INTRODUCTION

The financial forecast ("forecast") provides an overview of the City's current financial position and long-term outlook, drawing on historical financial data through the second quarter of 2026 and relevant regional economic trends.

The forecast focuses on the following funds:

- **Operating Funds**: General Fund (001) and the Youth and Family Services (YFS) Fund (160).
- **Capital & Reserve Funds**: Capital Improvement Fund (320) and Contingency Fund (130).

Although financial projections extend through 2032 for long-term planning, revenue forecasts for 2027–2028 set baseline spending levels for the Preliminary 2027–2028 Biennial Budget, scheduled for City Council review this fall.

As projected in May 2025 (AB 6680), the General and YFS Funds are entering a structural deficit, with expenditures exceeding revenues in both 2027 and 2028. While accumulated prior year savings will temporarily bridge operations for the upcoming biennium, a permanent funding solution is required by 2028 to maintain current service levels.

2027-2028 PRELIMINARY BIENNIAL BUDGET

Financial Forecast

Sept 15, 2026

GENERAL FUND REVENUES

Fiscal Year 2026
Adopted Budget
$38.7 million

Sept Forecast
$39.2 million

Fiscal Year 2027
$39.9 million

Fiscal Year 2028
$40.9 million

Contents

GENERAL FUND – 001

Figure 1 includes General Fund revenue projections for fiscal year 2026 through 2032. A summary of each revenue category is in the left column.

Figure 1 - General Fund Financial Forecast

RESOURCES *($ in thousands)*	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Beginning Fund Balance (Includes Reserves)	**$9,442**	**$9,447**	**$8,727**	**$7,030**	**$5,690**	**$3,844**	**$1,562**
REVENUES							
Appropriated Fund Balance	972	0	0	0	0	0	0
Property Tax	14,469	14,614	14,800	14,975	15,153	15,324	15,497
General Sales Tax	8,041	8,353	8,677	8,917	9,163	9,417	9,678
Utility Taxes	5,852	6,043	6,240	6,407	6,580	6,760	6,945
Business & Occupation Tax	1,052	1,052	1,052	1,083	1,116	1,149	1,184
Parks & Recreation Programs	1,556	1,615	1,635	1,635	1,656	1,656	1,656
Overhead Allocation Charges	2,527	2,630	2,736	2,861	2,992	3,129	3,272
Licenses & Permits	305	301	304	307	310	314	317
State Shared Revenues	1,285	1,238	1,256	1,211	1,232	1,254	1,277
Miscellaneous Revenues	2,543	2,580	2,650	2,716	2,783	2,850	2,918
Interest Earnings	1,321	1,209	1,290	1,090	927	881	854
Municipal Court	209	220	231	235	240	245	250
Total Revenues	**40,132**	**39,853**	**40,870**	**41,438**	**42,153**	**42,978**	**43,848**
Total Fund Resources	**$49,573**	**$49,300**	**$49,596**	**$48,468**	**$47,843**	**$46,821**	**$45,410**
EXPENDITURES							
Personnel	18,255	18,551	19,300	19,857	20,430	21,020	21,627
Supplies	724	756	760	773	787	801	815
Contractual Services	9,731	10,430	10,751	11,083	11,433	11,795	12,169
Other Services & Charges	7,653	7,602	7,904	7,885	8,123	8,369	8,624
Interfund Transfers	3,763	3,235	3,851	3,180	3,227	3,275	3,325
Total Expenditures	**$40,127**	**$40,573**	**$42,566**	**$42,779**	**$43,999**	**$45,259**	**$46,560**
Net Operating - Over/(Under)	*5*	*(720)*	*(1,697)*	*(1,340)*	*(1,846)*	*(2,282)*	*(2,713)*
Ending Fund Balance (Includes Reserves)	**$9,447**	**$8,727**	**$7,030**	**$5,690**	**$3,844**	**$1,562**	**($1,151)**

Note: Slight differences occur due to rounding.

Figure 1 illustrates projected General Fund revenues and expenditures through 2032. From 2026 to 2028, revenues are projected to grow by 4.4%, while expenditures are expected to outpace revenue growth at 6.1% over the same two-year period.

The General Fund is structurally sound through 2026, meaning overall revenues exceed expenditures. An operating deficit emerges in 2027 – with annual expenditures consistently outpacing revenues – as indicated in the “Net Operating – Over/(Under)” row at the bottom of Figure 1.

To maintain current service levels, the City will need to draw on its unassigned (available) fund balance in the General Fund beginning in 2027, as indicated in Figure 2. Unassigned fund balance is the portion of the City’s financial resources available to be spent or "appropriated" in the next budget cycle. It comprises funds remaining after state statues and City Council policies set aside resources that are restricted, committed, and assigned per the City’s financial management policies.

Figure 2 - Estimated Fund Balance

Fund Balance - General Fund (001) *($ in thousands)*	2026F	2027F	2028F
Beginning Fund Balance	$ 9,442	$ 9,447	$ 8,727
Revenue	40,132	39,853	40,870
Expense	(40,127)	(40,573)	(42,566)
Reserves[1]	(4,610)	(4,695)	(4,780)
Ending Available Fund Balance	**$ 4,836**	**$ 4,031**	**$ 2,250**

[1] *Includes resources that are "restricted," "non-spendable," and "committed" per state law and local policy.*

The General Fund closed 2025 with $5.1M in available fund balance. Accounting for City Council appropriations through September 2026, the estimated year-end 2026 available fund balance is $4.8M, projected to decline to $2.3M by the end of 2028.

