

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

AGENDA TITLE: 2012 Strategic Budget Issues
DEPARTMENT: Administrative Services
PRESENTED BY: Debbie Tarry, Assistant City Manager
_____ Ordinance _____ Resolution _____ Motion
__X__ Discussion _____ Public Hearing

PROBLEM/ISSUE STATEMENT:

During the Council retreat held in May of this year, Council indicated that they would like to have an earlier discussion regarding the 2012 operating budget, allowing the City Council to have earlier influence on the City Manager's proposed budget. The purpose of tonight's discussion is to provide that opportunity to the City Council. In order to facilitate that discussion staff will provide an update on any significant issues related to the 2011 budget, a briefing on the policy issues expected to be considered during the preparation and review of the 2012 budget, an update of the City's long-term financial projections, and an introduction of the City Manager's initiatives related to long-term financial sustainability. The City Manager will present her proposed budget to the City Council on October 17th, with adoption of the 2012 budget scheduled for November 28th.

This report focuses on the City's operating budget which includes the General and City Street Funds. The 2012 operating budget primarily is focused on sustaining current levels of service, but does include funding for start-up costs to bring Animal Control services in-house in 2012.

RECOMMENDATION

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2012 budget information. Staff anticipates that Council may provide additional budget direction to the City Manager as a result of this review.

Approved By: City Manager jm City Attorney _____

INTRODUCTION

Staff is preparing the City Manager's 2012 Proposed Budget and updating long-term financial 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 2012 budget process. The 2012 budget adoption schedule is as follows:

Discussion of Strategic Budget Issues	September 6
Second Quarter 2011 Financial Report	September 26
Transmittal of Proposed 2012 Budget	October 17
Department Budget Reviews	October 24
Department Reviews & Budget Discussion	November 7
Public Hearing on Revenue Sources & 2012 Property Tax Levy	November 14
Final 2012 Budget Discussion	November 21
Adoption of 2012 Property Tax Levy	November 28
Adoption of 2012 Budget	November 28

BACKGROUND

2011 Operating Budget

Projected 2011 General Fund Savings

Although it is still early to project the 2011 budget outcomes, staff has completed the 2011 preliminary forecast. The preliminary forecast projects that the City's operating budget will end 2011 with net budget savings of \$815,000. The primary reason for the projected level of savings is that revenues are projected to exceed the 2011 budget by \$143,859 and expenditures are projected to be below budget by \$671,542. The following summarizes the primary areas of expenditure savings:

Expenditures:

Salaries & Benefits: Salaries and benefits are projected to be \$118,251 less than budgeted at the end of the year. The primary savings comes from changes in the City Manager, Assistant City Manager, and the Administrative Services Director positions. The 2011 budget savings from the changes in these positions totals approximately \$94,262. These savings are considered one-time as the 2012 budget will reflect budgeted salaries and benefits that reflect these personnel changes. In addition to savings created from vacancies and changes in these positions, the State adopted employer retirement contribution rate (PERS) is lower than budgeted.

Intergovernmental Charges: Staff anticipates that there will be approximately \$450,000 in savings from both of the jail and the police contracts in 2011. Jail savings of \$315,000 are occurring as a result of the contract with Snohomish County and the reduced level of jail activity. Through June, 83% of bookings and 85% of jail days have occurred at the Snohomish County Jail. The 2011 budget had assumed that 87% of jail days would occur at Snohomish County; therefore, the City is utilizing the contracts as expected. The 2011 budget anticipated a total of 14,839 jail days. Current projected jail days for 2011 are only 9,410 a reduction of nearly 36%. The 2011 budget for the jail

contract was based upon 2010 activity which was much higher than expected. Staff now believes that the level of activity last year was an anomaly; therefore, future projections have been modified to reflect what we now believe to be the normal range of activity.

Total police contract charges are anticipated to be \$135,000 less than the 2011 budget as a result of the joint supervision program between Shoreline and Kenmore and a significant change in charges for the 911 Dispatch and Communication Center. In 2011, King County increased the amount 911 tax revenue that was credited against the costs for the 911 Dispatch and Communication Center costs. This resulted in lowering the cost that was allocated to contracting cities. King County has said that this credit will continue in future years, and as such will have an on-going impact of lowering the call center costs in future years.

