

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

<b>AGENDA TITLE:</b> 2010 Budget Update
<b>DEPARTMENT:</b> Finance
<b>PRESENTED BY:</b> Debbie Tarry, Finance Director

**PROBLEM/ISSUE STATEMENT:**

Staff is currently in the process of finalizing the 2010 Proposed Budget. The purpose of this discussion will be to provide the City Council with a preliminary briefing on the status of the 2010 budget, an update on any changes to the City's long-term financial projections and some of the primary policy issues that will need to be addressed during the 2010 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 and during the 2010-2015 capital project review. The Council recently completed a review of the capital budget through the 2010-2015 Capital Improvement Program (CIP) process. Staff is not anticipating any significant changes between the 2010 Proposed Budget and the project list adopted in the CIP for 2010.

**FINANCIAL IMPACT:**

As of September 10, the City's 2010 preliminary operating budget has been balanced. The 2010 operating 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 park improvements and the new City Hall. The budget does not include any new personnel positions, programs or services. In fact the 2010 preliminary budget reflects a reduction in personnel positions as we leaving the CRT Supervisor and an Administrative Assistant position in Planning and Development Services vacant and have shifted a Technical Assistant position out of the operating budget into the capital budget to provide support for capital projects.

The preliminary 2010 operating budget does include the use of \$980,000 of funds from the City's Revenue Stabilization Fund as a result of the current economic recession. The City Manager does not anticipate any increases in service levels for 2010 given the current down-turn in revenue streams as a result of the recession. The City Manager will present his recommended balanced 2010 budget to the City Council on October 12, 2009.

The Council last reviewed the City's long-term financial projections during the May City Council Retreat. At that time staff was projecting \$1.8 million 2010 operating budget gap before any adjustments. As discussed at the Council Retreat staff recommended the following adjustments to start closing the gap:

- ◆ Use of Revenue Stabilization Fund = \$880,000
- ◆ Targeted Department Budget Reductions = \$200,000
- ◆ Shift of Personnel to perform Capital Project Functions = \$176,000
- ◆ Proceeds from the \$20 Vehicle License Fee (TBD) = \$450,000

The net 2010 budget gap would be approximately \$120,000 if these adjustments were made. Since that time additional adjustments have been made to the 2010 projected revenues and expenditures as a result of changes in the economy or as a result of having better information, resulting in a current budget gap of \$210,000. In order to close the final gap staff will be recommending that Council authorize the use of \$980,000 of the Revenue Stabilization Fund, an additional \$100,000 from what was discussed in May, and will be reducing the amount of monies allocated for equipment in replacement in 2010. Basically vehicles and major equipment will have their useful lives extended by one year.

Some of the primary changes that have occurred in the 2010 forecast since May include a reduction in anticipated gambling tax revenues as a result of a continuation in the decline of card room activity, further reductions in projected development revenues, and a reduction in projected jail expenditures for 2010 as a result of the success the home detention alternative jail sentencing program. Even though the preliminary 2010 budget still has budget gap, the City Manager will present a balanced budget in October.

Although the City Council will be focused on review of the 2010 operating 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 21, 2009.

### **RECOMMENDATION**

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2010 budget information.

Approved By:        City Manager \_\_\_\_\_ City Attorney \_\_\_\_\_

## **INTRODUCTION**

Staff is preparing the 2010 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 2010 budget workshop reviews. The Council 2010 budget schedule is as follows:

Preliminary 2010 Budget Update	September 21
Transmittal of Proposed 2010 Budget	October 12
Department Budget Reviews	October 19
Public Hearing & Department Reviews	October 26
Public Hearing on Revenue Sources & 2010 Property Tax Levy	November 2
Final 2010 Budget Discussion	November 16
Adoption of 2010 Property Tax Levy	November 23
Adoption of 2010 Budget	November 23

## **BACKGROUND**

As Council is aware, staff has projected operating budget gaps for the years of 2010 and beyond. For this reason the City Council appointed a Citizen Advisory Committee to develop recommendations on how to continue fund City services over the long-term. In May 2009 the Committee presented their recommendations to the City Council which included the creation of a Transportation Benefit District (TBD) and implementation of a \$20 vehicle license fee and proposing a property tax levy increase to voters in 2010.

In July 2009 the City Council created the Shoreline TBD and adopted the \$20 vehicle license fee. This fee will be implemented in February 2010 and the proceeds will be used to help fund the City's pavement management program. The City had been using General Fund and fuel tax monies for this purpose. It is anticipated that the annual vehicle license fee collections will be approximately \$600,000. Since collections will not start until February 2010, staff has estimated the 2010 collections will total approximately \$550,000.