By 2029, cumulative operating deficits will fully deplete unassigned resources, pushing the available fund balance in the General Fund into a negative position.

GENERAL FUND REVENUES

PROPERTY TAX

The 2026 Adopted Budget assumed $14.2M in property tax revenue, representing 38% of total General Fund revenues. This is a stable revenue source with payments received in April and October of each calendar year.

Revenues through June are on track to meet 2026 budget assumptions. For 2027 and 2028, the forecast assumes the City will assess a property tax increase of the statutorily allowed 1% of the previously levied amount (e.g., 2026 actual regular levy) plus new construction each year.

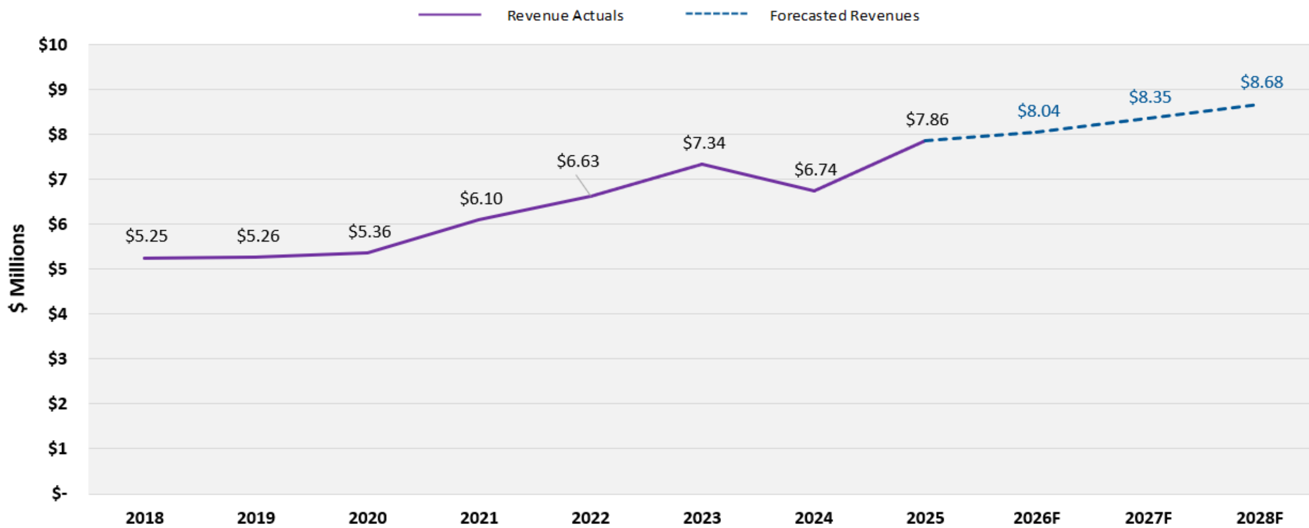
SALES TAX

The 2026 Adopted Budget assumed $7.9M in total sales tax revenues (general and local criminal justice sales tax revenues), representing 21% of total General Fund revenues. Total sales tax earnings in 2025 were $7.86M, notably more than 2024 revenues primarily due to an accounting change to cash basis reporting beginning January 1, 2024.

Overall, sales tax revenues are up 3% during the first half of 2026 compared to the same period of the prior year. While this trend is positive, underlying consumer spending shows mixed signals with an 8% decline in July 2026 sales tax revenues relative to July 2025.

For a long-term view of general sales tax activity, Figures 3 illustrates historical revenues and year-over-year trends for the City from 2018 through 2025, with 2026-2028 projections included for reference.

Figure 3: Total General Sales Tax Revenues



The historical data from the Department of Revenue in Figure 3 highlights the sensitivity of the sales tax revenues. The dip in 2024 reflects the City's change to cash-basis accounting, not a lull in sales tax activity. Distributions of sales tax revenues received in January 2024 were accounted as revenue earned and reported in December 2023. That aside, Figure 3 illustrates consistent year-over-year (YOY) sales tax revenue growth since 2018, with forecasted figures from 2026 through 2028.

During the 2025-2026 legislative sessions, Washington State enacted structural adjustments to its tax code that broadened the underlying definition of a taxable retail sale. Most notably, engrossed substitute Senate Bill 5814 (effective October 1, 2025) expanded retail sales tax to cover previously exempt business and professional services – such as IT support, custom software and web development, temporary staffing, live training presentations, and security monitoring.

Because local sales taxes in Washington rely on the state's retail tax definitions, expanded definitions at the state level were thought to increase municipal tax bases. From October 2025 through June 2026, there has not been a material change in the general sales tax revenues.

Based on trends through the end of 2025 and the first half of 2026, the forecast projects a 2.3% increase in sales tax revenues in 2026 compared to 2025, with a 4% annual increase projected in 2027 and 2028. These projections are also informed by the King County Office of Economic and Financial Analysis and the Washington State Economic and Revenue Forecast Council.

UTILITY TAXES

The 2026 Adopted Budget assumed $5.5M in utility tax revenues, representing 15% of total General Fund revenues. A utility user tax is imposed on utility services provided on Mercer Island, such as cellular phone service, natural gas, electricity, along with City utilities (water, sewer, and stormwater).

This revenue is, for the most part, not subject to economic volatility. The forecast assumes utility tax revenues will finish the year on track meeting the $5.8M budget estimate. Utility tax revenues are projected to increase 3.3% annually in 2027 and 2028, mostly tied to anticipated electricity and gas year-over-year growth.

