

**CITY COUNCIL AGENDA ITEM**  
CITY OF SHORELINE, WASHINGTON

<b>AGENDA TITLE:</b> 2005 Budget Strategy & I-864 Options
<b>DEPARTMENT:</b> City Manager's Office
<b>PRESENTED BY:</b> Steve Burkett, City Manager

**PROBLEM/ISSUE STATEMENT:**

The City's preliminary 2005 budget forecast projects an operating budget gap of \$600,000. The City's long-term financial projections indicate that the operating budget gap will grow in future years with a gap of \$800,000 projected in 2006 and \$1.4 million in 2007. This operating gap is primarily due to the continued slow growth in sales tax revenues and the impact of previous initiatives limiting property tax revenue growth to 1% or less. In addition to the projected budget gaps, Tim Eyman has developed a new initiative (I-864) that would reduce local government property tax levies by 25% starting in 2005. This equates to an additional \$1.7 million loss of revenue for the City of Shoreline. The combination of the operating budget gap and the possible passage of I-864 would amount to a 8.5% (\$2.3 million) Operating Budget shortfall in 2005.

**DISCUSSION:**

During the April City Council retreat I made the following recommendations:

- Pursue a levy lid lift on the November 2004 general election ballot if I-864 is certified to appear on the same ballot.
- Continue to monitor expenditures and reduce dependence on the operating budget for those services that are a lower priority to our community.
- Place a bond issue for capital projects on the election ballot in 2005; and,
- Begin negotiations with Seattle City Light (SCL) to extend the franchise fee to the distribution portion of the SCL rates.

Since that time I have had additional time to evaluate our financial position and refine my recommendations for our 2005 budget strategy and the City's options related to I-864. I am now recommending that the following actions be taken to balance the 2005 budget:

- The City Council authorize a 6% utility tax on our Surface Water utility;
- Evaluate recreation fees and increase them up to 10% while at the same time providing some enhancements to the scholarship program;
- Reduce 2005 base budget targets for departments by 1%; and,
- Pursue a revenue-generating regulatory business license program.

I am also recommending that if I-864 is certified for the November General Election ballot and passes, that we authorize a levy lid lift election during the spring of 2005.

**FINANCIAL IMPACT:**

The previous recommendations would be used to close the projected 2005 operating budget gap of \$600,000. A levy lid lift could restore any lost revenue from the passage of I-864 (\$1.7 million). Additionally, we have capacity within the legal property tax levy rate of generating an additional \$2 million in property tax revenues through a voted levy lid lift.

**RECOMMENDATION**

No Council action is required for this item, but staff would like feedback from the Council on the City Manager recommendations.

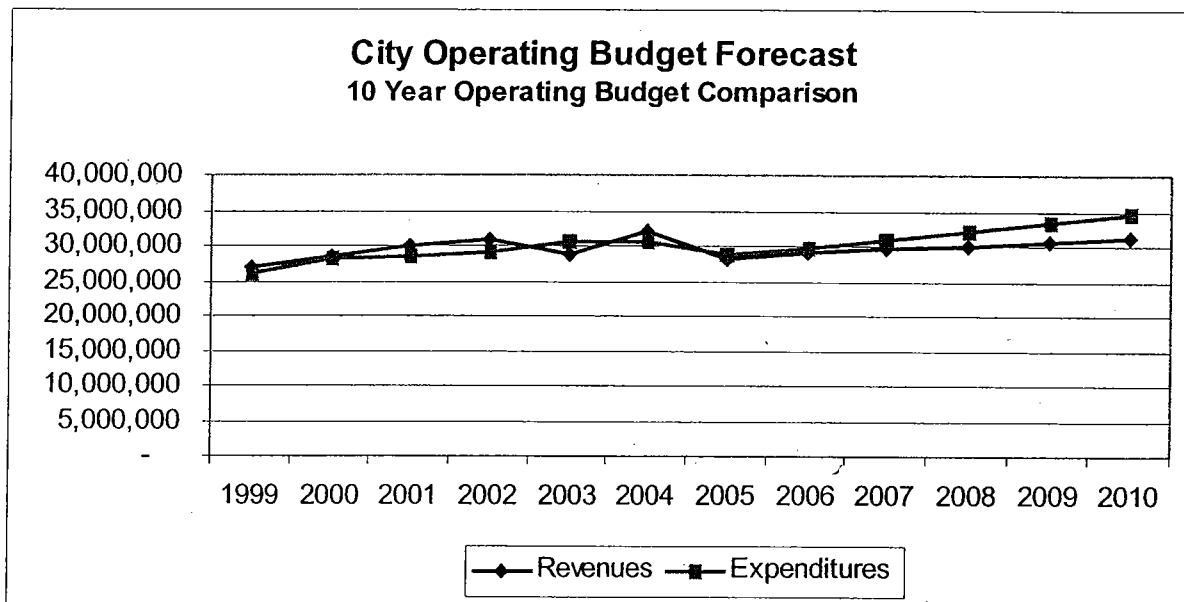
Approved By: City Manager  City Attorney N/A