Even with the implementation of this revenue source, the operating budget forecast shows anticipated budget gaps for the long-term. Prior to the recession this was the case primarily because of the annual growth in property taxes limited to 1% while inflation and cost increases have been above this level for the past several years. The recession has exacerbated this with substantial drops in sales tax and development revenues. Other revenue changes that are beyond the City's control are the drastic drop in investment interest rates resulting in lower investment interest revenue and the projected 17.1% drop in natural gas rates scheduled for October 1, 2009, resulting in a corresponding drop in natural gas utility taxes of \$183,000.

The long-term forecast, that was completed in May and updated after the adoption of the \$20 vehicle license fee, showed the following projected operating budget gaps:

	2010	2011	2012	2013	2014	2015
Annual (Budget Gap)/Surplus	(1,307,884)	(1,929,039)	(1,814,305)	(1,999,982)	(3,200,011)	(4,154,080)

As discussed at the May Council Retreat staff recommended the following adjustments to start closing the gap:

- ◆ Use of Revenue Stabilization Fund = \$880,000
- ◆ Targeted Department Budget Reductions = \$200,000
- ◆ Shift of Personnel to perform Capital Project Functions = \$176,000

The net 2010 budget gap, at that time, would be approximately \$120,000 if these adjustments were made. Since that time additional adjustments have been made to the 2010 projected revenues and expenditures as a result of changes in the economy or as a result of having better information, resulting in a current budget gap of \$210,000. In order to close the final gap staff will be recommending that Council authorize the use of \$980,000 of the Revenue Stabilization Fund, an additional \$100,000 from what was discussed in May, and will be reducing the amount of monies allocated for equipment in replacement in 2010. Basically vehicles and major equipment will have their useful lives extended by one year.

Since May, staff has continued to evaluate revenue and expenditure trends and updated the City's long-term financial model. Also departments have submitted their 2010 budget requests and 2010 revenue estimates. Some of the major changes that have occurred since the May projections include:

- **Gambling Tax:** Card room, 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 \$200,000 since the long-term projection was completed in May. This represents a 15% decline from the 2009 budget. The City has received two quarters of gambling activity for 2009. Through the second quarter card room gross receipts are down 9.5% in 2009 as compared to 2008. The actual second quarter activity was down 12.3% while the first quarter activity was down 6.7%. Since the second quarter activity continued to lag, staff reduced the 2010 projected activity levels. One casino has only paid approximately 50% of the taxes due in 2009 while the remaining casinos are current on their taxes with one casino still owing some previous penalties. Staff will continue to evaluate card room gambling tax throughout 2009 to determine if any additional adjustments should be made.
- **Utility Tax/Franchise Fee Adjustments:** Recently Puget Sound Energy (PSE) requested a 17.1% rate decrease in natural gas rates, as a result of lower gas costs, to be effective October 1, 2009. 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 to basically

2005 levels. Staff is continuing to evaluate the impact of the rate decrease on City revenues. PSE is also requesting a 2.5% rate increase effective April 1, 2010.

The 2009 natural gas receipts are projected to be slightly higher than originally anticipated as a result of the cold winter experienced earlier this year. Staff does not anticipate the same level of collections for the winter of 2009-2010. The net result of the projected rate changes and a milder winter is a \$183,000 reduction in projected natural gas utility tax revenue in 2010 as compared to 2009, or a 17.7% revenue reduction. The reduction in natural gas rates did lower the City's projected natural gas costs for 2010 by approximately \$20,000.

Comcast cable has announced rate increases of approximately 3% to take effect later in 2009 and the City's contract with Ronald Wastewater provides for a 3% increase in their utility contract payment for 2010. Utility taxes and franchise fees from other sources appear fairly stable and therefore no substantial changes are projected for 2010.

- **Fuel Taxes:** The City receives fuel tax on a per capita basis to be used for funding costs related to city streets. Prior to 2005, State law required that 31.9% of these funds be used for capital purposes. In 2005 the State Legislature recognized that 100% of the fuel taxes was not adequate to fund on-going costs related to city streets, and eliminated the requirement that a portion be allocated to capital. Although this was the case, the City continued to allocate 31.9% of the fuel taxes to capital and increase its allocation of general fund monies for on-going maintenance costs of city streets for the past several years.