BUSINESS AND OCCUPATION (B&O) TAXES

The 2026 Adopted Budget assumed $755,000 in B&O tax revenue, representing 2% of total General Fund revenues. B&O tax is paid annually before April 15 unless a business earns greater than $1M annually in gross receipts, in which case the tax is paid quarterly.

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

Revenues for the first half of 2026 exceeded budget expectations. Annual filings are typically received in the first four months of the calendar year (April 15 filing deadline). For the first six months of the year, the City received $676,000 in revenues, of which 21% resulted from annual filings.

The forecast projects B&O tax revenues will exceed budget expectations by $296,000 by 2026 year-end. This projection is based on payment data from 2023 through Q2 2026. Revenues are expected to hold at $1.05M in both 2027 and 2028.

PARKS & RECREATION PROGRAM REVENUES

The 2026 Adopted Budget assumed $1.25M in Parks and Recreation revenues, representing 3% of total General Fund revenues. Revenues include field and community center rental fees, boat launch fees, program fees, and rent payments from the annex building located behind the Community Center.

Recreation program revenues through the first half of the year are 6% higher than in 2025. This is largely due to improvements made with the online platform for managing field and MICEC room rentals. Revenues are forecasted to finish 2026 at $1.55M, 24% above budget expectations, based on hourly rentals and community center bookings secured through the end of the year. Revenues are projected to increase 3.8% in 2027 and 3.3% 2028.

OVERHEAD ALLOCATION CHARGES

On May 21, 2024, the City Council adopted a new Cost Allocation Policy (appendix B of the City's financial management policies). The policy was based on established best practices from the Government Finance Officers Association (GFOA), Washington State Auditor's Office, and the Municipal Research and Services Center (MRSC). A cost allocation policy establishes a consistent and transparent methodology for distributing shared costs across City funds and programs based on their use of services and resources paid for by the General Fund.

The overhead allocation revenue category accounts for overhead costs charged to the Utility and Capital Funds through internal transfers. The 2026 Adopted Budget assumed roughly $2.5M in cost allocation transfers, representing 7% of total General Fund revenues. These revenues are forecasted to meet budget expectations by the end of 2026. Administrative overhead in the General Fund will increase 4% annually in the 2027-2028 preliminary budget.

LICENSE & PERMITS

The 2026 Adopted Budget assumed $245,000 in license and permit revenues, representing 0.7% of total General Fund revenues. Beginning in 2025, all revenues unique to development services transitioned out of the General Fund and into a newly established Development Services Fund (180).

The remaining revenues include business license fees and fees related to fire inspection services. Revenues in 2025 amounted to $301,000, while revenues through the first half of 2026 are tracking 2% higher than the same period the prior year. Collectively, the forecast projects $305,000 in 2026, $301,000 in 2027, and $304,000 in annual revenues in 2028.

STATE SHARED REVENUES

The 2025 Adopted Budget assumed $1.2M in shared/intergovernmental revenues, representing 3% 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.

Revenues in 2026 are projected to end the year 8% or $98,500 above budget estimates. This is mainly due to increased grant funding (e.g., the King County 4Culture Arts program) through 2028.

Revenues in 2027 and 2028 are projected to stabilize and remain relatively flat at $1.2M year over year.

MISCELLANEOUS REVENUES

The 2026 Adopted Budget assumed $2.6M in miscellaneous revenues, representing 7% of General Fund revenues. This category includes the emergency medical service (EMS) utility, the King County EMS levy, judgment settlements, cell tower leases, and disability reimbursements received from the Washington State Department of Labor and Industries, among others.

The forecast assumes miscellaneous revenues will end 2026 in line with budget estimates. Overall, this revenue category is projected to incrementally increase through 2028 and beyond.

INTEREST EARNINGS

The 2026 Adopted Budget assumed $1.1M in General Fund revenue from interest earned on the City's holdings in the Local Government Investment Pool (LGIP). Interest earnings in the General Fund amounted to $2.1M in 2024 – a historic high – that continued through 2025, resulting in $1.7M in General Fund revenues.

The forecast considers the projected principal balance, the annual LGIP 30-day yield, and the General Fund portion of the City's principal investments. In 2025, the LGIP's average 30-day yield was 4.30%. Through the first six months of 2026, the average 30-day yield dropped to 3.70%. The forecast projects an average 30-day yield on the City's principal investments of 3.60% in 2026, shifting to 3.50% in 2027 and 2028. Interest earnings in the outyears are projected to stabilize and return to historical averages.

Interest earnings are distributed quarterly to various funds based on their relative cash balances at quarter end. The Contingency Fund (130) achieved its funding target (12.5% of budgeted General Fund expenditures) in the first half of 2026. With the Contingency fully funded (see Contingency Fund section of this Exhibit), interest earnings tied to Fund 130 revert to the General Fund, unless Fund 130 falls below its funding target. The target funding level is revisited each new fiscal year, according to the City Council's adopted financial management policies.

Background Information on Interest Earnings

Through 2025, LGIP experienced a minor decrease in the 30-day interest rate, beginning the year at 4.45% and ending at 3.87% in December 2025. The net earnings rate for the month of June 2026 was 3.69%.

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 June 2022 and June 2024, 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 in the federal funds target rates helped slow the pace of inflation, it also increased the LGIP's earnings rate.

