



**BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND**

**AB 5777
November 17, 2020
Regular Business**

AGENDA BILL INFORMATION

TITLE:	AB 5777: Public Hearing: Resolution of Substantial Need; NORCOM and Utility Rate Resolutions; 2021 Property Tax Ordinances; and Second Public Hearing: 2021-2022 Biennial Budget.	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input checked="" type="checkbox"/> Ordinance <input checked="" type="checkbox"/> Resolution
RECOMMENDED ACTION:	Conduct public hearings; approve resources to fund the Housing Needs Assessment in 2021; pass the resolution of “substantial need,” adopt the 2021 Property Tax ordinances, and pass the 2021 Water, Sewer, Stormwater, and EMS rate resolutions; and pass the 2021 NORCOM Budget.	

DEPARTMENT:	Finance		
STAFF:	Matthew Mornick, Interim Finance Director		
COUNCIL LIAISON:	n/a	n/a	n/a
EXHIBITS:	<ol style="list-style-type: none"> 1. 2021-2022 Budget Proposal Selection Results from 11/02 2. Resolution No. 1587 (finding of substantial need to set 2021 levy limit at 101%) 3. Ordinance No. 20-22 (2021 Property Tax levy amount) 4. Ordinance No. 20-23 (2021 Property Tax levy increase) 5. Resolution No. 1588 (2021 Water Utility Rates & Service Charges) 6. Resolution No. 1589 (2021 Sewer Utility Rates & Connection Charges) 7. Resolution No. 1590 (2021 Storm Water Utility Rates) 8. Resolution No. 1591 (2021 EMS Utility Rates) 9. Resolution No. 1592 (2021 NORCOM Budget) 		
CITY COUNCIL PRIORITY:	2. Articulate, confirm, and communicate a vision for effective and efficient city services. Stabilize the organization, optimize resources, and develop a long-term plan for fiscal sustainability.		

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

SUMMARY

This agenda bill provides an overview of the 2021-2022 Preliminary Budget changes resulting from the City Council’s budget proposal decisions on November 2, 2020. This agenda item also includes approval of the 2021 Property Tax levy ordinance and resolution of “substantial need,” along with adoption of resolutions and ordinances central to finalizing the 2021-2022 biennial budget, scheduled for adoption on Tuesday, December 1, 2020.

Prior to approval, [RCW 84.55.120](#) requires the City to hold a public hearing on levy and revenue sources. The initial public hearing took place October 20, 2020, with the second public hearing taking place this evening, at which time staff seeks City Council approval of the 2021 Property Tax levy and resolution of “substantial need.”

GENERAL FUND OVERVIEW

At the November 2, 2020 City Council meeting, staff presented the estimated unassigned General Fund Balance for fiscal year 2021 and 2022, and a number of budget proposals – both one-time and ongoing – for City Council consideration. After concluding the discussion and prioritization process, the City Council approved the following:

- One-time contributions to pay down the City’s unfunded long-term liabilities tied to the Firefighter’s Pension Fund and LEOFF 1 retiree long-term care.
- Funding for 15 one-time proposals including projects, purchases, a limited-term position, and one-time resources to restart recreation services and the Thrift Shop.
- Funding for 13 proposals with ongoing costs ranging from new positions, park and Town Center maintenance, diversity training, health initiatives, and an annual operating subsidy for the Farmer’s Market.

A detailed summary of the approved budget proposals is included in Exhibit 1.

Cumulative Impact of Budget Proposals

The table below summarizes the estimated financial impacts of the budget proposal decisions.

GENERAL FUND OVERVIEW	2019A	2020E	2021B	2022B
TOTAL REVENUES	\$ 32,411,525	\$ 30,493,128	\$ 29,981,487	\$ 30,690,407
TOTAL EXPENDITURES	\$ 31,250,600	\$ 30,527,539	\$ 29,153,452	\$ 29,621,855
REVENUES OVER/(UNDER) EXPENDITURES	1,160,925	(34,411)	828,035	1,068,552
FUND BALANCE-FYE	6,958,857	6,924,446	7,752,481	8,821,033
LESS: COMMITTED/RESERVED	4,220,612	3,301,969	3,390,769	3,479,569
UNASSIGNED FUND BALANCE-FYE	\$ 2,738,245	\$ 3,622,477	\$ 4,361,712	\$ 5,341,464
NET IMPACT, ONE-TIME CHANGES			1,581,504	1,749,146
NET IMPACT, ONGOING CHANGES			461,604	1,243,095
REMAINING UNASSIGNED BALANCE	\$ 2,738,245	\$ 3,622,477	\$ 2,318,604	\$ 306,115