Council indicated during the 2012-2017 CIP process that one of their primary priorities was identifying a funding source for sidewalks. Council further indicated that they were not looking to implement new revenue sources that would increase costs to City tax payers to fund sidewalks. As such, staff suggested that Council may want to consider allocating operating budget savings towards building a fund for future sidewalk projects.

Revenue Stabilization Fund

The 2011 adopted budget includes authorization to use \$605,000 from the Revenue Stabilization Fund. The General Fund ended 2010 approximately \$509,657 better than projected, as a result of expenditures being less than expected. For 2011, this savings is being used to offset the need for support from the Revenue Stabilization Fund; therefore, the level of expected 2011 support is now \$95,343. The City is also planning on using an amount equal to one-time permit revenues received from the two high school construction projects in 2011 to repay the Revenue Stabilization Fund approximately \$605,000 toward the \$1.2 million used during 2010. This results in an estimated 2011 year-end balance of \$4.83 million.

DISCUSSION

Budget Policy Issues

2012 Property Tax Levy

Proposition No. 1, approved by voters in November 2010, includes a provision to increase the City's annual property tax levy by the change in the June to June Consumer Price Index for All Urban Consumers for the Seattle Area (CPI-U) for years 2012 through 2016. This index increased by 3.15% between June 2010 and June 2011. This is higher than was anticipated and higher than was used in the six year projections for Proposition No. 1. The six year projections for Proposition No. 1 anticipated an average annual 2.43% inflation rate (change in CPI-U) between 2012 and 2016 and specifically 2.08% for the 2012 levy.

Council basically has two options in adopting the 2012 property tax levy:

1. Use the change in June to June Seattle CPI-U (3.15%) as the basis for the increase for the 2012 levy, as was approved by voters with Proposition No. 1.

This would result in a projected levy of \$10,258,205. This would result in a \$16 increase for a residential home valued at \$336,500.

2. Council could opt to adopt a 2012 levy increase that is less than the 3.15% change in the CPI-U and bank the difference. For example Council could adopt a 2012 levy that is 2.08% greater than the 2011 levy, as this was what was projected in the City's long-term financial planning and discussed with the community during the Proposition No. 1 process, and bank the difference between the actual change in CPI-U (3.15%) for the future. This would result in a 2012 levy of \$10,152,184, approximately \$106,000 less than a levy using the change in CPI-U. This difference is what can be banked and used at a future date. The banked capacity can only be used by authorization of the City Council when it adopts a future property tax levy for a given year. There is no requirement to use the banked capacity, but if the Council adopts a 2012 property tax levy lower than that allowed and does not bank the difference between the adopted levy and the maximum that would have been adopted, then the difference cannot be used in the future. Banked capacity does not result in an increase in property taxes until such time, if ever, it is levied in the future. A 2.08% levy increase would result in a \$10 increase for a residential home valued at \$336,500.

Voters passed Proposition No. 1 in November 2010 with a 56.5% approval rate. Voters authorized the City to set the 2011 property tax rate at \$1.48 per \$1,000 assessed valuation resulting in a 2011 levy of \$9.9 million, and in years 2012 through 2016 to increase the City's annual property tax levy by the change in the CPI-U. Staff also recognizes that the City issued several documents that estimated the expected inflationary levels when estimating the long-term revenue and tax payer impacts related to Proposition No. 1, and as such would recommend that Council consider option two above. Staff further recommends that if Council adopts a levy less than the change in CPI-U that the difference be banked so that it would be available in future years.

2012 Salary and Benefit Considerations:

During the 2011 budget process the City Council reviewed the City's compensation policy. At that time Council confirmed that they believed the City's compensation policies provided competitive and fair compensation for City employees. The following discussion includes components of the compensation policies that have an impact on the City's 2012 budget.