Figure 4: WA State Treasurer Local Government Investment Pool

June 2022 - June 2026

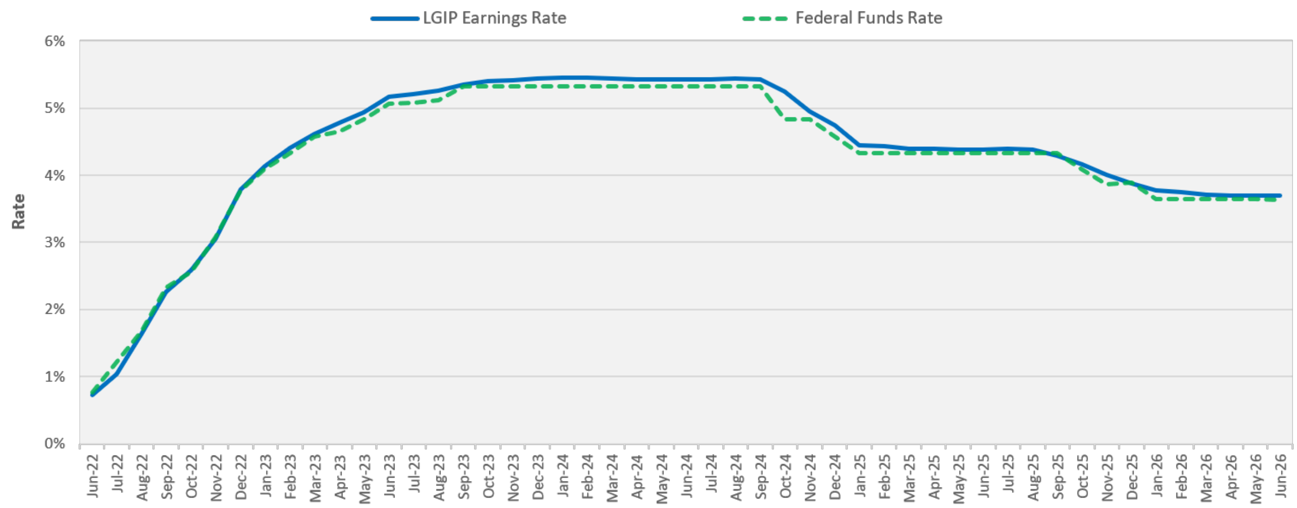
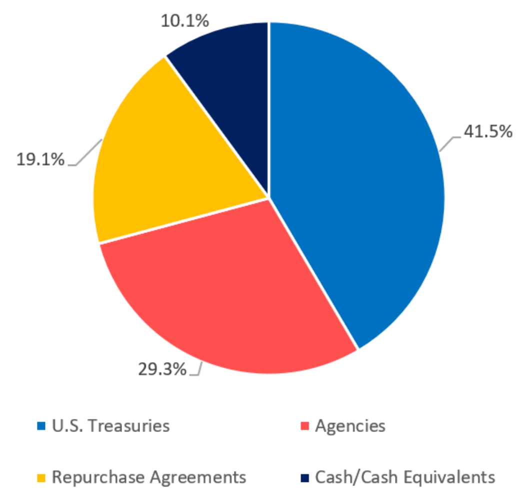


Figure 5 illustrates the average balance of holdings in the LGIP as of July 2026. These include:

Figure 5: WA State LGIP Holdings by Issuer Type

July 31 2026



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 May, Freddie Mac, and the Federal Deposit Insurance Corporation (FDIC).
3. **Cash/Cash Equivalents** refers to highly liquid investments that can be easily converted into cash within a short period of time, usually 7 days or less. These investments are generally considered to have minimal risk.
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 a 360-day basis), to be paid to the buyer.

Economic projections from the Federal Reserve are being closely monitored. The Federal Open Market Committee (FOMC) is the policy-making body of the Federal Reserve System, the central bank of the United States. Based on indications from FOMC economic projections, the forecast assumes one 0.25% cut in the federal funds rate before the end of 2028.

MUNICIPAL COURT REVENUES

The 2026 Adopted Budget assumed $185,000 in General Fund revenue collected from fines, forfeitures, fees, costs, and penalties associated with the enforcement of local and State law. In 2025, total revenues amounted to $199,000.

Relative to the first half of 2025, municipal court revenues were 30% greater during the same period in 2026 due to an increase in the case load. The forecast projects $209,000 in municipal court revenues in 2026, increasing on average 5% per year in 2027 and 2028. In the outyears, revenues are projected to stabilize, increasing 2% year over year pending further analysis.

YOUTH & FAMILY SERVICES (YFS) FUND – 160

Outside of Thrift Shop revenues and Mercer Island Youth and Family Service (MIYFS) Foundation funding, the YFS Fund relies on operating fund balance and the General Fund. The operating fund balance was established by the City Council in 2021 to address temporary revenue losses due to economic cycles or other time-limited causes.

With YFS operating fund balance anticipated to be fully exhausted in 2028, the anticipated General Fund annual contribution is proposed to increase from $350,000 in 2026 to $1.07M by 2028. Utilizing one-time General Fund available fund balance maintains service levels in 2027-2028 while the City Council evaluates long-term funding options.

Figure 6 outlines the 2026-2032 forecast for the YFS Fund. It also includes the Fund's designated reserves and how they change over time. The forecast assumes a General Fund interfund transfer of $477,000 in 2027 and $1.07M in 2028. The interfund transfer from the General Fund reverts to $350,000 per year from 2029 through 2032 to illustrate the growing operating deficit.

