

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	2008 Budget and City Financial Long-Term Projection Update
DEPARTMENT:	Finance
PRESENTED BY:	Debbie Tarry, Finance Director

PROBLEM/ISSUE STATEMENT:

Staff is currently in the process of finalizing the 2008 Proposed Budget. The purpose of this discussion will be to provide the City Council with an update of the City's long-term financial projections and some of the primary policy issues that will need to be addressed during the 2008 budget deliberations. This report focuses on the City's operating budget which includes the General and City Street Funds. The Surface Water Fund is an enterprise fund supported by the surface water utility fees and therefore the budget is reflective of the needs that were considered as part of the Surface Water Master Plan. The Council recently completed a review of the capital budget through the 2008-2013 Capital Improvement Program (CIP) process. Staff is not anticipating any significant changes between the 2008 Proposed Budget and the project list adopted in the CIP for 2008.

FINANCIAL IMPACT:

As of September 7, the City's 2008 proposed operating budget has a budget gap of approximately \$150,000 and the 2009 projected operating budget gap is \$335,000. The budget gap represents expenditures in excess of revenues within the City's base operating budget. The base budget is to provide the current level of services with the exception of any new maintenance needs related to capital projects that have been completed, such as the Interurban Trail and the 145th to 165th Aurora Avenue improvements. The base budget does not include any new personnel positions, programs or services. The current budget gap is still preliminary and subject to change as more revenue and expenditure information is gathered during the finalization of the proposed 2008 budget. Staff anticipates that the 2008 budget will be balanced within currently available resources. The base budget will need to be balanced before the City Manager determines if any service level changes or program changes should be included in his recommended budget. The City Manager will present his recommended balanced 2008 budget to the City Council on October 15, 2007.

The Council last reviewed the City's long-term financial projections during the January City Council Retreat and again in March 2007. At that time staff was projecting that the 2008 and 2009 operating budget would be balanced assuming that the City absorbed a approximately \$78,000 in base budget reductions, \$47,000 in increased on-going revenues from recreation and permitting programs, an increase in the cable utility tax rate from 1% to 6%, and the implementation of a 3% contract payment on the City's electric distribution revenues effective April 1, 2008. Budget gaps were projected for

2010 and beyond. Since that time we have been able to update some of our projections based on additional information. This includes gambling tax trends, sales tax trends, utility rate changes, health insurance premium increases, Public Employee Retirement System (PERS) employer contribution rate increases, increased election costs and trends of bookings and usage of jail beds that affect the City's jail costs. These changes have resulted in a preliminary forecast of the operating budget having a \$155,000 budget gap for 2008. As stated earlier, although there is currently a budget gap, the City Manager will present a balanced budget in October.

Although the City Council will be focused on review of the 2008 budget later this year, it is important that we continue to monitor our long-term financial position and consider policy decision impacts on the City's long-term financial health. The purpose of the long-term projections is to provide information so that staff and the City Council can make resource allocation decisions that provide sustainable public services to the Shoreline community. Staff will be providing the Council an update of the long-term financial forecast during the Council meeting of September 17, 2007.

RECOMMENDATION

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2008 budget information.

Approved By: City Manager  City Attorney ____

INTRODUCTION

Staff is preparing the 2008 Proposed Budget and updating financial indicators and projections as part of the process. This workshop will provide an opportunity for staff to share with the City Council the latest financial projections, along with a discussion on some of the major policy issues that will need to be discussed during the 2008 budget workshop reviews. The Council 2008 budget schedule is as follows:

Preliminary 2008 Budget Update	September 17
Transmittal of Proposed 2008 Budget	October 15
Department Budget Review	October 22
Public Hearing & Department Reviews	November 5
Public Hearing on Revenue Sources & 2008 Property Tax Levy	November 19
Adoption of 2008 Property Tax Levy	November 26
Adoption of 2008 Budget	November 26

BACKGROUND

During the January 2007 City Council retreat and the March 2007 update, staff provided Council with an update of the City's long-term financial projections. At that time, staff projected a 2008 operating budget gap in excess of \$760,000 and a projected gap for 2009 of \$1.1 million. In March 2007 The City Council addressed anticipated budget gaps for 2008 and 2009 by authorizing the following:

- Base budget changes of \$125,000. This included reducing base budget expenditures by \$78,000 and anticipated revenue increases of \$47,000 through either activity or fee adjustments.
- Increase in the cable utility tax from 1% to 6%. This is projected to generate approximately \$500,000 in annual revenue.
- Phased implementation of a contract payment from Seattle City Light on the electric distribution revenues. The first phase will be a 3% contract payment starting April 1, 2008, and the second phase will be adding an additional 3% for a total 6% contract payment starting January 1, 2009. The full 6% contract payment is projected to generate approximately \$550,000 in annual revenue.