## INTRODUCTION

City staff will be preparing the 2005 budget during the next several months and I will be presenting the 2005 proposed budget to the City Council on October 18, 2004. Prior to fully developing the budget I would appreciate Council's feedback on the following preliminary budget recommendations. This report also presents some options that the City can take if I-864 passes.

## BACKGROUND

During the April City Council retreat, the Finance Director provided the latest long-range financial update. Based on current assumptions, those projections anticipate a \$600,000 budget gap for the 2005 operating budget and nearly a \$800,000 gap in 2006. The budget gaps are projected to continue to grow through 2010. The following graph depicts the City's baseline operating budget projections for 2005-2010.



These budget gaps are projected to occur because the City's revenue base is growing at a slower rate than expenditures. Through increased efficiencies and continuing budget growth constraint efforts we have been able to maintain expenditure growth at or below the rate of inflation. However, two of our primary revenue sources, property and sales taxes, have grown at an even slower rate. As you are aware we are required to adopt a balanced budget, and therefore will be submitting a "balanced" 2005 proposed budget in October. The "Discussion" section of this staff report contains our current proposal for how to develop this balanced budget.

In addition to anticipating operating budget gaps, we must be prepared to address the latest Tim Eyman initiative. We will know in early July if the required number of signatures (over 192,000) are gathered for the initiative to appear on the November ballot. As we have discussed previously, I-864 would reduce local government property tax levies by 25% starting in 2005. This would reduce our operating revenues by \$1.7 million starting in 2005.

In order to address both the projected operating budget gaps and to prepare for the possible impacts of I-864 it is important that the City Council continue to discuss options. I am recommending that we concurrently pursue two courses of action. The first is to develop a plan to address the projected operating gap, while the second is to develop a contingency plan to address the impacts of I-864 in addition to the projected operating shortfall.

**DISCUSSION**

**Addressing Operating Budget Gaps**

As we discussed at the April retreat, the City will be challenged to continue providing our current level of services to the community in the future. As was explained at the retreat there are only four general options for the City to consider:

- Reduce expenditures
- Reduction in operating funds allocated for capital purposes
- Increase revenues
- Combination of expenditure reductions and revenue enhancements

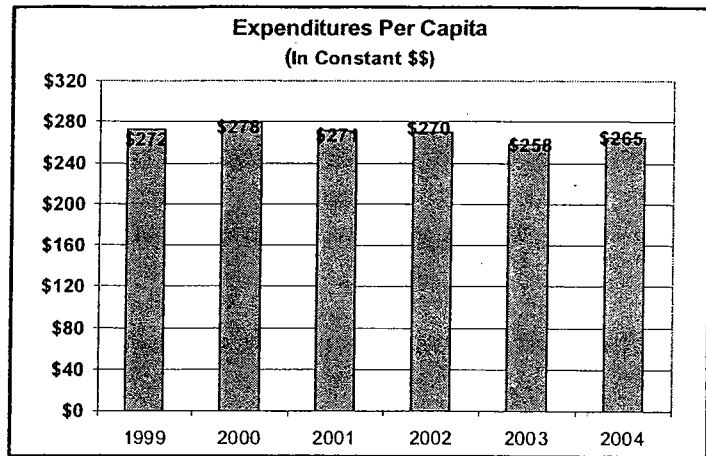
Since we know that the operating budget forecast is a long-term structural issue I am proposing a phased combination of expenditure reductions and revenue enhancements as indicated in the following table.