Figure 6 - YFS Fund Financial Forecast

RESOURCES *($ in thousands)*	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Beginning Fund Balance (Includes Reserves)	**$1,209**	**$571**	**$133**	**$70**	**($790)**	**($1,738)**	**($2,825)**
REVENUES							
Federal, State & Local Grants	96	58	46	46	46	46	46
Healthy Youth Initiative Grants	93	110	0	0	0	0	0
School Counselor Program Support	60	60	60	60	60	60	60
Thrift Shop	1,903	2,094	2,198	2,242	2,287	2,287	2,287
Emergency Assistance Program Support	15	15	15	15	15	15	15
MIYFS Foundation Support	610	580	580	580	580	580	580
Opioid Settlements	44	34	52	52	48	44	44
Affordable and Supplemental Housing	35	35	35	35	35	35	35
Program Fees & Donations	298	163	163	163	163	163	163
Interfund Transfer	350	477	1,067	350	350	350	350
Total Revenues	**3,504**	**3,626**	**4,216**	**3,543**	**3,584**	**3,580**	**3,580**
Total Fund Resources	**4,713**	**4,196**	**4,348**	**3,614**	**2,794**	**1,842**	**756**
EXPENDITURES							
YFS Administration	520	549	601	617	634	651	668
Thrift Shop	1,373	1,470	1,592	1,638	1,684	1,732	1,782
School Counselor Program	977	991	1,069	1,102	1,136	1,171	1,207
Family Counseling & Outreach	633	454	474	489	504	519	535
Emergency Assistance & Food Pantry	341	317	325	336	346	357	368
Senior Programs & Services	101	101	103	106	109	113	116
Healthy Youth Initiative Grants	199	181	113	117	120	124	127
Interfund Transfers	0	0	0	0	0	0	0
Total Expenditures	**4,142**	**4,064**	**4,278**	**4,403**	**4,533**	**4,666**	**4,804**
Net Operating - Over/(Under)	*(638)*	*(438)*	*(62)*	*(860)*	*(949)*	*(1,086)*	*(1,224)*
Ending Fund Balance (Includes Reserves)	**$571**	**$133**	**$70**	**($790)**	**($1,738)**	**($2,825)**	**($4,048)**
FUND RESERVES							
Operating Fund Balance	383	1	0	(860)	(1,809)	(2,895)	(4,119)
Emergency Assistance & Food Pantry	12	12	12	12	12	12	12
Opioid Settlement Funds	175	120	58	58	58	58	58
Ending Fund Balance (Gross)	**$571**	**$133**	**$70**	**($790)**	**($1,738)**	**($2,825)**	**($4,048)**

YFS FUND REVENUES

FEDERAL, STATE, AND LOCAL GRANTS

The 2026 Adopted Budget included $46,000 in ongoing grant funding from King County to support YFS school-based programs as well as an agreement with the King County Children, Youth, and Young Adults

Division (CYYAD) for YFS to host clinical classroom presentations through December 2027. The forecast assumes the grant resources supporting YFS school-based programs will continue through 2027 and 2032, respectively.

HEALTHY YOUTH INITIATIVE GRANTS

The 2026 Adopted Budget included $92,500 in grant funding to support the YFS Department Healthy Youth Initiative. In Fall 2024, King County's Best Start for Kids (BSK) Positive Family Connections Program awarded the YFS department a $288,000 grant, spread across 2025–2027. The grant will fund a portion of various YFS positions and result in establishing stronger parent support groups, parent-focused Town Hall events, and connections between healthy parenting and healthy youth.

The forecast projects these programmatic grants funds will continue through the end of the grant period (December 2027) and sunset thereafter.

SCHOOL COUNSELOR PROGRAM SUPPORT

The 2026 Adopted Budget included $60,000 in revenues from additional YFS services, representing the annual contribution from the Mercer Island School District (MISD) to support YFS school counseling services.

The May forecast anticipates MISD's annual contribution will continue through the upcoming biennium and through the remainder of the forecast period.

MERCER ISLAND THRIFT SHOP

The 2026 Adopted Budget included $2.08M in Thrift Shop revenues, representing 63% of YFS Fund revenues.

In Q1 2025, the Thrift Shop was closed for six weeks while the building was renovated. This hindered sales activity in the first part of that year. By the second half of 2025, monthly sales significantly increased relative to prior years. That positive trend continued through the first half of 2026.

The forecast projects the Thrift Shop gross revenues will come slightly below the 2026 budget expectations, but finish the year 9% above 2025 gross revenues, generating $1.9M. Gross revenues are projected to increase 10% in 2027 compared to 2026. A 5% annual rate of growth is projected in 2028.

YFS EMERGENCY ASSISTANCE PROGRAM SUPPORT

This revenue category includes revenues from pass-through fundraising generated at the Thrift Shop and direct donations that are restricted for emergency assistance. At the end of 2025, $12,000 remained in the Emergency & Rental Assistance Reserve within the YFS restricted fund balance. This ongoing revenue is projected to meet budget expectations in 2026 and continue through the forecast period.

MIYFS FOUNDATION

The Mercer Island Youth and Family Services Foundation (Foundation) provides critical funding to support human services provided through the Youth & Family Services Department. In 2023, the City and the Foundation entered a new four-year funding agreement that formalized the Foundation's annual contribution to the Youth and Family Services Department at $515,000. This support extended the middle school's second Mental Health Counselor position. It also supports Emergency Assistance rental and food security programs, alongside funding for YFS school- and community-based services.

The funding agreement was updated in 2025, increasing the MIYFS annual contribution by $65,000 for YFS staff salaries because of the Compensation Plan for Non-Represented employees adopted by the City Council in July 2024. In the spring of 2026, MIYFS contributed an additional $30,000 in 2026 to support senior programming.