In 2007 the State Legislature amended the financing options for transportation benefit districts. The legislation provided for the creation of Transportation Benefit District (TBD) which could levy certain revenues to help fund transportation needs of cities. In July 2009 the City Council formed the Shoreline TBD and implemented a \$20 vehicle license fee which will be used to help fund the City's pavement management program. As a result the City will allocate the TBD proceeds towards the pavement management program and will program a 100% of the fuel taxes for on-going costs related to city streets such as right-of-way maintenance, street and traffic lights, minor street repairs, street signs, etc., in 2010. Even with this change the General Fund will continue to supplement the fuel tax revenues to fund the on-going maintenance costs of city streets by \$927,000 in 2010.

- **Development Revenue:** Development activity has continued to lag behind estimates as a result of the current recession. Development revenue collections have been lowered from the original 2009 budget estimate of \$1.45 million to \$760,000 for 2009. Projected 2010 collections have been lowered from the May 2010 forecast of \$972,000 to \$804,000.
- **Investment Interest:** Investment interest rates have been falling since August 2007. At that time short-term interest rates were approximately 5.3%. In June 2009 short-term interest rates were down to 0.7%. As a result of the fall in investment interest rates the City's investment income in the General Fund has fallen from \$517,000 in 2007 to a projected \$160,000 in 2010.

- **Public Employee Retirement System (PERS) Contribution Rates:** As was projected in the May forecast, PERS employee and employer contribution rates were reduced effective July 1, 2009, as a result of legislative action taken to help balance the State's budget. Prior to July 1, 2009, the City's contribution rate was 8.31%. The City has incorporated these lower rates into its 2010 budget, resulting in a 35% drop (\$230,000) in contribution costs in 2010 when compared to the 2009 budget. Even though the State Legislature lowered the contribution rates for the 2009-2011 biennium, it is projected that rates will increase substantially in future years in order to meet the actuarially calculated retirement needs for the retirement system. The following table shows the most recent projected rate changes:

<b>PERS Employer Contribution</b>	<b>Effective 9-1-09</b>	<b>Effective 7-1-10</b>	<b>Effective 7-1-11</b>	<b>Effective 7-1-12</b>	<b>Effective 7-1-13</b>	<b>Effective 7-1-14</b>
Legislative Adopted Rate	5.31%	5.31%				
State Actuary Proj. Rates			8.48%	9.23%	11.37%	11.52%

The City can expect a substantial increase in future retirement contributions as the rate is projected to more than double in the next three years.

- **Health Benefits:** Preliminary information from AWC shows that they anticipate medical premium rates to increase between 6% and 8% for 2010, while dental and vision increases will be less. As a result, we have estimated that the City's contribution towards health benefits will increase by approximately 6% in 2010. In the operating budget this equates to approximately \$86,000 city-wide, of which approximately \$68,000 is budgeted within the City's operating budget. The AWC Board will finalize rates in September.
- **Market Rate Adjustment (or COLA):** Historically the City has based its market adjustment at 90% of the June Seattle-Tacoma-Bremerton CPI-W. The June 2009 CPI-W was actually a negative 0.7%. As such, there will be no market adjustment or cost of living increase for City employees in 2010.
- **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 2009 staff is completing a salary survey on classifications 1 through 43, 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 2010 budget.
- **City Hall Debt Service Costs:** The 2010 budget allocates \$610,000 from the General Fund towards the annual debt service payment of \$1.27 million for the new City Hall. The \$610,000 in allocation represents the annual cost that the City previously had paid in rent for the City Hall and City Annex space. The remaining \$660,000 needed for debt service payments will come from Real Estate Excise Taxes (REET).

- **Jail Activity:** Jail activity has fallen since the peak in 2006. Currently 2009 jail usage trends continue to reflect this trend. The following chart summarizes the actual jail activity for 2007 through 2008, along with the projections for 2009 and 2010.

Jail Overview								
Facility	2007		2008		2009		2010	
	Jail Usage	Cost	Jail Usage	Cost	Jail Usage	Cost	Jail Usage	Cost
King County Bookings	719	\$141,808	588	\$122,698	525	\$121,424	545	\$131,544
King County Jail Days	4,251	\$438,576	3,881	\$423,417	3,550	\$432,600	4175	\$476,684
Yakima Jail Days + Medical Costs + Unused Bed days	5,042	\$408,217	4,884	\$406,898	4,200	\$436,392	4150	\$442,183
Issaquah + Medical + Transportation	817	\$61,132	851	\$70,448	848	\$84,584	850	\$100,089
Total Jail Costs	10,829	\$1,049,733	10,204	\$1,023,461	9,123	\$1,075,000	9720	\$1,150,500