Action	Revenue Effective Year		
	2005	2006	2007
Reduce department base budgets by 1% and review low priority services for elimination			
Implement a utility tax on our surface water utility			
Increase recreation fees by approximately 10% and enhance the City's scholarship program			
Implement a revenue generating regulatory business license program			
Seattle City Light franchise fee (6%) on the distribution portion of the electric utility fees			
Property tax levy lid lift			

*Reduce Department Base Budgets by 1% and review low priority services for reduction or elimination (\$290,000, Effective 2005):* Each year the Finance Department establishes a base budget for departments in which their budget proposals must fit. The base budget usually includes any known contract increases, new services required as a result of the completion of capital projects, and impacts of anticipated personnel cost changes related to salary and benefit cost changes. Other than these changes departments have not been given any inflationary increases in their base budgets since 2001. This has put staff in the position of looking for ways to become more efficient in providing their services and finding alternative revenue sources to provide any enhanced services. It has also resulted in the City's operating expenditures per capita, when adjusted for inflation, being less in 2004 than they were in 1999. For 2005 the Finance Department will once again establish base budget levels for departments, but

will reduce the base budget target by 1% for departments. Departments will need to identify any service impacts this will create.

In addition to the base budget reductions we will utilize the budget prioritization results from the City Council, results from the Citizen Survey, and feedback from our public process to identify lower priority services and/or programs that can be eliminated.



*Utility tax on surface water utility (\$150,000, Effective 2005):* I am recommending that we include our surface water utility (SWM) as a utility subject to the City's utility tax. Currently we receive either a utility tax or franchise/contract fee of 6% on the following utilities: cable, water, sewer, garbage, telephone, and electricity (power portion). Collection of a utility tax on our surface water fees will impact both residential and commercial customers. Single family residential customers currently pay \$102 annually for their SWM fees. A 6% utility tax on a single-family customer will increase their annual bill by slightly more than \$6 annually. Commercial customers pay their SWM fee based on the percentage of their property that is impervious surface, and therefore their fees are determined on a per acre rate. The City's SWM program already provides exemptions for fees for low-income seniors.

*Increase recreation fees and enhance the City's scholarship program (\$55,000, Effective 2005):* The City's operating budget has continued to provide recreational programs that are supported by a combination of fees and general tax subsidy. Many programs will still be funded in this way, but I am requesting that our Parks & Recreation Department begin to look at our fees and identify programs in which we can reduce or eliminate the tax subsidy to provide the program. In order to remain competitive we will continue to monitor how our fees compare to neighboring jurisdictions. We will also continue to provide a scholarship program to assure that everyone who wants to participate will be able to, regardless of financial means.

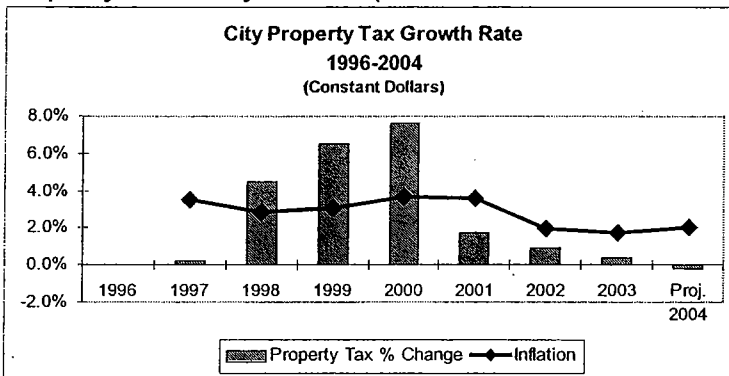
*Revenue Generating Regulatory Business License Program (Net Revenue of \$50,000, Effective 2005/2006):* The City does not currently have a business license program. We have discussed both the advantages and disadvantages of this program and I believe a program can benefit our ability to track commercial activity within the City and would provide beneficial information for our public safety providers. This is also a way to distribute impacts to both the commercial community and our residential community. Currently property tax is the City's largest source of operating revenue and approximately 86% of that revenue is generated from residential properties.