The forecast assumes $610,000 in 2026 annual funding and reverts to $580,000 for 2027 through 2032.

OPIOID SETTLEMENTS

On December 21, 2022, Washington state joined in multistate resolutions with several companies resulting in potentially over $430M in settlements from a nationwide legal action against pharmaceutical companies and distributors who were found to have contributed to the opioid epidemic.

The Opioid Abatement Council (OAC) is the oversight body responsible for ensuring appropriate documentation and reporting of opioid settlement funds used by cities within King County that receive funds from opioid lawsuits, Mercer Island among them. This revenue is restricted to services that focus on harm reduction, prevention efforts, and treatment services tied to the opioid epidemic.

As of 2025, Mercer Island has received $268,000 of a total projected payment of $805,000 from opioid settlement funds. Funds are distributed annually based on population and opioid impacts within each jurisdiction, among other factors. The forecast projects the City will receive $44,500 in 2026, $34,000 in 2027, and $52,000 in 2028 based on the OAC's projected allocations through 2038.

AFFORDABLE AND SUPPLEMENTAL HOUSING

In 2023, HB 1406 was passed to address the housing crisis by providing local jurisdictions with additional funding for affordable and supportive housing. The bill allows cities to impose a local state-shared sales and use tax, which is not directly paid by consumers. Instead, the 0.0146% of sales tax is credited against the state sales tax based on population and other factors.

Mercer Island collects this credit to support rental assistance through the City's YFS Department, specifically for emergency rental assistance. The forecast assumes the City will receive $35,000 from HB 1406 funding in 2026, and this revenue will continue through 2032.

YFS PROGRAM FEES & DONATIONS

The 2026 Adopted Budget included $170,000 in this revenue category, representing 5% of the YFS Fund revenues. These revenues include fees from counseling, pass-through food pantry donations, and related services.

In 2025, family counseling service fees generated $139,000 in revenues, 7% below budget expectations. Revenues through the first half of 2026 are 5% less compared to the same period the year prior. Between food pantry donations and family counseling services, the forecast projects $150,000 will be received by 2026 year-end. The forecast projects $130,000/year in family counseling service fees and $33,000/year for food pantry donations in both 2027 and 2028.

CAPITAL IMPROVEMENT FUND – 320

Figure 7 outlines the 2026-2032 forecast for the Capital Improvement Fund (320). It also includes the Fund's designated reserves and how they change over time.

Figure 7 - Capital Improvement Fund (320) Financial Forecast

RESOURCES *($ in thousands)*	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Beginning Fund Balance (Includes Reserves)	**$6,782**	**$805**	**$4,177**	**$1,889**	**$2,267**	**$1,837**	**$2,787**
REVENUES							
Property Tax	1,178	1,195	1,212	1,232	1,253	1,274	1,284
Real Estate Excise Tax	2,642	2,179	2,230	2,345	2,466	2,595	2,731
Grants	251	5,645	841	0	0	0	0
Impact Fees	21	25	25	25	25	25	25
Shared Revenues	1,271	632	290	290	290	290	290
Miscellaneous Revenues	306	210	250	250	250	250	250
Interfund Transfers	1,311	155	0	0	1,700	0	0
Total Revenues	**6,979**	**10,040**	**4,848**	**4,142**	**5,984**	**4,434**	**4,580**
Total Fund Resources	**13,761**	**10,845**	**9,025**	**6,031**	**8,251**	**6,271**	**7,368**
EXPENDITURES							
Bonds and Reserves	137	140	137	139	142	145	148
Project Management Expenses	2,372	1,086	1,119	1,149	1,181	1,213	1,246
Public Buildings	1,061	4,083	3,618	1,523	3,133	1,308	3,084
Parks and Natural Resources	9,386	1,359	2,263	952	1,959	818	1,929
Total Expenditures	**12,956**	**6,668**	**7,136**	**3,763**	**6,415**	**3,484**	**6,407**
Ending Fund Balance (Includes Reserves)	**$805**	**$4,177**	**$1,889**	**$2,267**	**$1,837**	**$2,787**	**$961**
FUND RESERVES							
Operating Fund Balance minimum	114	114	114	114	114	114	114
King County Parks Levy	0	0	0	283	578	884	1,191
Turf Fields Replacement Sinking Fund	955	1,155	1,355	1,555	55	255	455
Impact Fees	29	54	79	104	129	154	179
Reserve - Freeman Landing	330	330	330	330	330	330	330
Reserve - RCO property	28	28	28	28	28	28	28
Unreserved	(652)	2,495	(18)	(148)	602	1,021	(1,337)
Ending Fund Balance (Gross)	**$805**	**$4,177**	**$1,889**	**$2,267**	**$1,837**	**$2,787**	**$961**

Note: Slight differences may occur due to rounding.

CAPITAL IMPROVEMENT FUND REVENUES

The following details additional revenue streams and underlying assumptions through 2026 and beyond.

PROPERTY TAX

King County 2026-2031 Parks Levy

Approved by King County voters as Proposition 1 on August 5, 2025, the 2026–2031 King County Parks Levy is a six-year property tax levy lid lift that replaces the previous levy which expired at the end of 2025. The local pass-through portion of the levy lid lift for cities supports the maintenance, operation, and investment in parks and open spaces.

Based on the latest County projections, parks levy funds are projected to increase 3% each year through 2028, and 4% annually thereafter through 2031. The forecast assumes the levy will be renewed in 2031, subject to voter approval, and includes the associated revenues.