Budget Proposal Recommendation: Housing Needs Assessment

The City Council requested staff return with more information about the Housing Action Plan and/or a Housing Needs Assessment budget proposal. After meeting with ARCH representatives, staff maintains its alternative recommendation from November 2, 2020 for the City Council to allocate \$30,000 of one-time General Fund Balance in 2021 to support the completion of a “Housing Needs Assessment” (as opposed to a more comprehensive “Housing Action Plan”).

The Assessment will inventory the community’s existing housing stock, analyze current and future housing needs, identify gaps where the current housing market is not delivering needed housing types, and review

existing policies, programs, and regulations to identify focus areas for future work. Completing a Housing Needs Assessment is a necessary step to inform the upcoming 2024 periodic update to the Comprehensive Plan, specifically the Housing Element, and build a base for a future Housing Action Plan.

2021 PROPERTY TAX RESOLUTION & ORDINANCES

Background

RCW Chapters 84.52 and 84.55 grant cities the authority to impose a local Property Tax. Revenues from Property Taxes are considered general government revenues and are allocated to the General Fund to be used for basic governmental services such as public safety, public works, parks, and/or administration.

Property Tax is a budget-based tax, which means that the percent increase from year-to-year is applied to the amount of taxes collected in the prior year. Municipalities levying Property Tax in Washington can increase the Property Tax levy by up to 1% each year or by the amount of the implicit price deflator (IPD) – whichever is lower – plus the value of new construction. The IPD is used to measure inflation based on personal consumption.

Implicit Price Deflator Impacts in 2021

In most years, IPD is greater than 1% and the ten-year history of the IPD is summarized in the table below. For fiscal year 2021, however, the Bureau of Economic Analysis set the IPD at 0.602%, which limits the Property Tax increase to that amount unless the City Council declares there is a “substantial need.”

[RCW 84.55.0101](#) allows municipalities to levy the full 1% Property Tax increase if an ordinance or resolution is adopted declaring a “substantial need.” While “substantial need” is not defined in detail, the Municipal Research and Services Center (MRSC) notes municipalities have historically cited declining revenues and/or expenditure growth exceeding revenue growth as the basis for “substantial need.” The City of Mercer Island declared “substantial need” in 2016 and 2017 when the IPD was less than 1%.

Implicit Price Deflator		
Historical Trends 2011-2021		
Period	Fiscal Year Impact	Percent
Q2 2019 to Q2 2020	2021	0.602
Q2 2018 to Q2 2019	2020	1.396
Q2 2017 to Q2 2018	2019	2.169
Q2 2016 to Q2 2017	2018	1.533
Q2 2015 to Q2 2016	2017	0.953
June 2014 to June 2015	2016	0.251
June 2013 to June 2014	2015	1.591
June 2012 to June 2013	2014	1.314
June 2011 to June 2012	2013	1.295
June 2010 to June 2011	2012	2.755

Staff recommends the City Council take similar action as they did in 2016 and 2017 and adopt a resolution of “substantial need” (Exhibit 2) in conjunction with the 2021 Property Tax levy to assess the 1% amount plus new construction for 2021. Staff recommends the resolution of substantial need on the basis that:

- General Fund revenues are forecast to decline in 2021 by 8.4% relative to the 2020 Adopted Budget due to the impacts of the COVID-19 Pandemic (“Pandemic”).
- Expenditures are growing despite declines in revenue, with personnel costs increasing by roughly 4% in 2021 relative to 2020.

- The City anticipates using more than \$1.8 million in one-time General Fund Balance to address revenue shortfalls and to restart revenue-generating City operations impacted by the Pandemic.

Levying 1% will allow the City to collect \$55,661 more in annual Property Tax revenue than if levied at the 0.602% IPD rate. According to data collected in the American Community Survey (ACS), in 2018 there were 10,123 households on Mercer Island. The difference between the 1% levy versus the 0.602% levy is an average annual impact of \$5.50 per household.

2021 Preliminary Levy Calculation

The table below summarizes the proposed 1% levy increase from 2020 to 2021.