*Franchise/Contract payment on the distribution portion of the SCL electricity rates (\$0 to \$600,000, Effective 2005/2006):* Currently the City collects a franchise fee (6%) on the power portion of electricity rates billed and collected by SCL within Shoreline. The franchise contract allows the City to place a franchise fee on the distribution portion

(approximately 50% of the overall charge) with a 12 month notice provision to SCL. Placing a franchise fee on the distribution portion of the electric rates will have an impact to City rates, as SCL is allowed to recoup this cost from Shoreline's rate payers. SCL is currently in a rate review process and will be submitting a recommendation to the Seattle City Council in late 2004. Since 2001 SCL's rates have included power surcharges to cover the excessive power costs that were a result of the power crisis of 2001. These surcharges are scheduled to be removed during the later part of 2004. The removal of the surcharges should result in fee decreases, but the current rate review process may result in a recommendation that includes other costs being incorporated into future rates that may or may not result into a net rate reduction. Since our franchise agreement requires a 12 month notification period, if the Council agrees with this option, we should proceed with the notification to SCL.

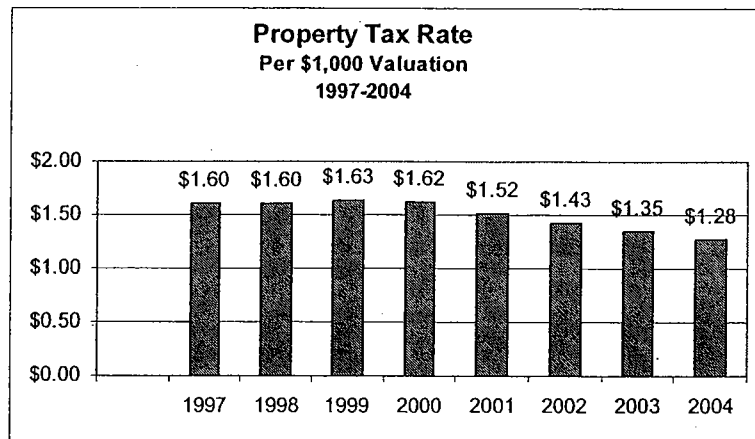
This again is an option that distributes impact to both the residential and commercial community.

**Property Tax Levy Lid Lift (\$0 to \$2 Million, Effective 2007):** Since the passage of I-747, November 2001, property tax levy increases have been limited to 1% annually plus any new construction. The net impact has been that property tax levy increases have not kept pace with inflation and the City's property tax levy rate has continued to decline.



Since the passage of I-747, November 2001, property tax levy increases have been limited to 1% annually plus any new construction. The net impact has been that property tax levy increases have not kept pace with inflation and the City's property tax levy rate has continued to decline.

If I-864 does not appear on the November 2004 ballot or does not pass, then I am recommending that the City authorize a levy lid lift vote in 2006 that would be effective for 2007 property tax revenues. The City's 2004 property tax rate is \$1.28 and this rate is projected to fall to \$1.18 by 2006. By 2007 the City will have maintained its property tax levy increases to 1% for five years, and it seems reasonable to ask Shoreline voters if they are willing to pay additional property taxes to maintain and/or increase City services. Each 10 cent increase in levy rate is projected to generate approximately \$500,000 of revenue.



**Outstanding Items:** The City's financial forecast is based on assumptions that we have adequate information to analyze at any given time. Two specific items that may have additional impact on the projections are the City's gambling tax collections and the City's lease cost for facilities. At this time we have only received two quarters of

gambling tax revenue from Hollywood Casino. Our baseline financial forecast is conservative in that it provides for increases in gambling tax from the Hollywood Casino to be partially offset by decreases in others. If we continue to see the current level of gambling tax collections from Hollywood Casino with no decrease in gambling tax collections from other casinos, we may be able to increase our revenue projections.