2022 City of Mercer Island Parks Levy

This revenue accounts for the portion of the 2022 Mercer Island Parks Levy tied to:

- Luther Burbank Park capital investments
- Pioneer Park capital investments
- Open space vegetation management
- Playground replacement funding

- Forest management plan funding

These funds increase by a maximum of 1% each year, subject to City Council approval.

REAL ESTATE EXCISE TAX (REET)

REET is a 0.5% tax paid by the seller during property transactions. State law restricts its use to street, park, utility, affordable housing, and facility capital investments. Neither REET-1 nor REET-2 may be used for equipment or technology.

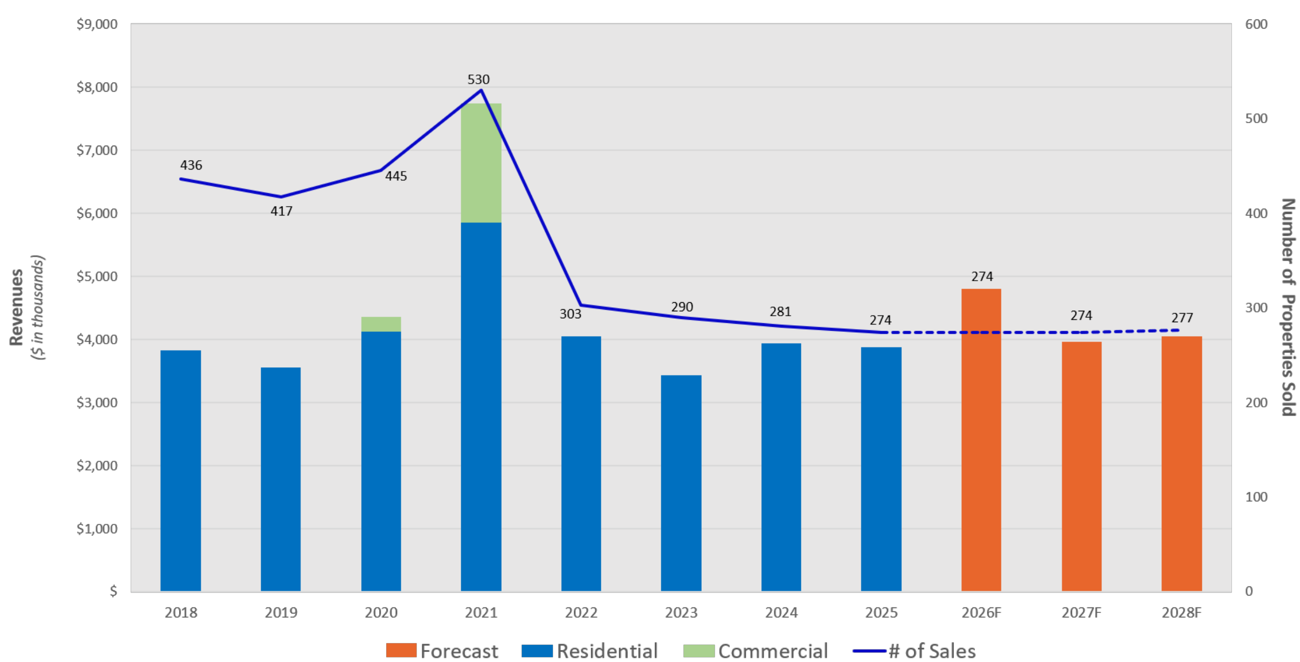
- REET-1 is the first 0.25% tax levied on the property sale price.
- REET-2 is the second 0.25% tax levied on the property sale price.

As the largest source of revenue in the Capital Improvement Fund, REET allocations are governed by local policy as follows:

- City Council budget policy commits 100% of **REET-1** revenues to Fund 320 to support parks, open space, public building maintenance projects, and debt service on the outside financing used for the 9655-building acquisition.
- **REET-2** revenues are split, with 10% allocated to Fund 320 and the remaining 90% dedicated to the Street Fund (110) for the construction and maintenance of streets, pedestrian pathways, and bicycle facilities.

Figure 8 illustrates the number of property sales each year and the resulting REET revenues from 2018 through 2025, with revenue projections in 2026 – 2028. Because REET revenue is tied to real estate transaction volumes, it is inherently volatile and fluctuates significantly from year to year. Following a 15-year revenue peak of $7.7M in 2021, REET revenues experienced a sharp downward swing, leading to a sustained, sluggish market that persisted from 2022 through the second quarter of 2026. This slowdown mirrored the Federal Reserve's aggressive increases to the federal funds rate, which simultaneously cooled inflation and raised borrowing rates.

Figure 8: Mercer Island Property Sales and Total Revenues
2018-2028



In 2025, the average property sale price on Mercer Island dropped 2% relative to the previous year. This trend continued into the first quarter of 2026. Combined with a low overall volume of property sales, indicators point to real estate market activity remaining flat.

REET revenues are projected to remain low in 2026, with minimal growth through 2028, as presented in Figure 9. This projection is informed by year-to-date 2026 average home prices, local sales data over the past 18 months, and historical seasonal sales trends.

Figure 9 – REET Revenue Forecast 2026 – 2028

Fund *($ in thousands)*	Description	Allocation	2025A	2026F	2027F	2028F
110 - Street	REET-2	90%	1,738	2,161	1,783	1,825
320 - Capital Improvement	REET-1	100%	1,943	2,401	1,981	2,028
320 - Capital Improvement	REET-2	10%	193	240	198	203
Total			**$ 3,875**	**$ 4,803**	**$ 3,962**	**$ 4,055**

** 2026 forecast includes $900,000 in revenues that resulted from two extraordinary sales in July.*

GRANTS

State Grants

Two state grants are accounted for in the six-year forecast as outlined in Figure 10.