- **Police Contract:** The City's contract for police services is projected to increase by nearly 5% from 2009 to 2010. This is primarily a result of the wage and benefit increases that were approved by the King County Council in 2008 as part of the ratified 5 year police guild contract. This contract provided for 5% cost of living adjustments for deputies for each of the next five years starting in 2008. Contracting cities have requested that the County consider reopening the negotiations with the police guild given the changes in the economy and the lack of inflationary measures to support such increases, but at this time it does not look promising that changes will be made.
- **Human Service Funding:** Currently the 2010 preliminary budget includes the second year of allocation of the 2009-2010 Human Services Funding Plan approved by the City Council in September 2008. The 2010 budget includes an additional \$18,000 in annual funding for the Senior Center. The Council committed to increasing the Senior Center allocation by \$18,000 for both 2009 and 2010.
- **Election Costs:** The 2010 projected budget includes the cost for both the 2009 primary and 2009 general elections. King County has estimated these to cost approximately \$77,000.

## DISCUSSION

Some of the primary factors affecting the 2010 proposed budget and the 2010-2015 long-range forecasts include:

### **GENERAL FUND**

#### **Revenues**

General Fund operating revenues, excluding the use of fund balance for one-time expenditures, are projected to decrease by approximately 3.8% from the 2009 current budget to the proposed 2010 budget. This is approximately a \$1.2 million decrease. The primary decreases are a result of the declines in natural gas utility taxes, investment interest, and development revenues.

A description of the most significant revenue trends for 2010 are discussed below.

*Property Tax Revenues:* Property tax revenues are projected to grow by 0.7% in 2010, or \$56,000. This growth is a result of projected new construction within the City, which

results in increased valuation. There is no projected growth in the property tax levy except that related to new construction.

As Council discussed at the May retreat, the property tax levy can only be increased by the lower of 1% or the implicit price deflator (IPD) without voter approval. In 2009 it is expected that the IPD will actually be negative, resulting in a limit factor that is less than 100%. In other words the 2010 property tax levy would actually be less than the 2009 levy. One option that is available to the City Council is to increase the 2010 by 1% with a finding of "substantial need." This would require that the Council adopt an ordinance or resolution stating that there is substantial financial need and it must be approved by a majority plus one of the City Council or five City Council members.

The preliminary 2010 budget assumes that the Council will hold the 2010 levy to a 0% increase when compared to 2009 plus new construction. Even though it is a 0% property tax levy increase, it will require that the City Council find substantial need and approve the levy by at least five Council members.

The 2009 property valuations are projected to fall by 15%. As a result the 2010 levy rate will actually increase, even though the overall levy will not increase. Currently staff projects that the 2010 levy rate will be \$1.11 per \$1,000 assessed valuation. This is 16.8% increase over the 2009 rate of \$0.95 per \$1,000 assessed valuation. It is important to realize that the levy rate is purely a mathematical function based on the levy and the City's assessed valuation. The increase in levy rate does not mean that an individual property owner's property taxes will increase.

*Sales Tax Revenues:* The current projection for 2010 is for sales tax to remain flat with projected 2009 collections. Currently the City's sales tax collections are slightly behind the 2009 projections. The latest economic projections for King County and the Puget Sound Region show a modest 1% growth in retail sales from 2009 to 2010. Given the changes in the economy, the continued downturn in development and construction activity, and the cautionary economic forecast information from the State of Washington, holding the line on sales tax projections appears to be prudent at the current time.

The City also receives criminal justice sales tax, which is collected county-wide and then distributed on a per capita basis. As the City Council is aware, earlier this year we reduced projected 2009 collections by 18.5% (\$252,000) to \$1.11 million, as a result of the recession. The 2010 projected collections are \$1.1 million, just slightly under projected 2009 collections.

*Utility Contract Payments, Utility Taxes & Franchise Fees:* Overall utility tax, franchise fees, and interlocal utility contract agreement revenues are projected to decrease by 2%, \$118,000, when compared to the 2009 budget. The primary reason for the decline is the projected 17.7% drop in natural gas utility taxes discussed earlier in this report.

*Recreation Revenues:* Participation in the City's recreation programs has fallen slightly in 2009, primarily in preschool drop-in programs, summer recreation camps and aquatics. Staff believes that this is related to the economic recession and the opening of the new YMCA pool. As a result overall recreation revenues are projected to be 8%,



\$83,000, under budget for 2009. For this reason, staff has not increased the 2010 projected revenue collections beyond those in the 2009 budget.

Rentals of the City's artificial turf fields continues to increase and as such are projected to be 9%, \$30,000, over the 2009 budget. This trend is expected to continue in 2010 and therefore 2010 rental collections are projected to be 8% greater than the 2009 budget. A portion of these revenue collections are allocated to future replacement of the turf.