These changes have been incorporated into the most recent long-term projections.

Since March staff has continued to evaluate revenue and expenditure trends and updated the City's long-term financial model. Also departments have submitted their 2008 budget requests and 2008 revenue estimates. Some of the major changes that have occurred since the April projections include:

- **Gambling Tax:** Punch-card and pull-tab related gambling tax revenue has continued to decline. As a result revenue from this source has been decreased by an additional \$30,000 for 2008. Card room gambling tax has not changed since the

March update. Staff will continue to evaluate card room gambling tax throughout 2007 to determine if adjustments should be made.

- **Utility Tax Adjustments:** Recently Puget Sound Energy (PSE) requested a rate decrease in natural gas rates, as a result of lower gas costs, to be effective October 1, 2007. Although approval of this rate will not occur until later in September, it is likely that this decrease will be approved since it is basically a "pass-through" rate decrease, in other words it is only a result of lower energy costs to PSE. The rate decrease is projected to lower residential billings by an average of 13%. Staff is continuing to evaluate the impact of the rate decrease on City revenues. For purposes of completing the long-range financial forecast natural gas utility tax revenues were reduced by approximately \$156,000 annually.

Utility taxes from telephone (land lines and wireless) continues to grow. Staff has revised the 2007 projected revenue collections to \$1.7 million, and as a result has increased the projected 2008 revenues by another \$132,000 to approximately \$1.8 million.

- **Public Employee Retirement System (PERS) Contribution Rates:** As was projected in the March forecast, PERS employee and employer contribution rates will continue to increase through 2011. The following table shows the most recent projected rate changes:

PERS Employer Contribution	Effective 7-1-07	Effective 7-1-08	Effective 7-1-09	Effective 7-1-10	Effective 7-1-11	Effective 7-1-12
January 2007 Projected Rate	6.01%	8.20%	8.69%	8.70%	8.70%	8.70%
September 2007 Projected Rate	6.13%	8.31%	9.10%	9.10%	9.12%	9.12%

As a result of these legislative changes, the City's PERS contribution will increase by approximately 30.3% from 2007 to 2008. The 2007 operating budget PERS contribution totaled \$430,042 and the 2008 budget is projected at \$562,406, a \$132,364 increase. The rate increases are a result of the declining investment rate returns since 2002 and the growing long-term retirement obligation. Prior to 2005, rates had been as low as 1.8%.

- **Health Benefits:** Preliminary information from AWC shows that they anticipate medical premium rates to increase between 6% and 8% for 2008, while dental and vision increase will be less. As a result, we have estimated that the City's contribution towards health benefits will increase by approximately 4.8% in 2008. In the operating budget this equates to approximately a \$65,000 increase. The AWC Board will review health premium recommendations at the end of September and finalize the rates.
- **Market Rate Adjustment:** The preliminary 2008 budget anticipates a salary market rate adjustment of 3.15%. This is based on 90% of the June Seattle-Tacoma CPI-W. This CPI figure was 3.5%. Historically the City has based its market adjustment on the median market adjustment awarded by the City's comparable jurisdictions, as

outlined in the City's compensation policy. This median has been very close to 90% of the Seattle-Tacoma CPI-W.

- **Salary Survey:** The City's compensation policy includes a routine salary survey of classifications every three years to ensure that the City's salaries are at the median of the City's comparable cities. During 2007 staff is completing a salary survey on classifications 44 through 54, along with a few other positions that are linked to positions within these classifications. Any changes recommended as a result of this review will be included in the proposed 2008 budget.
- **Lease Costs:** The 2008 budget allocates \$300,000 in lease savings, since the City now owns the Annex, towards the funds for the City Hall/Civic Center project. The 2007 budget included \$288,000 for this purpose.

