- and long-term municipal facility needs.

Project Categories in the 2025-2026 CIP

The Capital Improvement Program is further organized into specific functional areas to create a clear "line of sight" between the City's strategic goals, financial accounting, and state legal requirements. Further, these project categories serve as a management tool to organize and prioritize the City's limited resources.

Figure 3 below organizes the City's 142 active capital projects into separate project categories, the kind of revenues that support these investments, and the corresponding Funds. Refer to Exhibit 1 for a detailed list of active capital projects. These figures represent the total resources allocated to capital project budgets in each asset category.

Figure 3

Project Category (\$ in millions)	Active Projects	Amended Budget 2025-2026 ¹	Type of Revenues	Fund(s)
Public Buildings	21	\$15.1	Real Estate Excise Tax (REET-1), grants, and general revenues.	320; 350; 001
Technology	8	\$1.1	General revenue, grants.	330; 001
Equipment	3	\$4.1	General revenue, grants.	330
Streets, Pedestrian, & Bicycle Facilities	24	\$12.3	REET-2, Transportation Benefit District vehicle fees, motor vehicle fuel taxes, grants, state shared revenues, and transportation impact fees.	110
Parks, Recreation, & Open Space	29	\$18.1	REET-1, REET-2, property taxes, 2022 parks levy, King County parks levy, grants, private contributions, parks impact fees, general revenues.	320
Water Utility	27 16	\$38.4 \$12.4	Water utility rates, connection charges, PWTF loans, LTGO debt financing.	410
Sewer Utility	16 14	\$12.4 \$4.2	Sewer utility rates, connection charges, grants, PWTF loan, LTGO debt financing.	420
Storm Water Utility	14 27	\$4.2 \$38.4	Storm water utility rates, connection charges, grants.	430

¹ Excludes administrative overhead for the capital improvement program.

State Laws and Local Policy

The 2025-2026 CIP relies on existing available fund balances, projected state shared revenues, and utility rates, along with the prudent use of outside funding including debt financing, state, and federal grants as outlined in Sections 4 and 5 of the City's [financial management policies](#). The General Fund is the sole source of funding for technology and equipment capital investments.

Even with various funding sources, most resources that fund the CIP are restricted. This means they carry enforceable limitations required by state law. For example, state laws limit how motor vehicle 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.

The City's capital financing strategy has been to use these restricted revenues on a "pay as you go" basis for needed improvements. This strategy remains unchanged, except for costly utility and public building projects for which debt financing is used to "smooth" utility rate spikes or to match the costs of the project more

equitably to the benefit period. For example, staff secured a competitive low-interest loan from the Washington State Public Works Trust Fund (PWTF) in 2023 and proceeds from the sale of limited-tax general obligation (LTGO) bonds in 2024 to fund major investments in the City's water distribution system.

Use of Restricted Revenues

Within state requirements for the use of restricted revenues, the City Council may prioritize their use for specific capital investments. A good example of a local policy informed by state legal requirements is the City's budget policy for revenues from the Real Estate Excise Tax (REET).

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.

Put differently, 100% of REET can be used for streets, parks, or utilities. Whereas 50% of REET can be used on public facilities.

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 (320) and the remaining 90% to the Street Fund (110) for the construction and maintenance of the transportation network. Figure 4 provides REET revenue actuals and their distributions for the past three years.

Figure 4

REET Allocation per Council Policy			Fiscal Year (\$ in millions)		
Fund	Type	%	2023	2024	2025
320 - Capital Improvement	REET-1	100%	\$ 1.7	\$ 2.0	\$ 1.9
110 - Street	REET-2	90%	1.5	1.8	1.7
320 - Capital Improvement	REET-2	10%	0.2	0.2	0.2
320 Subtotal			\$ 1.9	\$ 2.2	\$ 2.1
110 Subtotal			1.5	1.8	1.7
Total REET			\$ 3.4	\$ 3.9	\$ 3.9

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

For example, the City Council could revise this current policy so that 50% of REET-2 revenues were allocated to park and open space improvements via the Capital Improvement Fund, and the remaining 50% of REET-2 revenues would be allocated to the Street Fund to invest in the City's transportation system. The result is more resources available for park improvements, and in turn, public facility improvements. Completion of future investments in the City's transportation system would then rely on outside funding sources like state and federal grants or be deferred to a later time.

State law and local policy guide the application of restricted revenues towards eligible uses. In practice, a clear nexus must exist between a project component and the restricted revenue.

