



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 6065
April 19, 2022
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 6065: Financial Status Update: FY 2021 Year-End and Budget Amending Ordinance	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input checked="" type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Receive the FY 2021 Year-end Financial Status Update and adopt Ordinance No. 22-04, amending the 2021-2022 Biennial Budget.	

DEPARTMENT:	Finance
STAFF:	Matt Mornick, Finance Director LaJuan Tuttle, Deputy Finance Director Ben Schumacher, Financial Analyst
COUNCIL LIAISON:	n/a
EXHIBITS:	1. Financial Status Update – FY 2021 Year-End 2. Ordinance No. 22-04 2021-2022 Budget Amendments
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

EXECUTIVE SUMMARY

The purpose of this agenda bill is to provide the City Council with the fiscal year (FY) 2021 Year-End Financial Status Update, which includes year-end fund balances.

- The Fund Balance in the City's General Fund at the end of FY 2021 is \$11.6 M. Of this amount, \$7.6 M is committed because of prior City Council actions, including restricted uses and appropriations for one-time strategic investments in 2021-2022.
- The remaining available unassigned General Fund balance is \$4.0 M, due to Federal funding via the American Rescue Plan Act (ARPA) providing one-time support to City finances, better than anticipated general Sales Tax revenues, Business and Occupation (B&O) Tax revenues, Licensing, Permitting, and Zoning fees and savings from departmental budgets.

This agenda bill provides context for how the FY 2021 General Fund year-end surplus came to be. Detailed analysis across all Funds is provided in Exhibit 1, the FY 2021 Year-End Financial Status Update. Budget Amending Ordinance No. 22-04 (Exhibit 2) outlines changes the City Council has approved to the 2021-2022 biennial budget since 12/1/2021.

ISSUE/DISCUSSION

Financial Status Update: FY 2021 Year in Review

The Financial Status Update (Exhibit 1) includes revenue and expenditure actuals from January 1 through December 31, 2021. The budget reflected in the update includes budget amendments adopted by ordinance through December 2021.

In November 2021, staff presented the City Council with a third quarter Financial Status Update for FY 2021 (see [AB 5975](#)) along with a Revenue Forecast (see [AB 5953](#)) for the remainder of the FY 2021-2022 biennium. At the time, staff projected General Fund revenue would exceed FY 2021 budget estimates by year-end due to Sales Tax, License, Permitting, and Zoning fees, and Business and Occupation (B&O) taxes performing above revenue projections from January through July 2021.

General Fund Balance

The November 2021 Revenue Forecast correctly projected higher-than-expected revenue trends through the end of FY 2021. Overall, the Fund Balance in the General Fund at the end of FY 2021 amounted to \$11.7 M (table 1). Of this, \$7.6 M is reserved because of prior City Council actions. This includes nearly \$1 M in restricted uses, almost \$3.0 M in committed uses, and \$3.5 M that has been assigned by the City Council for one-time strategic investments and expenditure carryovers from FY 2021.

The remaining surplus of \$4.0 M unassigned Fund balance represents the year-end surplus in the General Fund. This surplus is due to the offsetting use of ARPA dollars, better than anticipated general Sales Tax revenues, Business and Occupation (B&O) Tax revenues, Licensing, Permitting, and Zoning fees and savings from departmental expenditure budgets.

During the 2021-2022 biennial budget process, the City Council offset the \$1.0 M anticipated shortfall in Thrift Shop revenues with available General Fund balance. This one-time contribution to the Youth & Family Services (YFS) Fund bridged YFS services during the Thrift Shop's Restart and Rebuild process in response to the ongoing the COVID-19 pandemic ("Pandemic").

This past fall during the mid-biennial budget process, the City Council authorized use of the more restricted ARPA funds in place of the less restrictive General Fund surplus dollars to bridge the YFS Fund through the end of the current biennium. The City's finances were bolstered by this immediate use of a portion of the City's ARPA funds. In general, this kind of use of ARPA funds has positioned the City to address important priorities in the time that it will take City revenues impacted by the Pandemic to recover.

GENERAL FUND - FUND BALANCE COMPONENTS (\$ in thousands)	YEAR-END 2021
RESERVED	
NON-SPENDABLE	
Petty cash	\$2
Inventory of supplies	121
RESTRICTED	
Law Enforcement and Criminal Justice restricted	82
DSG technology fee reserve	120
Customer deposits	201
Deferred development fee revenue	567
COMMITTED	
Deferred MICEC facility rental revenue	22
Compensated absences reserve	751
LEOFF I long-term care reserve	2,215
ASSIGNED	
Emerging Innovations Reserve (EIR)	0
Expenditure carryovers to 2022 budget	1,135
Budgeted fund balance-2022 budget	2,438
RESERVED SUBTOTAL	\$7,653
UNASSIGNED - AVAILABLE BALANCE	\$4,009
TOTAL FUND BALANCE	\$11,662

Table 1.

General Fund Revenues

Property tax performed as expected. General Sales Tax and Business and Occupation Tax (B&O) performed better than anticipated. At year-end, the City received nearly \$5.3 M in General Sales Tax, exceeding the November Forecast by \$600,000.