Levy Elements	2020 Final Levy	2021 PRELIM Levy
Regular Levy:		
Prior Year Levy	\$12,012,111	\$12,261,847
Plus 1% Optional Increase	120,121	122,618
Plus New Construction	129,615	115,000
Plus Re-levy of Prior Year Refunds	19,376	3,711
Total Regular Levy	\$12,281,223	\$12,503,176
Levy Lid Lifts:		
2008 Parks Maintenance & Operations + 1%	964,630	974,276
2012 Fire Station & Fire Rescue Truck + 1%	688,880	695,769
Total Levy Lid Lifts	1,653,510	1,670,045
Total Levy	\$13,934,733	\$14,173,221
% Change Relative to Prior Year	1.00%	1.00%

The 2021 preliminary Property Tax levy includes two ordinances as required by State law:

1. Ordinance No. 20-22, which identifies the 2021 total Property Tax levy amount (Exhibit 3); and
2. Ordinance No. 20-23, which identifies the dollar and percent increase in the 2021 Property Tax levy relative to the 2020 levy (Exhibit 4).

For the 2021 tax year, the City’s total Property Tax levy consists of the following elements:

- **Regular levy:** Funds general government operations, fire apparatus replacement, pre-LEOFF I firefighters’ pension benefits, and LEOFF I retiree long-term care costs.
- **1.0 % optional increase:** Applies to the regular levy and the levy lid lifts, which are noted above, and represents the maximum increase the City Council can adopt for the coming year, excluding new construction and the re-levy of the prior year refunds.
- **New construction:** Represents the new and improved properties included in the Property Tax rolls. A preliminary estimate of \$115,000 is assumed for new construction pending final numbers from the King County Assessor’s Office.

- **Re-levy of prior year refunds:** Represents the amount refunded to property owners who successfully appealed their property valuations by the Assessor’s Office. This amount is re-levied in the following year to make the City financially whole.
- **2008 levy lid lift:** Approved by voters in November 2008 for parks maintenance and operations (a 15-year levy ending in 2023). The 1.0 % optional increase was included in the 2021 levy amount.
- **2012 levy lid lift:** Approved by voters in November 2012 for the replacement of the South Fire Station and a fire rescue truck (a 9-year levy ending in 2021). The 1.0% optional increase, which pays for debt service on Station 92 and a contributes to the fire apparatus replacement reserves, was included in the 2021 levy amount.

Banked Capacity

Municipalities can choose to not levy the full 1% resulting from the resolution of substantial need. If the City Council chooses to levy less than the maximum amount allowed, it may "bank" capacity not levied to use in the future. To bank capacity, however, the City Council will still be required to approve the resolution of substantial need. Staff is not recommending assessing less than 1% in 2021.

Preliminary Versus Final Levy Amount

All King County cities are legally required to submit an estimate of their 2021 Property Tax levies to the Metropolitan King County Council by early December. The King County Assessor’s Office does not, however, provide each City with the final assessed valuation and new construction amounts for the new tax year until the second week of December.

As a result, cities adopt Property Tax levies for the coming year based on a preliminary assessed valuation and new construction amounts. When the finalized amounts are distributed by the Assessor’s Office in December, staff simply notify the Metropolitan King County Council of the corrected levy amount.

Alternatives to the 1% Property Tax

The City Council could choose not to adopt the resolution of substantial need. Without passage of the resolution, the maximum allowed increase for the Property Tax levy in 2021 will be limited by the IPD rate – 0.602% - rather than the full 1%, thereby reducing the total amount of the Property Tax the City will collect in 2021 by \$55,661. Furthermore, this reduction will be compounded in future years.

Alternatively, the City Council could choose not to adopt the Property Tax levy ordinance. Without passage, the City is only allowed to levy the same amount as the year prior. This will result in \$13.93 million in Property Tax revenues, \$238,488 below the maximum allowable levy. This will require reducing expenditures in the 2021 proposed budget by the equivalent amount to maintain a balanced budget.

2021 UTILITY RATE RESOLUTIONS

The City operates three separate utilities (Water, Sewer, and Storm Water), with customer charges funding all operating and maintenance costs as well as capital investments. Based on this “pay as you go” financing strategy, the City Council adopts incremental rate increases each year to ensure utility systems and infrastructure are well managed, maintained, and when appropriate, replaced.