Utility Rate Revenues

In Washington state, the relationship between City operations and its water, sewer, and storm water utilities are governed by a strict "nexus" of cost of service (RCW 35.92). Because the City of Mercer Island operates its utilities as Enterprise Funds, there is a legal firewall between the money customers pay in their bill and the money the City uses for general services like parks or public safety. Refer to [AB 6839](#) for additional information regarding Fund Accounting.

Following this example, rates for utilities must be "just and reasonable" and based on the actual cost of providing the service. Eligible uses of revenues collected for utility service include the operation and maintenance, capital improvements, and debt service for the utility. This includes the cost to house City staff who manage the operation, billing, capital maintenance and reinvestment for the water, sewer and storm water utility systems.

Staff rely on state law (RCW 43.09.210) and the City's cost allocation plan (Financial Management Policies – [Appendix B, section 5.8 Facilities](#)) to determine the "proportionate share" of City facility expenses that can be paid for with rate revenues from the utility funds.

The "nexus" requirement is not just a policy preference; it is a legal requirement to ensure that utility ratepayers are not unconstitutionally subsidizing the general functions of the city. In practice, this "true cost mandate" is calculated based on the total square footage by FTE.

For example, if a new City facility houses 100 new staff members – 10 of which oversee the City's water utility operations – than 10% of the new facility can be paid for with rate revenues in the Water Fund. However, if water rate revenues paid for 50% of said facility, the City would be in violation of state law and its own local policies because the utility is "benefitting" the General Fund.

In summary, the use of capital revenues must comply with state laws. The City Council's policy decisions within the state's enforceable limitations is how restricted revenues are prioritized to best serve the Mercer Island community. Not just within two-year budget appropriations or the six-year planning period of the current Capital Improvement program, but also so infrastructure improvements keep pace with the community's needs over a 20-year horizon as outlined in the City's Comprehensive Plan.

ISSUE/DISCUSSION

In January, the City Council requested additional information on the current Capital Improvement Program to better understand which projects could be delayed or deferred to free up funding for other priorities, particularly facility projects.

Exhibit 1 provides a detailed list of capital projects by category within the 2025-2026 CIP, as amended through Ordinance No. 25-33. Included is each project's identification number, title, amended budget for fiscal years 2025 and 2026, and eligible funding sources based on state law and local policy direction. More information about each capital project can be found within [Section E of the Adopted 2025-2026 Biennial Budget](#), specifically detailed project summary pages (E-11 through E-173).

Exhibit 1 includes two columns that indicate which 2026 capital projects are funded with revenues that could potentially be repurposed to support facility projects. For example, the City Council allocated \$77,766 in the 2026 capital budget to improve the pedestrian and passive recreational amenities at Wildwood Park

(90.25.0040). This project is funded with REET-1 revenues, and the project scope includes a new park sign on Island Crest Way, a soft surface perimeter path, and installation of an ADA trail connection from Island Crest Way to 86th Avenue SE. As an example, the City Council could choose to delay this project work and reprioritize the associated REET-1 resources to invest in public facility improvements.

City Council Discussion

Given the breadth of infrastructure investments needed to meet current and future demands on Mercer Island, the City has reached the practical limits of what can be accomplished within the 2025–2026 Capital Improvement Program using existing financial resources. If the City Council wishes to advance facility projects using current City resources, policy direction will be required to reprioritize capital investments.

Potential questions for the City Council to consider in approaching this discussion:

1. What questions does the City Council have regarding current capital projects, including project sequencing, funding, or related considerations?
2. What about the long-term capital project plan?
3. Should capital funding be reprioritized to advance facility projects? If so, to what extent, and what process would the City Council like to use to review and adjust the project list?
4. What guiding principles should inform decisions about reprioritizing capital investments (e.g., life-safety, continuity of operations, regulatory requirements, asset condition, community impact)?
5. How should we engage with the community on these discussions?

Staff are seeking initial feedback and direction from the City Council on how it wishes to proceed. This input will inform the scope, focus, and approach to capital planning discussions later this year.

NEXT STEPS

Staff will receive the feedback and return to the City Council with additional information on the capital program. This work is intended to continue this year and will inform future facility planning as well as development of the 2027-2028 budget.

In March, findings from the community survey will be shared with the City Council.

RECOMMENDED ACTION

Receive report and provide initial staff direction.