2011 Salary Survey

In July 1997, Council approved the City's Classification and Compensation Plan. The plan established a comprehensive set of classification specifications for the work performed by City employees, and based on the City's adopted job market, established appropriate competitive salary ranges for these classifications.

The goals of the City's Compensation Plan are to:

- Ensure the City has the ability to attract and retain well-qualified personnel for all job classes;
- Ensure the City's compensation practices are competitive with those of comparable public sector employers;

- Provide defensibility to City salary ranges based on the pay practices of similar employers; and
- Ensure pay consistency and equity among related classes based on the duties and responsibilities assumed.

The Plan established a policy of paying at the median of the market of our comparable jurisdictions. We compare salaries at the top of the salary range. If the City's salary is within five percent, above or below, of the market median salary than we consider the salary to be at market.

Beginning in 2005, staff instituted a plan of surveying approximately one third of our classifications each year. We divided the classifications into three hierarchically-based groups. The first year we began the one third approach we surveyed the first third; the second year the middle third and the third year the top third. In the following years we continue this rotation.

2011 Salary Survey Results

This year we surveyed the classifications in the upper third of our salary ranges. This included 22 existing classifications. The survey results are still being reviewed and therefore, no estimated cost is currently available. After reviewing the preliminary results staff does not anticipate that there would be any significant impacts to the 2012 budget. Staff will be completing the review over the next few weeks, so that if needed, Council can consider any recommended adjustments during the 2012 budget process.

2012 Market Adjustment - Cost of Living Adjustment (COLA)

The City's compensation policy includes a provision for an annual market adjustment, cost of living adjustment (COLA), based on the defined labor market. Historically the median of the COLA granted by the comparable cities has been 90% of the Seattle/Tacoma/Everett June Consumer Price Index-All Urban Consumer (CPI-U). Since many of the cities do not complete their negotiations or formally adopt the cost of living adjustments until late November, when their budgets are adopted, staff has found that basing the City's recommended market adjustment on the benchmark of 90% of Seattle/Tacoma/Everett June CPI-U has met the City's compensation policy guidelines.

The June 2011 CPI-U for the Seattle/Tacoma/Everett area was 233.25. This represents the highest index since June of 2008 which was 228.068. Normally the City would compare the June CPI-U index of the current year to the previous year to determine the change in CPI, but given that the index actually fell in 2009 and 2010, the change in the index from 2008 to 2011 is the more accurate method to determine the recommended COLA for City employees for 2012. The increase in the index from June 2008 to June 2011 was 5.182 or 2.27%, while the change in index from June 2010 to June 2011 was 3.15%. Under the City's compensation policy, the 2012 market adjustment would result in an increase of 90% of the increase in the CPI-U change from 2008 to 2011, or 2.04%. The City's long-term projections had anticipated an increase of 1.88%, which is just slightly less than the actual 2.04%. The 2.04% COLA totals \$230,000 for 2012. The City had anticipated a 1.88% COLA in its long-term financial projections. The 2.04% COLA is approximately \$18,000 more than was anticipated. This would be the first cost of living adjustment after two consecutive years without one.

Health Benefits

During the 2011 budget process Council directed staff to review the City's health plan offerings to determine if the City could obtain similar health plans to those currently obtained through the Association of Washington Cities Trust (AWC) for a lower cost on the open market. To help the City evaluate its options the City issued a Request for Proposals (RFP) for a Health Benefits Consultant. The City selected MCM through this process. MCM reviewed the current offerings through AWC, the City's employee census and issued a RFP for medical insurance plans. MCM received a single bid for health plans from Aetna. MCM said there were three primary reasons why they only received one quote:

