



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 5953
November 1, 2021
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 5953: Fiscal Year 2021 and 2022 Revenue Forecast	<input checked="" type="checkbox"/> Discussion Only
RECOMMENDED ACTION:	Receive the November Revenue Forecast.	<input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution

DEPARTMENT:	Finance
STAFF:	Matthew Mornick, Interim Finance Director Ben Schumacher, Financial Analyst
COUNCIL LIAISON:	n/a
EXHIBITS:	1. November Revenue Forecast.
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 REQUESTED	\$ n/a

SUMMARY

The purpose of this agenda bill is to share with the City Council the fiscal year 2021/2022 revenue forecast as part of the mid-biennial budget process, as outlined in Exhibit 1.

Known as the November revenue forecast, it is based on 1) budget actuals January through July 31, 2021, and 2) updated assumptions based on the impacts that extended COVID-19 restrictions have had on the regional and local economy.

The November revenue forecast projects revenues in the General Fund will exceed revenue estimates in fiscal year (FY) 2021 by \$2.0 M, and \$1.1 M in FY 2022. This is largely due to higher-than-expected Sales Tax performance, B&O tax revenues, Licensing, Permitting, and Zoning fees.

During the 2021-2022 mid-biennial budget process, the City Council will consider the funding needed to continue the recovery of the Recreation Division and the Thrift Shop, in addition to other strategic investments. The November revenue forecast serves as a basis for this deliberative effort.

BACKGROUND

Each Fall, staff prepares a revenue forecast that projects the City’s current year financial position and anticipates the revenues for the subsequent fiscal year in preparation for budget deliberations. Like the prior year, this year’s November revenue forecast has been developed amidst the ongoing COVID-19 pandemic (“Pandemic”). As noted in other financial updates to the City Council during this period, the situation remains fluid and in many respects without comparison, requiring the City to make assumptions based on the best local and regional data available at the time to project the trajectory of the economy and in turn, the City’s financial position.

The revenue forecast projects the City’s current year financial position as part of the 2021-2022 mid-biennial budget discussion. Referred to as the November revenue forecast, it is based on 1) budget actuals January through July 31, 2021, and 2) updated assumptions based on the impacts that extended COVID-19 restrictions have had on the regional and local economy.

GENERAL FUND

At the end of FY 2020, the General Fund had a surplus of \$2.24 M. This was largely due to the three rounds of cost saving measures implemented in the wake of the April 2020 revenue forecast, when staff projected a \$4.7 million revenue shortfall in the General Fund (15%) by the end of 2020. Better than anticipated general sales tax revenues, Business and Occupation (B&O) Tax revenues, new revenues resulting from the Ground Emergency Medical Transport (GEMT) Program, and savings from departmental budgets also resulted in the FY 2020 General Fund surplus.

The November forecast projects the General Fund revenue will end 6.4% above budget revenue estimates in FY 2021, and 3.5% above estimates in FY 2022.

General Fund	2021 Adopted Budget	2021 Year-end Forecast	2022 Adopted Budget	2022 Forecast (NOV)
Revenues	\$30.1 M	\$32.0 M	\$30.7 M	\$31.8 M
<i>Percent Change from Budget</i>		6.4% ↑		3.5% ↑

Slight differences may occur due to rounding

This increase in FY 2021 bottom-line revenues is the result of Sales Tax revenues, License, Permitting, and Zoning fees, and Business and Occupation (B&O) taxes performing above budget expectations from January through July 2021. The revenue forecast projects these higher-than-expected revenue trends for these three revenue categories to continue through the end of FY 2021, and then decline slightly in FY 2022.

The remainder of the agenda bill focuses on the details of the FY 2021 year-end and FY 2022 revenue forecasts. The following analysis addresses the underlying assumptions and anticipated impacts to revenues within the General Fund.

Property Tax

Property tax in Washington state is due April and October each calendar year. Revenues collected through July of this year align with pre-Pandemic financial assumptions. Staff anticipates revenues through the end of this year will meet budget expectations.

As Exhibit 1 demonstrates, the 2022 Adopted Budget assumed \$13.2 million in property tax revenue, representing 43% of total General Fund revenues. This is a relatively stable revenue source. Staff project property tax revenues for FY 2022 will come in at the FY 2022 adopted revenue projection.

The November forecast assumes the City will assess a property tax increase of the statutorily allowed 1% of the previously levied amount (e.g., 2021 Adopted) plus new construction each year.

Property Tax (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$12,983	\$12,970	\$13,215	\$13,215
<i>Percent Change from Budget</i>				0%

Sales Tax

The 2022 Adopted Budget assumed \$5.0 million in sales tax revenue, representing 16% of total General Fund revenues. Sales tax revenue is susceptible to economic fluctuations. Staff conservatively projected sales tax revenues in the fall of 2020, during the formation of the 2021-2022 biennial budget, given the uncertainty with how the Pandemic would impact households on Mercer Island.

Based on sales tax revenue data through July, FY 2021 revenues are projected to be 14% greater than budget estimates, due to increased activity in the retail and wholesale trade, construction, and the administrative and support services business sectors.