The November Forecast was based on revenue actuals from January thru July 2021, the City's overall financial position, and regional and statewide socioeconomic activity at that point in time. Sales tax revenues began the year somewhat sluggish in the construction and food services, sectors that were down from the same period in FY 2020. However, total revenues were buoyed by gains in the retail and wholesale trade and administrative and support services sectors.

With supply chain issues and federal stimulus money to households coming to an end in the final six months of the year, staff anticipated sales activity in the construction, retail, and wholesale trade sectors to slow but still end the year above FY 2020 totals. No such slowdown occurred.

The regional economy continued with strong growth and performed much better in the last six months of 2021 than expected. From July through December, the City generated \$2.7 M in General Sales Tax, \$200,000 more than the same period in 2019. All business sectors surpassed FY 2020 revenue totals except for telecommunications, which was 2% below 2020 figures.

Strong growth during the middle of the year was also apparent at year-end in business license and B&O tax revenues. Although local businesses continued to be impacted by the ongoing Pandemic, business license and B&O tax revenues grew, exceeding amended budget estimates by nearly \$260,000. Since the City transitioned to the State Department of Revenue Business Licensing Service (BLS), the number of Mercer Island business licenses has grown, which in turn is resulting in increased revenues in both business licensing and B&O taxes.

On January 1, 2021, the Community Planning & Development department applied an updated fee schedule ([AB 5781](#)) to their development and construction permitting services and a better system for employee time-tracking. The result is more accurately charging for permit-related services. Staff also caught up on a backlog of work and processed a higher-than-normal volume of permits. This coupled with an increase in the number of permits issued throughout the year has resulted in revenues exceeding budget estimates by \$500,000.

General Fund Expenditures

At the end of FY 2021, General Fund expenditures were \$2.1 M underbudget. Of this amount, over \$1.1 M is salary and benefit savings due to unfilled vacant positions and \$0.6 M from unspent contractual services budget. These savings reflect the difficulty the City has experienced with hiring both skilled professional staff and contractors to complete project work in the 2021-2022 work plan.

Other Fund Revenues

Real Estate Excise Tax (REET) is the primary revenue source for both the Steet Fund and Capital Improvement Fund. It is currently split into two revenue streams – REET-1 and REET-2 – each with restricted uses per State law.

The real estate market continues to boom on Mercer Island and throughout the Puget Sound region. Total REET revenues for 2021 were \$7.7 million, exceeding November Forecast expectations by over \$2.2 million. This revenue source is subject to fluctuations in the housing market and is historically volatile. The higher-than-expected returns can be attributed to a historically high amount of property sales, more sales of

properties greater than \$5.0 M (deemed extraordinary sales) than anticipated, and two sales of commercial properties that resulted in a \$1.8 M revenue.

These significant one-time revenues come at a notable time. The City is embarking on one of the most robust capital programs in City history. These unique resources will support the 2023-2028 Capital Improvement Program (CIP). Staff will work with the City Council to determine best use of these funds to repair and maintain the aging infrastructure on the Island during the biennial budget workshops this fall.

Uses of FY 2021 Year-End Surplus

By its nature, the \$4.0 M General Fund year-end surplus is a one-time resource. As outlined above, this is not an unanticipated windfall. The 2021 year-end surplus is the collective result of the difficult, yet strategic decisions made by City leadership over the past two years to steward the public's resources, protect public services, and preserve the City's financial position through the Pandemic.

During the biennial budget workshops this fall, the City Council will receive a Revenue Forecast for all Funds, the FY2023-2024 preliminary budget, and the opportunity to determine best uses of the General Fund surplus. Newly adopted Financial Management Policies (see Section Six of [Resolution No. 1602](#)) provide guidance on how to strategically use Fund balances. Examples include replenishing operating reserves to target levels, buffering against economic pressures such as the current pace of inflation, addressing short-term goals like electrification of the City's fleet and long-term risks such as a correction to the real estate market activity.

Staff will present the City Council with a list of budget proposals, informed by the City Council March 2022 Planning Session and input received between now and early October. Budget proposals represent a variety of projects and programs for City Council consideration to incorporate into the 2023-2024 biennial budget, with detailed cost estimates and trade-offs. Many of the budget proposals entail use of the one-time funds that may require the General Fund Balance 2021 year-end surplus.

FY 2021 Carryover Requests

Carryovers – also referred to as carry-forwards – relate to uncompleted projects, programs, contracts, or purchases that were authorized but not spent in the first year of the 2021-2022 biennial budget. Within a biennium, the funding and the expenditure authority are automatically “carried over” to the second year of the 2021-2022 budget. Funding for carryovers primarily comes from recognizing internal resources such as cash and external resources such as grants that were obligated but not spent in the first year of the two-year budget.

A list of the operating carry-forward requests is included in table 2, totaling \$1.1 M in the General Fund. An additional \$10.6 M in capital project funding across other Funds will also be available in FY 2022, for a total of \$11.8 M in carryover needs.

GENERAL FUND (\$ in thousands)	AMOUNT
Operating Carry-Forwards	
Outside Legal - Sound Transit	\$ 314
Election Costs	96
Fire MIH Levy funding	108
Software implementation costs	141
Professional services	436
Parking study transfer to Street Fund	40
TOTAL	\$ 1,135

Table 2.

RECOMMENDED ACTION

Adopt Ordinance No. 22-04, amending the 2021-2022 Biennial Budget.