1. The relatively small number of anticipated City enrollees. This is a result of the City's relatively small staff size and the options that the City provides for alternative medical options. By Washington State law the City is required to provide a Health Management Organization (HMO) option for employees. The City's HMO option is Group Health of which there are 23 employees and their dependents who have chosen this health plan. The other factor is that the City's current health benefits policy provides an incentive for employees to "opt out" of choosing medical insurance if they can obtain the insurance through other means. Currently the City has 27 employees who have opted out of purchasing medical insurance through the City.
2. The ability to be competitive with the level of benefit and the premium cost offered through the current AWC Regence Health Plan.
3. The inability to have specific data on the City's actual medical benefit claims. Insurance providers base their premiums on the cost of claims that they anticipate will be paid out. AWC will not provide experience information for individual cities – this is a challenge for any current participant in the AWC Trust who wants to explore alternative insurance options outside of AWC. As a result, insurance providers have to offer a premium that they are hedging will cover the cost of claims in a given year without actual historical data. The City did disclose some information of the significant health issues that employees have experienced over the last 12 to 18 months, but we have no specific information on the dollar value of the claims.

The benefit level, coverage, of the proposed Aetna plan is lower in some areas when compared to the benefit level of Regence. The proposed Aetna premiums are comparable to the Regence premiums with the exception of family coverage or employee plus multiple children coverage. In the case of family or multiple children coverage Aetna premiums appear to be lower. Given the method in which the City allocates health benefit dollars Aetna would result in lower out-of-pocket premium costs for employees who have selected family or multiple children medical coverage, but these employees could see higher out-of-pocket costs when receiving medical service as a result of the change in benefit coverage. In evaluating the cost to the City, it appears that there could be approximately \$18,000 in savings if the Aetna plan was selected, which is less than 1% of the projected 2012 expenditures of \$1.9 million for health benefits. This does not account for any transition costs that could outweigh the preliminary savings estimate.

Beyond the level of benefits and the actual premium prices, there are a few other major issues that would need to be resolved prior to a change from AWC to another medical insurance provider. These include:

- **Retiree Insurance Options.** Currently the AWC Trust allows participants who have purchased medical insurance through the Trust as an employee for at least three years prior to retirement to purchase medical insurance, at the retirees own expense, through the Trust following retirement. Although the City does not provide any funding for this, it is a benefit that allows retirees to purchase insurance without having to get their own individual policy. The City currently has several employees who have indicated that they will be retiring in the next few years, and this is an important issue for them. This is not an option if the City purchases its medical insurance outside of the AWC Trust.
- **Wellness Program.** Currently the AWC Trust provides many incentives, training opportunities, and support for the City's Wellness Program. MCM does provide on-line programs that the City could use in its wellness programs, but it is not the same level of support that the City currently receives from AWC.
- **Long-Term Premium Costs.** Whether the City purchases medical insurance through the AWC Trust or through a separate provider premium costs will continue to increase. Aetna's premium increase trend in the State of Washington has averaged 10% over the last few years. This is similar to what the City has experienced through the AWC Trust over the last few years. Through AWC the City is part of the total Trust pool and premium changes are based on the overall claims of the entire pool. On the Aetna plan the City's future premiums would be based on our demographics, claims history, and the vendor's overall plan experience. As such, future premium increases may or may not be less than what the City has experienced through AWC.
- **The Federal Health Insurance program** that is currently scheduled to be in effect in 2014 may significantly change the current health insurance landscape and create another transition opportunity for the City.

Staff believes that changing medical plans will be a substantial change for employees and that significant investment must be made in educating and communicating to employees about the process of selecting a new provider, the differences in plans, and the change process itself. Staff would anticipate that if there were substantial savings both to the City and to employees, that this may be well worth the effort, but given that the projected City savings are less than 1% of the anticipated 2012 costs, staff does not recommend that we should move forward with this change at this time. Nevertheless, starting in 2012 an Employee Advisory Group will evaluate other plans within AWC, such as evaluating the combination of lower premiums, high deductible, and a health savings account.

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 that the balance of the fund equal 30% of economic sensitive revenues. Historically the City has considered sales, gambling and utility taxes; franchise and recreation fees; development revenues; investment interest and

many of the state shared revenues to be susceptible to decline during times of recession. Given that we have recently experienced a severe recession it was an opportunity to review how the City's revenue stream was affected by the recession.