Emergency Medical Service (EMS) utility revenues are directly tied to the average budgeted salary and benefit costs, excluding overtime, of four firefighters hired in 1996. The four firefighter positions were added to the Department to provide capacity to handle simultaneous EMS calls during high call demand. This cost constitutes the annual revenue requirement to the General Fund.

The 2020 adopted, 2021 proposed, and 2022 forecasted bi-monthly utility rates for water, sewer, storm water, and EMS services are included in the table below for a typical single-family residential customer.

The 2021 proposed rates were unanimously approved by the Utility Board on October 14, 2020.

Utility Rate Component		Bi-Monthly Charge			\$ Change		% Change	
		2020	2021	2022	2021	2022	2021	2022
		Adopted	Proposed	Forecast	Proposed	Forecast	Proposed	Forecast
City	Water	\$ 110.29	\$ 116.08	\$ 122.17	\$ 5.79	\$ 6.09	5.25%	5.25%
City	Sewer Maintenance	90.26	93.87	97.63	3.61	3.76	4.00%	4.00%
County	Sewer Treatment	90.66	94.74	99.00	4.08	4.26	4.50%	4.50%
City	Storm Water	35.77	37.74	39.81	1.97	2.07	5.50%	5.50%
City	EMS	9.56	9.73	9.90	0.17	0.17	1.78%	1.78%
Total Increase		\$ 337	\$ 352	\$ 369	\$ 16	\$ 16	4.64%	4.64%

The utility rate increase in 2021 is 4.64%, or \$15.62 every two months, which is slightly less than the 4.7% increase (\$16.11) adopted for fiscal year 2020. Resolutions 1588-1591 (Exhibits 5-8) set the water, sewer, storm water, and EMS rates respectively beginning January 1, 2021.

2021 NORCOM Budget Resolution

Resolution No. 1592 (Exhibit 9) approves Northeast King County Regional Public Safety Communication Agency’s (NORCOM) 2021 budget allocation to the City of Mercer Island. Every participating City must adopt such a resolution before NORCOM approves its 2021 Budget in December 2020. Compared to 2020, NORCOM’s 2021 budget allocation to Mercer Island decreased \$29,557, or by 4.0%, as shown in the table below.

NORCOM Budget Allocations				
Department	2020	2021	\$ Change	% Change
Police	569,569	539,114	(30,455)	-5.3%
Fire	165,022	165,920	898	0.5%
Total	\$ 734,591	\$ 705,034	\$ (29,557)	-4.0%

ADOPTION OF 2021-2022 BUDGET

All of the changes approved at this City Council meeting, along with any other Council-directed changes, will be incorporated into the 2021-2022 Final Budget ordinance, which will be brought to the City Council for final review and adoption on December 1, 2020.

RECOMMENDATIONS

1. Approve Resolution No. 1587, declaring a finding of “substantial need” and setting the 2021 Property Tax levy limit at 101%.
2. Suspend the City Council Rules of Procedure 6.3, requiring a second reading for an ordinance.
3. Adopt Ordinance No. 20-22, appropriating funds and establishing the amount of Property Taxes to be levied for fiscal year 2021.

4. Adopt Ordinance No. 20-23, establishing the dollar amount and percentage increases of the regular Property Tax levy and the levy lid lifts for fiscal year 2021.
5. Allocate \$30,000 of unassigned General Fund Balance to complete the Housing Needs Assessment as part of the 2021-2022 budget.
6. Approve the following utility rates:
 - a. Approve Resolution No. 1588, establishing classifications of water users and a schedule of charges for water usage, a schedule of rates for fire service, a schedule of special service charges, meter and service installation charges, and connection charges effective January 1, 2021 and thereafter.
 - b. Approve Resolution No. 1589, establishing rates and connection charges for sewage disposal services provided by the City of Mercer Island effective January 1, 2021 and thereafter.
 - c. Approve Resolution No. 1590, establishing the bi-monthly service charge for storm and surface water services provided by the City of Mercer Island effective January 1, 2021 and thereafter.
 - d. Approve Resolution No. 1591, establishing the bi-monthly utility fee for the emergency medical and ambulance services supplied by the City of Mercer Island effective January 1, 2021 and thereafter.
7. Approve Resolution No. 1592, approving NORCOM's 2021 budget allocation to the City of Mercer Island.