Figure 10 – State Grants

Grant	Description	FY 2027
Washington State Capital Grant (**secured**)	Awarded in 2025, this state grant offsets costs to replace the HVAC system at the MICEC.	$1,030,000
To Be Determined	Staff are pursuing local, state, and nationally competitive grant opportunities to secure outside funding for the MICEC generator replacement construction project. Project design is funded by the Capital Improvement Fund. Staff will re-evaluate the project should no outside grant be secured.	1,768,000
Total		**$ 2,798,000**

WA Recreation & Conservation Grant

The City secured $3.5M in Washington State Recreation and Conservation (RCO) grant funding for the Luther Burbank Park Waterfront and Boiler Building projects. The City will seek reimbursement for the remaining $2,521,000 in grant funds in 2027.

At the July 7,2026 meeting, the City Council approved Resolution No. 1697, authorizing staff to submit an RCO grant application seeking $250,000 in both 2027 and 2028 for Deane's Play Area Improvement project. Of the grant programs currently accepting applications, the Washington Wildlife and Recreation Program (WWRP) for local parks is the funding opportunity for which the Deane's Play Area project qualifies.

WA St Dept of Transportation Grant

The City is pursuing $665,600 in competitive grant funding through the Washington State Department of Transportation to complete lighting improvements along Aubrey Davis Park's Mountain to Sound Trail. The project would be fully grant funded. Pending the outcome of the grant application, it is slated to be designed in 2027 and constructed in 2028.

King County Conservation District

The King Conservation District (KCD) member jurisdiction grant program provides dedicated, non-competitive funding to partner cities. The program focuses on enhancing local green infrastructure, restoring local ecosystems, and supporting sustainable urban agriculture. The City anticipates applying for and receiving $70,000 each year and that revenue is reflected in the six-year financial forecast.

KC Flood Control District

The King County Flood Control District (FCD) offers grant funding to help cities manage stormwater, prevent flooding, and protect critical municipal infrastructure. The Flood Reduction Grant Program targets small-to-medium local flood reduction and infrastructure resiliency projects. A second non-competitive grant program − the Subregional Opportunity Fund − is designed to ensure a steady, equitable return of funds to local jurisdictions for localized stormwater control.

The City will apply for and is anticipated to receive $342,000 in FCD grant funding to support the Luther Burbank Waterfront Improvement project in 2027. This funding is projected to continue annually and will be used to support eligible capital projects.

PARK IMPACT FEES

The City collects impact fees per MICC Chapter 19.18. Per state law (RCW 82.02.050 through 82.02.110), fees are levied on new development projects that create additional user demands on the park system. They are not assessed on remodeling projects or replacing an existing legal residence. In turn, the fees result in revenue that is restricted to funding proportionate "park system improvements" resulting from new development.

Park impact fee revenues can vary significantly from year to year. The financial forecast assumes $25,000 in annual park impact fee revenue. Revenues are held within a reserve and committed to a proportionate share of eligible projects annually.

SHARED REVENUES

King County Conservation District

The King Conservation District (KCD) member jurisdiction grant program provides dedicated, non-competitive funding to partner cities. The program focuses on enhancing local green infrastructure, restoring local ecosystems, and supporting sustainable urban agriculture. The City anticipates applying for and receiving $70,000 each year in 2027 and 2028 and that revenue is reflected in the financial forecast.

KC Flood Control District

The King County Flood Control District (FCD) offers grant funding to help cities manage stormwater, prevent flooding, and protect critical municipal infrastructure. The Flood Reduction Grant Program targets small-to-medium local flood reduction and infrastructure resiliency projects. The City anticipates receiving $220,000 each year in 2027 and 2028 and that revenue is reflected in the financial forecast.

A second non-competitive grant program − the Subregional Opportunity Fund − is designed to ensure a steady, equitable return of funds to local jurisdictions for localized stormwater control. In 2027, the City will apply for and is anticipated to receive $342,000 in FCD grant funding to support the Luther Burbank Waterfront Improvement project. This funding is projected to continue annually and support eligible projects through the financial forecast.

MISCELLANEOUS REVENUES

Field Use

Each year, a portion of turf field facility rental revenues are set aside for the turf field replacement sinking fund, a reserve dedicated to paying for future turf field replacements in city parks. The six-year forecast assumes the annual contribution of $200,000 will continue through 2032.

In 2030, an estimated $1.7M from the turf field replacement reserve will pay for turf field replacement as part of the Island Crest Park athletic field turf and backstop replacement project. The 2027-2028 Work Plan will include a review and update of the Turf Replacement Sinking Fund.

INTERFUND TRANSFERS

In 2027, nearly $155,000 in improvements will be completed to the City's water, sewer, and storm water utilities as part of the work underway for specific park-related capital projects.

The City's utility funds may pay for system improvements associated with a parks capital project when there is a sufficient and demonstrable nexus between the expenditure and the proprietary purpose of the utility (e.g., collecting, treating, and supplying safe drinking water). When this condition is met, the result is an interfund transfer to pay for the exact costs of the utility-related improvements.

CONTINGENCY FUND

At the end of 2025, the Contingency Fund balance was $4.9M, meeting the target per the City’s financial policies. The balance remains $4.9M, representing 12.8% of the 2026 adopted expenditure budget. The Contingency Fund’s target funding level will be revisited following the adoption of the 2027–2028 biennial budget.