The long-term projections also provide for some level of inflationary increases in our facility lease costs, but both of our major lease agreements (City Hall and the Annex) are open for negotiations this year. Depending on the outcome of those negotiations we may see lease costs increase beyond the level provided for in our long-term projections.

*Summary of Operating Budget Recommendations:* By 2008 the City's operating budget gap is projected to be approximately \$2 million. The options presented in this report will allow the City to close these gaps and continue to provide critical services to our community. By determining a draft plan of action now, it will allow time to interact with the community to further understand their priorities and how those priorities will be funded.

#### **Addressing I-864**

Initiative 864 would add to the City's financial challenges if it were to pass in November 2004. This initiative would reduce the City's property tax levy by approximately \$1.7 million starting in 2005. The previous plan did not take into consideration impacts from I-864.

As we have discussed, a \$1.7 million decrease on the City's operating revenues would result in decreased services to our community. This loss of revenue could be equivalent to any of the following groupings:

- The net cost of our Recreation and Park Maintenance operations; or,
- The City's cost to provide support to human service agencies, the City's 24 hour customer response team, police storefront operations, the School Resource Officer program, teen programs, museum and arts council funding, and a 10% reduction in our park maintenance funding; or,
- 42% of our support service (City Manager, City Clerk, Finance, City Attorney, Human Resources, Communications & Intergovernmental Relations) costs; or,
- The contract cost for 14 police officers; or,
- A 17% reduction in our non-police personnel (approximately 23 of our 139 regular positions)

If I-864 does pass in November I would recommend that we follow the plan that was outlined in the previous section of this report, with the exception of moving the levy lid lift vote to the Spring of 2005. The Department of Revenue has interpreted I-864 to exempt voter approved levies, therefore a voter approved levy lid lift would exempt the City from I-864.

Many cities are debating whether to pursue a levy lid lift in 2004 or 2005 in anticipation of the passage of I-864. As mentioned previously we will not know until July whether sufficient signatures will be gathered for I-864 to appear on the November ballot, although most initiative experts are predicting that sufficient signatures will be gathered.

The two remaining election dates in 2004 are September 14 (primary election) and November 2 (general election). In order for Shoreline to place a levy lid lift on the September ballot, the City Council would need to adopt an ordinance of intent by July 30<sup>th</sup>. There is not adequate time for the City Council to fully discuss this issue and make this decision by that deadline. In order for the issue to appear on the November ballot the City Council must adopt an ordinance no later than September 17, 2004. In either case a campaign committee would need to be identified, as the City is prohibited from campaigning for such a levy.

Passage of a levy lid lift on the November ballot is the only way to exempt the City from the affects of I-864 for 2005. At the same time there are certain risks in pursuing a levy lid lift in November, including the limited amount of time for the City Council to make the decision, the limited amount of time for a campaign committee to form and campaign, the limited amount of time for the City to provide educational information to the public, the number of items that will appear on the November ballot, and probably most significantly is that the outcome of I-864 would not be known until after the November election.

For these reasons I am recommending that we wait until the spring of 2005 to place a levy lid lift on a ballot measure. The major risk in waiting until this time is that if I-864 does pass in November, the City's property tax levy will be reduced by \$1.7 million in 2005. Fortunately the City is in good financial position and has reserves that could be used to cover this gap. As the Council is aware it is recommended that the City use approximately \$10 million in cash as a down payment for a new City Hall. Given this, our General and General Reserve fund balances will be approximately \$5.5 million or approximately 21% of our operating revenue at the end of 2004. If the City were in a position to use an additional \$1.7 million in reserves to cover the loss of property tax in 2005, our general reserves would still be approximately 15% of our operating revenues. The City's financial policies require that our general reserves be equal to at least 10% of our operating revenues.