As a result of that review staff is recommending revisions to the revenues categorized as "economically sensitive." Based on recent experience utility taxes and franchise fees for natural gas, electricity, water and garbage; state shared criminal justice funding; ongoing grants; and athletic field rentals have been removed from the calculation. Revenue from business licenses; preschool and youth recreation activities; adult sports; and fuel tax have been added to the calculation. We have also included the negative impact of fluctuations in the amount of real estate excise tax collected as it can result in an increase in the amount of General Fund contribution toward City Hall debt service payments. As a result of these recommended changes the City's minimum required Revenue Stabilization Fund balance has been lowered from \$5.8 million to \$4.4 million. The current balance of the fund is \$4.9 million. With the revised calculation, the General Fund will not be required to transfer any funds to the revenue stabilization fund in the next few years as the projected fund balance for the fund is already sufficient to meet the 30% target.

2012 Supplemental Budget Requests

Staff is still developing the 2012 proposed budget and reviewing budget requests with departments. The City Manager is focused on supplemental budget requests that directly support Council goals, but at this time the City Manager has not made any decisions on her recommendations for funding supplemental requests. Although this is the case staff wanted to provide the City Council with some sense of the types of requests that have been submitted by department staff.

One-Time Funding

The one-time investments include GIS aerial photography to update the City's topography GIS information; professional services to perform the Environmental Impact Statement in order to complete the City's Comprehensive Plan update within the timeframe requested by the City Council; and a vehicle for Traffic Services.

One-Time Investment with On-Going Expenditure Impacts

This category includes the purchase of I-Pads for use by the City Council. This would eliminate the need to issue paper Council packets and manually distribute the packets. Analyzing the return on investment of this transition it appears to break even over a five year period. Staff estimates that this would be the maximum life cycle of the I-Pad. In addition to the financial return on investment consideration, this option does reduce the use of energy in printing and reproducing the packets.

The other major requests in this category include the acquisition of two major software systems: an Asset Management System and the implementation of Sharepoint for use as a document management system and a replacement for the City's current portal technology. The Asset Management System will be used to account for the various City infrastructure systems (i.e., streets, road signs, drainage pipes, catch basins, etc.) and their conditions. The system is used to track the management, maintenance and

repairs to the various individual components. Staff currently estimates that the system could cost as much as \$200,000. This system would have an on-going license fee. The Sharepoint software and implementation is expected to cost approximately \$70,000.

Personnel Requests

Personnel requests include a School Resource Officer partially funded for three years by a grant and additional School District contribution; an increase in the 0.8 FTE Police Administrative Assistant to a 1.0 FTE; the addition of 1.0 FTE at Spartan Recreation Center for front desk coverage, partially offset by a reduction in extra help hours; a City Engineer that is a separate position from the Public Works Director, and the addition of a Facilities Maintenance Worker partially offset by a reduction in extra help hours. In addition, a request includes an increase in 0.5 to 1.0 FTE for special event planning and coordination responding to an increase in events being organized and supported by Parks, Community Services, and Economic Development.

On-Going Programs

Other ongoing service enhancements include funding for additional city sponsored special and community events; additional funding for economic development to plan and promote major development projects; and additional financial support for Kruckeberg Botanic Garden.

As Council will see in the following section the City's long-term financial projections do not result in additional budget capacity to support new on-going expenditures. Since this is the case, if there are new priorities that would suggest the funding of new programs or personnel, existing expenditures would need to be reduced to sustain the long-term addition of new costs.

2012 – 2017 Long-Term Projections

The City's financial policies require that the City maintain a six-year operating budget financial forecast. Staff updated the forecast in March 2011 and has been updating the forecast again as part of the 2012 budget process. Below is a comparison of the projected bottom-line of the two forecasts:

	2012 Forecast	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
March 2011 - Net Budget Surplus (Gap)	(235,899)	(416,184)	367,890	908,885	492,297	(739,852)
September 2011 - Net Budget Surplus (Gap)	43,846	(63,131)	(171,473)	427,887	585,458	(464,032)

The difference in the two forecasts can be attributed to the following factors in the September forecast:

- Inflation is projected to be at a slightly lower rate which results in lower increases for fees and city services.
- The annual growth in sales tax is lower.
- Investment rates are lower.