*Development Revenues:* Development revenues are projected to continue to be substantially below historical norms. Projected 2010 revenues are \$804,000, approximately 5.8% (\$44,000) greater than projected 2009 collections. Staff will continue to monitor development revenue collections through the remainder of 2009 and early 2010 to determine if other adjustments may be necessary.

*Investment Interest:* Investment interest rates have been falling since August 2007. At that time short-term interest rates were approximately 5.3%. In June 2009 short-term interest rates were down to 0.7%. As a result of the fall in investment interest rates the City's investment income in the General Fund has fallen from \$517,000 in 2007 to a projected \$160,000 in 2010.

### **Expenditures**

Overall expenditures are projected to decrease by approximately 4% in 2010 as compared to the current 2009 budget.

A discussion of the most significant expenditure trends follows.

*Personnel:* Personnel expenditures represent approximately 34% of the City's operating budget. Personnel expenditures are actually projected to decline by 1.7%, \$178,000, from 2009 to 2010.

Overall salaries for regular and extra-help employees are expected to decrease by \$22,000 or approximately 0.1%. This is primarily a result of two vacant positions remaining unfilled in 2010 and the elimination of a city employee administrative position in the police department. The administrative position in police has now been included in the King County contract. The 2010 budget does not include a cost of living adjustment (COLA) for City employees, but it does provide for step increases for eligible employees per the City's compensation policy.

Benefit costs are projected to decline by \$156,000 from 2009 to 2010. The primary driver is the reduction in the City's retirement contribution rate to the State of Washington Public Employee Retirement System (PERS) as discussed earlier in this report. Health benefit costs are projected to increase by approximately 4.5%, \$60,000, in 2010 when compared to the 2009 budget.

*Police Contract:* The City's contract for police services is projected to increase by nearly 5% from 2009 to 2010. The total projected contract for 2010 is \$9.8 million. This represents 32% of the General Fund budget.

*Jail:* We are currently anticipating that the 2010 budget to be \$1.15 million.

*New Maintenance Costs:* The 2010 budget includes approximately \$148,000 in maintenance and utility costs related to the new City Hall. The 2009 budget included approximately 4 months of these costs, since move-in was anticipated for September 2009. The 2010 budget includes a full twelve months of these costs.

### **Revenue Stabilization Fund**

The City's revenue stabilization fund was created as a reserve to cover revenue shortfalls resulting from unexpected economic changes or recessionary periods. The City's reserve policy establishes this fund at 30% of economic sensitive revenues. The balance of the fund was \$6.12 million at the beginning of 2009. In 2009 the City Council authorized the use of \$595,000 of the fund in response to the current recession. The 2010 preliminary budget recommends using \$980,000 to balance the 2010 budget as the recession has continued to push down sales tax and development revenues. This will result in the revenue stabilization fund having a balance of \$4.55 million, or approximately 25% of the 2010 projected economically sensitive revenues. In future years, as the recession eases, the City's budgets will need to include an allocation to restore the stabilization fund to the required 30% balance.

### **2010 and Beyond**

Staff will be finalizing the proposed 2010 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.

As staff has discussed with the City Council, the long-term projections show budget gaps each year into the future. Our long-term forecast for 2011 through 2015 show increasing budget gaps in the out-years unless there are changes in expense or revenue levels. This is a result of costs increasing at a greater rate than projected revenue increases. The City's property tax revenue, which represents approximately 23% of the General Fund revenue, is limited to 1% annual growth rates. Sales tax revenues have actually been falling during the recession and only modest growth is projected for the long-term as the economy starts to grow. Revenue growth has not kept pace with inflation. Even though the City has tried to limit cost increases, our annual contract with King County for police services will continue to grow by 4 to 6% annually, personnel costs will continue to have modest increases, the City's required contribution rate for the State of Washington Public Employee Retirement System is projected to more than double within three years, and contracts to perform services such as landscaping, janitorial, and street maintenance have generally grown at inflationary levels.

The Citizen's Advisory Committee on Long-Range Financial Planning recommended that the City Council consider placing a property tax levy increase on the ballot in 2010. Staff is currently doing research on this and the 2010 budget will include funding for some citizen polling and survey related to a property tax ballot issue. Although it is difficult to ask voters to increase taxes, the City will not be able to sustain current service levels in 2011 without a tax increase.

Staff will continue to monitor the long-term projections as the 2010 budget is finalized. Staff anticipates providing additional updates on the long-term projections during the September 21, 2009, 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 2010 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 2010 budget information.