Although the use of reserves may not be ideal, this is a case in which it makes sense to use reserves on a one-time basis. The real purpose of the reserves is to help address declines in economically sensitive revenues, shifts in revenue sources that are out of the City's control, or to cover cash flow needs which alleviates the need for short-term borrowing.

The use of the reserves in 2005 would only be on a one-time basis. If our community does not approve a levy lid lift, then we must be prepared to make expenditure reductions to live within our revenue stream. This would mean that we would have a reduction in current service levels. In order to prepare for this possibility staff will be working, as part of the 2005 budget process, to identify what services would be eliminated and/or reduced if we were to lose \$1.7 million in operating revenue. This should be a realistic list of reductions that we can share with the community as the impacts of I-864 are discussed and should reflect the priorities of the City Council. I know that this process will produce some additional apprehension within our organization, but I believe it is a necessary part of our business planning.



If we postpone a levy lid lift vote until a spring election, the levy rate for the first year of the levy lid lift is established, but in the following years the levy will be subject to the 1% levy increase limit. In 2003 the legislature approved a measure in which a voter approved levy lid lift can be increased annually by some amount (i.e., CPI, any percentage amount, etc.) as stated in the ballot title for up to six years. Although this is the case, the legislation requires that this type of levy lid lift be approved on a September primary or November general election.

The following table summarizes the advantages and disadvantages of holding a levy lid lift election in 2004 or the spring of 2005.

<b>Election Dates</b>	<b>September 2004</b>	<b>November 2004</b>	<b>Spring 2005</b>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>• Passage would exempt City from I-864 in 2005</li> <li>• Levy lid lift ballot measure could include a way to annually increase the property tax levy beyond 1% for up to six years</li> </ul>	<ul style="list-style-type: none"> <li>• Passage would exempt City from I-864</li> <li>• Levy lid lift ballot measure could include a way to annually increase the property tax levy beyond 1% for up to six years</li> </ul>	<ul style="list-style-type: none"> <li>• Known outcome of I-864</li> <li>• More time for Council decision making process</li> <li>• More time for campaign process</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>• Limited time for Council decision making (July 30<sup>th</sup>)</li> <li>• Limited time for campaign development</li> <li>• May be most expensive option depending on the type of primary election held</li> <li>• Do not know outcome of I-864</li> </ul>	<ul style="list-style-type: none"> <li>• Limited time for Council decision making (Sept. 14<sup>th</sup>)</li> <li>• Limited time for campaign development</li> <li>• Do not know outcome of I-864</li> <li>• There will be numerous items on the ballot</li> </ul>	<ul style="list-style-type: none"> <li>• If I-864 passes we would lose \$1.7 million in revenue for 2005</li> <li>• Future annual levy increases would be subject to the 1% limit</li> </ul>

The recommendations discussed above do not include any recommended change in the City's current policy of allocating a portion of the City's operating revenue for capital purposes. We currently allocate approximately 5% of our General Fund revenues for capital purposes. Given the City's capital needs and our community's desire for capital improvements, such as sidewalks and parks, this is a reasonable amount of our operating revenue to allocate for such purposes. Although this is the case, it is not nearly enough to meet all of our capital needs. As the Council reviews the City's Master Plans for parks, transportation, surface water, and capital facilities a number of projects will be identified for which we do not have a funding sources to complete. As we have discussed, it will be appropriate to consider a voted bond issue as a way to finance

these projects. This is also an appropriate way to have those that are benefiting from the improvements help pay for them.

### **SUMMARY**

The City of Shoreline has done an excellent job in conservative financial planning and limiting cost increases as services have increased. The City is currently in good financial position with operating reserves nearing 30% of our annual operating revenues. Although this is the case, our long-term financial projections indicate that we will not be able to maintain current service levels as a result of the City's revenue base growing at a slower rate than expenditures. Additionally, the latest Eyman Initiative (I-864) would further erode our ability to maintain services. This report provides a recommended plan to address the long-term budget gaps and the loss of revenue the City would experience if I-864 passes in November.

### **RECOMMENDATION**

No Council action is required for this item, but staff would like feedback from the Council on the City Manager recommendations.