The 2008 proposed budget includes approximately \$50,000 in direct costs and an off-setting \$50,000 in revenue from the Kimm Property and remaining tenants in the Annex.

- **Jail Activity:** 2008 jail activity is projected to be roughly the same as in 2007. The following chart summarizes the actual jail activity for 2003 through 2005, along with the projections for 2006 and 2007.

Jail Overview								
Facility	2005		2006		2007 Projection		2008 Estimate	
	Jail Usage	Cost	Jail Usage	Cost	Jail Usage	Cost	Jail Usage	Cost
King County Bookings	673	\$ 118,583	790	\$ 134,270	708	\$ 139,639	708	\$ 148,014
King County Jail Days	3,909	\$ 360,723	4,543	\$ 430,543	4,436	\$ 457,662	4,436	\$ 485,121
Yakima Jail Days + Medical	7,262	\$ 468,276	8,487	\$ 576,222	7,874	\$ 562,834	7,874	\$ 590,944
Issaquah/Renton	387	\$ 25,948	1,233	\$ 81,391	1,233	\$ 84,152	1,233	\$ 88,357
Total	12,231	\$ 973,530	15,053	\$ 1,222,426	14,251	\$ 1,244,287	14,251	\$ 1,312,436

As the City Council is aware, jail usage had a significant increase beginning in August 2005. The City continues to maximize its contract with Yakima County and is working with the Jail Advisory Group to monitor the activities at the Yakima jail. Staff continues to evaluate the ability to process prisoners through the Issaquah/Renton jails in order to meet the savings goal used to justify the additional Street Crime Officer added in 2007.

- **Human Service Funding:** Currently the 2008 budget includes the second year of allocation of the 2007-2008 Human Services Funding Plan approved by the City Council in October 2006 and amended in July 2007. The amendment approved in July 2007 included the \$18,000 annual funding for the Senior Center for 2007 and 2008. The 2008 budget also includes \$25,000 in funding for utility assistance as authorized by Council during the approval of the Seattle City Light contract payment on electric distribution revenues.
- **Election Costs:** The 2008 projected budget includes a significant increase in projected election costs as a result of increased King County costs related to improvements that have been made to their election processes. The 2008 projected costs have increased by nearly \$80,000 since the March forecast was completed.

- **Street Lights:** The 2008 projected budget includes approximately \$275,000 for street light charges. This is a \$91,000 increase from the 2007 budget. The City has been working with Seattle City Light to identify street lights that the City has assumed responsibility for payment. Although SCL has not fully completed the inventory conversion, staff believes that this estimate is representative of the anticipated cost.
- **YMCA Contribution:** The 2008 projected budget includes \$40,000 as per the Council's decision in 2007 to contract with the YMCA for \$80,000 for future services.

DISCUSSION

Some of the primary factors affecting the 2008 proposed budget and the 2008-2013 long-range forecasts include:

GENERAL FUND

Revenues

General Fund operating revenues, excluding interfund operating transfers and the use of fund balance for one-time expenditures, are projected to increase by approximately 6% from the 2007 current budget to 2008. This is approximately a \$1.7 million increase.

A description of the most significant revenue trends for 2008 are discussed below.

Property Tax Revenues: Property tax revenues are projected to grow by 2% in 2008. Approximately 1% of this growth is a result of projected new construction within the City, which results in increased valuation. A 1% increase in levy accounts for the remaining increase in property tax for 2008. The 2% increase in property tax revenue equates to approximately \$170,000. The projected 2008 property tax levy rate is \$1.07, down approximately 3% from the 2007 levy rate of \$1.10.

Sales Tax Revenues: The current projection for 2007 is for sales tax to grow by 2.6% over the 2006 levels, or \$158,000, for a total of \$6.25 million. At the current time we are projecting a 4.7% increase from 2007 to 2008 for total sales tax collections of \$6.5 million. Staff is continuing to monitor sales tax collections in 2007 before finalizing the 2008 projections.

The City also receives criminal justice sales tax, which is collected county-wide and then distributed on a per capita basis. County-wide sales tax revenues in 2006 increased by 9% compared to 2005 collections. This was a positive change, as sales tax on a county-wide basis had shown modest growth in the previous year. County-wide sales tax is projected to continue in the growth mode, but at a slower pace. For this reason 2008 collections are projected to increase, 5.6%, to \$1.293 million in 2008, when compared to the 2007 budget. The June issue of the Economic Forecaster projected that retail sales in the Puget Sound would increase by 6.3% in 2008.