The November forecast assumes a 9% increase above adopted sales tax revenues for FY 2022. Long-term, the forecast assumes sales tax revenues increase 1% per year from 2023 and beyond.

General Sales Tax (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$4,792	\$5,485	\$5,031	\$5,486
<i>Percent Change from Budget</i>				9.0% ↑

Utility Taxes

The 2022 Adopted Budget assumed \$5.1 million in utility tax revenues, representing 17% of total General Fund revenues. This revenue stream is, for the most part, not subject to economic volatility. The November forecast assumes utility tax revenues will remain on track with budget estimates through the end of the biennium.

Utility Taxes (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$5,168	\$5,124	\$5,147	\$5,148
<i>Percent Change from Budget</i>				0.02% ↑

License, Permits, and Zoning Fees

The 2022 Adopted Budget assumed \$2.5 million in license, permit, and zoning revenues, representing 8% of total General Fund revenues.

Revenue tied to development services is challenging to predict given the variation between when City services are provided and when payment for these services is received. For example, the 2019 year-end revenue actuals were 20% below budget estimates for the year. The FY 2020 adopted budget was amended down to account for this trend that continued through December 2020.

In comparison, the Community Planning and Development (CPD) Department's 2021 year-end projected revenues are tracking 38% higher than budget estimates. This is due to several factors:

- A large one-time receipt of funds relating to the Xing Hua property development in Town Center came through earlier in the year.
- The permit fee schedule was updated in January of this year and a better system for employee time-tracking has resulted in more accurately charging for permit-related services.
- Staff caught up on a backlog of work and processed a higher-than-normal volume of permits, which added to this increase through the first seven months of the year.

The November forecast assumes FY 2022 revenues will increase 10% above adopted license, permit, and zoning fee revenues.

License, Permit, & Zoning Fees (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$2,368	\$3,270	\$2,485	\$2,735
<i>Percent Change from Budget</i>				10.1% ↑

Business and Occupation Taxes

The 2022 Adopted Budget assumed \$483,200 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 million 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.

Several local businesses closed and many curtailed operations due to the ongoing Pandemic. Though the business community has been significantly impacted by the Pandemic, B&O tax revenues have trended upward since 2019, predominantly due to when the City transitioned to the Washington State’s Business Licensing Service in 2019, which has resulted in better tracking of businesses eligible to pay B&O tax revenues.

The November forecast assumes FY 2022 B&O tax revenues will increase 68% above 2022 adopted budget estimates.

Business & Occupation Taxes (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$509	\$779	\$483	\$810
<i>Percent Change from Budget</i>				67.7% ↑

Parks and Recreation

The 2022 Adopted Budget assumed \$293,063 in Parks and Recreation revenues, representing 1% of total General Fund revenues. This includes revenues from community center rentals, recreation programming, and park facility rentals.

Park and Recreation revenues were significantly impacted by the Pandemic. The adopted budget served as a placeholder as staff worked on a recovery plan for the Division. As circumstances evolved, staff planned to return to the City Council with a path forward to restart and rebuild recreation services once conditions with the Pandemic were such that restarting programs and services could be done without a high likelihood they would need to once again be shut down.

The November forecast assumes FY 2022 parks and recreation revenues will increase 226% above adopted revenue estimates, with revenues returning to levels earned between 2016-2018.

Parks & Recreation (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$163	\$261	\$300	\$977
<i>Percent Change from Budget</i>				226% ↑

The details of the FY 2022 budget proposal for the Recreation Division will be presented to the City Council on November 1, 2021.

Emergency Medical Service (EMS) Revenues

The 2022 Adopted Budget assumed \$1.6 million for EMS revenues, representing 5% of total General Fund revenues.

This revenue stream includes the annual contribution from the King County EMS levy, an annual EMS utility charge adopted annually with utility rate changes; and revenues from emergency medical transport fees, also known as the Ambulance Transport Fee. The November forecast includes a minor adjustment based on the updated EMS levy allocation from King County for FY 2022.

Emergency Medical Service (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$1,576	\$1,422	\$1,599	\$1,526
<i>Percent Change from Budget</i>				-4.6%

Cost Allocation

The cost allocation revenue categories recover overhead costs from the Utility Funds through internal transfers between Funds. The 2020 Adopted Budget assumed \$806,724 for this revenue stream, representing 3% of total General Fund revenues.

Because of the technical nature of these revenues, this forecast assumes a minor adjustment through the end of the year and in 2022 based on assumptions for salaries, benefits, and facility costs. FY 2022 projections are based on recent historical trends and will be adjusted as work continues through the biennium.

Cost Allocation (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$793	\$732	\$807	\$800
<i>Percent Change from Budget</i>				-0.8%

Shared Revenues

The 2022 Adopted Budget assumed \$1.2 million in shared/intergovernmental revenues, representing 4% of total General Fund revenues. This category combines a variety of revenues and includes State shared tax revenues, grants, and the agreement with WSDOT for landscape services in Aubrey Davis Park.