Utility Contract Payments, Utility Taxes & Franchise Fees: Overall utility tax, franchise fees, and interlocal utility contract agreement revenues are projected to increase by 14%, \$831,000, when compared to the 2007 budget. Some of the primary reasons for this increase include:

- The largest component of the increase is related to the full year collection of the increased cable utility tax and the initial assessment of a 3% contract payment on electric distribution revenues effective April 1, 2008. The increase in cable utility tax and SCL increased payment represent \$720,000 of the \$831,000 overall increase.

State Shared Revenues: Liquor Board Profits and Liquor Excise taxes are two sources of revenue collected by the State of Washington and then distributed to cities on a per capita basis. It appears that these revenue sources will increase slightly (\$10,000) from 2007 to 2008.

Recreation Revenues: Participation in the City's recreation programs has continued to increase in 2008. Revenues in our recreation programs are expected to be 5.5% or \$67,000 higher than budgeted in 2007. This is primarily related to anticipated revenue increases related to field rentals as a result of the turf improvements made at fields A & B and at Twin Ponds. Any revenues received in excess of the rental revenue base that existed prior to the field improvements will be allocated to the General Capital Projects Fund to help restore some of the City's contribution towards these improvements.

Development Revenues: It is anticipated that activity levels will remain fairly constant between the 2007 and 2008. The 2008 budget will reflect increases in revenues that are also off-set with expenditure level increases related to contract services for plan review during high-activity periods. If the contract services are not needed then the revenue will not be collected.

Investment Interest: Investment interest rates have been on the incline since 2005. Currently the City is able to get a rate of return close to 5% new two year investments. In 2002-2003 the rate had fallen to close to 1%. As a result we are projecting that investment interest revenue will increase by 13% to \$450,000 in 2008. If interest rate trends change, staff will need to reevaluate the projected investment interest.

Expenditures

Overall expenditures, excluding one-time interfund operating transfers that were budgeted in 2007 and carry-overs, are projected to increase by approximately 6% in 2008 as compared to the adopted 2007 budget.

A discussion of the most significant expenditure trends follows.

Personnel: Personnel expenditures represent approximately 34% of the City's operating budget. Excluding any new personnel positions, personnel costs are projected to increase by approximately 5%, \$529,000. This is primarily based on anticipated step increases for employees who are not at the top of their salary range, an anticipated market rate adjustment of up to 3.15%, a projected 5% increase in the City's health benefit costs, and a 30% increase in the employer PERS contribution. The City's long-term financial forecast projects personnel costs to increase by approximately 5% annually, as future PERS rate increases are not going to be as large as those that occurred in 2006 and 2007 and economists project that inflation will remain under control and be closer to 3% for the next few years.

Overall salaries for regular and extra-help employees are expected to increase by \$311,000, or approximately 4.6%. The remaining \$218,000 (\$529,000 less \$311,000) in increased personnel costs are primarily related to the benefit changes. The largest increases are in the PERS contribution (\$132,000), social security replacement (\$20,000) and health benefits (\$65,000).

Police Contract: The police contract with King County is projected to increase by approximately \$545,000, 6.5%, in 2008, as compared to the 2007 adopted budget. This is primarily a result of anticipated labor cost increases, some shift in activity level allocated to the City for support services, and the addition of a Street Crime Officer in late 2007. This is a preliminary estimate in cost increase as it is based on historical trends. At this time King County has not provided cost increase estimates. The actual increase will not be determined until after the King County budget is adopted and the annual reconciliation is completed next spring.

Jail: We are currently anticipating that the 2008 budget to be \$1.3 million.

New Maintenance Costs: As capital projects are completed the City must absorb any related on-going maintenance costs. In 2007 this includes the maintenance costs related to the improvements on 15th Avenues and the improvements completed as part of the 145th and 165th Aurora project. The City anticipates these costs in its long-term financial projections. The preliminary cost estimate for the maintenance related to these projects is still being evaluated.

Capital Funding: The City will allocate approximately \$830,000 of general fund revenues in 2008 to the capital project funds. This funding is primarily for long-term facility repair/replacement and road surface management. This allocation is included in the City's long-term projections and the preliminary 2008 budget.

Outstanding Items

- *Natural Gas Utility Tax:* Staff is reviewing this revenue stream. The City has been notified that Puget Sound Energy (PSE) will be requesting a reduction in natural gas rates as a result of the cost of natural gas declining. PSE has projected that this rate reduction may result on an average 13% reduction for residential customers. Staff is analyzing how this rate reduction will impact the City's utility tax collections for 2008.
- *Telephone Utility Tax:* Staff is continuing to review 2007 receipts from this revenue stream to determine if 2008 revenue estimates should be modified.
- *Street Lights:* Staff is still working with Seattle City Light to fully identify all the street lights that the City is assuming. Staff has included the anticipated full cost of street lights, \$280,000, even though SCL has indicated that they are unsure when they will actually begin billing the City for all street lights. The City anticipates that we would be liable to pay the cost retroactively, even though the billing may not occur in 2008, and therefore has budgeted as if billings will occur in 2008.

Future Needs

Evaluating future financing options will be key in determining any future service enhancements the City may consider. Given our long-term financial projections the 2008 budget instructions to departments were that any service enhancement requests had to be funded by new on-going revenues, reductions in existing programs that are a lower priority or reductions that can be made as a result of efficiencies. Although this was the case, some needs were identified that would require either new one-time or on-going resources. Some of the departmental requests that have been identified include:

- *Community Services Administrative Support (.50 FTE)*: This position would provide administrative support to the new Community Services division. This division includes Emergency Management, Human Services, CRT, and Neighborhoods.
- *Financial Software Upgrade*: The vendor which provides the City's financial software (IFAS) is doing a major upgrade in the software's base operating system. The current software version will only be maintained through 2009. As a result the City must update software versions. The estimated cost for this is \$101,000.
- *Digital Aerial Photography and Mapping*: The City's current aerial photos used for mapping and the City's GIS systems were taken in 2004. Significant topographical and development changes have occurred since that time and as such updated aerial photography should be completed.
- *Kruckeberg Garden Operational Funding*: The City is currently negotiating with Art Kruckeberg and the Kruckeberg Botanic Garden Foundation to purchase the property and contract for maintenance services. It is anticipated that the City may need to provide some matching funds for the next three years to the Foundation to fully fund the maintenance costs.
- *Parks Maintenance Storage Building*: A new storage building is required for the storage of parks maintenance equipment and supplies.
- *Spartan Gym Exercise Equipment*: The exercise equipment at Spartan Gym needs to be replaced to maintain safety and provide adequate exercise equipment to facility users.
- *Southwest Shoreline Sub-Area Plan*: The plan would undertake a thorough land use, transportation, and environmental analysis of southeast Shoreline, which includes the southern portion of two neighborhoods – Briarcrest and Paramount.

As the City Manager finalizes his recommended 2007 budget it will be determined which, if any, of the requests should be included in the proposed 2007 budget.

2008 AND BEYOND

Staff will be finalizing the proposed 2008 budget during the next month and the City Manager will present a balanced budget to the Council in October. In making budget recommendations we continue to monitor our long-term forecasts.

Staff anticipates that we will balance the 2008 budget and 2009 projected expenditures within current resources. Our long-term forecast for 2010 through 2013 show increasing budget gaps in the out-years unless there are changes in expense or revenue levels. In order to continue to provide current services to the community in the future it will be necessary to continue to monitor our revenue and expenditure trends along with receiving feedback from the community on service priorities.

Staff will be bringing a proposal to Council in October 2007 on a process to involve the community in a review of the City's long-term financial plan in developing a recommended long-term plan to address future budget gaps.

Staff will continue to monitor the long-term projections as the 2008 budget is finalized. Staff anticipates providing additional updates on the long-term projections during the September 17, 2007, Council presentation.

SUMMARY

As Council has continued to monitor future financial projections, it has followed conservative financial planning. This has allowed the City to carefully plan service enhancements, and maintain a stable financial position through good and bad economic cycles. The purpose of the long-term projections is to provide information so that staff and the City Council can make resource allocation decisions that provide sustainable public services to the Shoreline community. As the Council continues to plan for 2008 and beyond, it will be a necessary to monitor financial trends and follow a plan that will allow for the long-term provision of public services.

RECOMMENDATION

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2008 budget information.