After reviewing revenue actuals through July 31, 2021, the November forecast reflects a slight increase through the end of 2021, and a modest 1% increase in FY 2022 above adopted revenue estimates. This is because of a modest increase in liquor excise tax revenues, FEMA reimbursements for Pandemic-related

expenses, and a one-time contribution from the State’s City Assistance Fund to offset costs generated by law enforcement and criminal justice related legislation ratified during the 2021 legislative session.

Shared Revenues (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$1,181	\$1,406	\$1,179	\$1,191
<i>Percent Change from Budget</i>				1.1% ↑

Municipal Court Revenues

The 2022 Adopted Budget assumed \$257,400 in General Fund revenue collected from fines, forfeitures, fees, costs, and penalties associated with the enforcement of local and State law. Because Court revenues are highly dependent on caseload and the Municipal Court is not yet tracking with pre-pandemic caseloads, the November forecast assumes the Court will earn revenues slightly below FY 2021 budget estimates and assumes no change to FY 2022 adopted budget.

Municipal Court	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$263	\$243	\$257	\$257
<i>Percent Change from Budget</i>				0%

Miscellaneous Revenues

The 2022 Adopted Budget assumed \$218,700 in miscellaneous revenues in the General Fund. This category includes a variety of revenues. The November forecast assumes a 48% increase above FY 2022 adopted budget estimates resulting from payments for anticipated judgment settlements, disability reimbursements, and cell tower leases.

Miscellaneous Revenues (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$218	\$290	\$219	\$323
<i>Percent Change from Budget</i>				47.7% ↑

Interest Earnings

The 2022 Adopted Budget assumed \$24,700 in General Fund revenue from interest earned on the City’s Law Enforcement Officer and Firefighter (LEOFF) I Long-Term Care Reserve. The City pools its cash and invests it in various instruments authorized by State law. Most of the City’s cash is invested in the Washington State Local Government Investment Pool and in U.S. Treasury and Agency obligations.

The City’s LEOFF I reserve assumed 1.6% interest earnings in 2020. The average true 30-day yield for the WA State LGIP was 0.1173%, from January 1 through September 30, 2021. Given the notable reduction in realized earnings, the November forecast assumes a 29% reduction from 2022 adopted budget estimates by the end of the biennium.

Interest Earnings (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$25	\$23	\$25	\$18
<i>Percent Change from Budget</i>				-28.9%

OTHER FUND REVENUE SOURCES

The Pandemic is also impacting other City revenues outside the General Fund. The following details additional revenue streams impacted by the Pandemic and corresponding assumptions through yearend and into the next biennium.

Real Estate Excise Tax (REET)

Revenues from Real Estate Excise Tax (REET) are used to support the City’s Street and Capital Improvement Funds. This is a revenue stream that is susceptible to swings in the real estate market.

REET revenues for the first half of FY 2021 were higher than historical averages for the past four years. Revenues through the end of FY 2021 are projected to reach levels akin to FY 2017, a peak revenue year.

This forecast assumes a 7.1% increase in the average sales price of homes in 2022 which follows the three-year average observed from 2019 through September 2021. Total number of home sales is anticipated to fall by nearly 9% with inventory limitations expected in 2022.

Given the trend that the total inventory of properties for sale is decreasing, the current projection is REET revenue will realize a 10% decrease in FY 2022 as compared to FY 2021. This projection is informed by the average price of homes sold in 2021 to date, the number of homes sold over the most recent 16 months, and the estimated number of homes that will sell based on historical trends.

Overall, however, the REET forecast remains strong and anticipates a 29% increase in REET revenues above the FY 2022 adopted budget estimates.

Real Estate Excise Tax (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$3,778	\$5,570	\$3,872	\$5,007
<i>Percent Change from Budget</i>				29.3% ↑

Mercer Island Thrift Shop

The 2022 Adopted Budget assumed \$320,000 in Mercer Island Thrift Shop revenue. With the onset of the Pandemic, the Thrift Shop suspended operations in mid-March 2020.

Significant time and energy in 2021 have been dedicated to creating and implementing strategies for a rolling restart, to rebuild Thrift Shop operations and services while navigating the constraints resulting from the ongoing Pandemic.

The November forecast assumes FY 2022 Thrift Shop revenues will increase above adopted revenue estimates, with revenues returning to levels like those earned in FY 2018.

MITS (\$ in thousands)	2021 Adopted	2021 Forecast	2022 Adopted	2022 Forecast
Revenues	\$310	\$734	\$310	\$1,667
<i>Percent Change from Budget</i>				438% ↑

The details of the FY 2022 budget proposal for the Thrift Shop will be presented to the City Council on November 1, 2021.

FUND BALANCE IMPLICATIONS

The City's Contingency Fund is \$3,884,010. The City Council increased the target funding level from 10% to 12.5% of General Fund budgeted expenditures as part of the 2019-2020 budget process. The current balance of uncommitted funds in the Contingency Fund is 12% of the adopted FY 2022 expenditure budget.

RECOMMENDATION

Receive November revenue forecast.