- The change in building permits is slightly lower in the early years, but higher in later years.
- PERS contribution rates are slightly lower.
- The annual salary escalator is slightly lower.
- The police contract escalator is slightly lower.
- Jail costs are lower based on the current jail usage trends.

Based on current assumptions the City can balance the operating budget for 2012 through 2016. Even though 2013 and 2014 currently project budget gaps, there is opportunity to balance over the five year period. As Council is aware the City's property tax levy that allows for the levy to increase at inflationary levels through 2016, approximately 2.5% per year, expires at the end of 2016, and therefore the levy limitation returns to a 1% cap in 2017.

2012 and Long-Term Budget Trends

Below are some of the major assumptions used in the most recent projections:

- **Sales Tax:** Sales tax collections continue to lag behind earlier projections. Most noticeably is the continued decline in construction related sales tax, both from retail sales of building materials and tax directly related to construction. The 2012 proposed budget expects sales tax to remain at \$6,091,418, the same level as 2011, with the addition of \$210,000 in one-time sales tax from the construction of two new high schools by the Shoreline School District. The following chart compares the March 2011 projections with the September 2011 projections for sales tax:

	2012	2013	2014	2015	2016	2017
March 2011 Projections	6,359,681	6,647,638	6,941,675	7,250,227	7,546,587	7,832,810
Sept. 2011 Projections	6,301,418	6,091,418	6,575,508	6,864,507	7,164,762	7,463,031

- **Gambling Tax:** The gambling industry is highly unstable at this time. Two casinos have signed promissory notes for unpaid overdue taxes. One casino is no longer operating and staff anticipates that at least one other casino may cease operations in 2011 or 2012. 2011 revenues are projected to be \$1,630,978. This amount includes \$100,978 in prior year unpaid taxes that will be paid during 2011 as promissory note payments. The 2012 baseline for gambling tax revenue from card rooms is projected at \$1,540,000 with promissory note payments for unpaid prior year taxes totaling \$202,146 for a total 2012 collection of \$1,742,146. Staff has assumed no growth in future years and therefore card room taxes will remain at the baseline level of \$1,540,000.
- **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 2011 budget estimate of \$1.39 million to \$1.23 million. Projected 2012 collections have been lowered from the March 2011 forecast of \$667,306 to \$641,725. Currently there are no significant projects on the horizon that would provide staff with a high level of assurance that the City will see a sustained rebound in development revenues in the next few years. As such, the long-term projections have been updated based on more recent experience and

tempering the King County and Puget Sound predictions to match more closely with what we now think may occur in Shoreline. Below is a comparison of the March 2011 forecast and the September 2011 forecast:

	2012	2013	2014	2015	2016	2017
March 2011 Projections	667,306	756,879	859,873	865,560	859,375	827,271
Sept. 2011 Projections	641,725	680,904	760,528	844,203	915,021	943,976

- **Investment Interest:** Investment interest rates have been falling since August 2007. At that time short-term interest rates were approximately 5.3%. Rates are currently down to 0.19% for short-term investments and around 1% for two-year government securities. 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 \$90,000 in 2012. The January forecast projected investment interest at \$225,000 for 2012 based on an average investment rate of 3%, as it had been expected that we would start to see some recovery in investment rates by that time. This assumption has now been pushed out to 2013 and 2014.
- **Public Employee Retirement System (PERS) Contribution Rates:** The PERS employee and employer contribution rates were reduced on July 1, 2009 to 5.31%, 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%. When the 2011 budget was developed, the rate was projected to increase on July 1, 2011 to 8.48%. The State again tempered the projected rate increase in response to the budget challenges faced by the State and other local governments and on July 1, 2011, the contribution rate actually changed to 7.07% resulting in savings of approximately \$70,278. These savings will carry forward into 2012. The rate is now projected to remain at this level until July 1, 2013 when it is estimated to increase to 10.143%. This increase will be reviewed by the legislature in early 2013 for inclusion in the 2013-2014 biennial budget. While the lowered rate has reduced the required contributions for 2012, it only delays the impact of the future required increase in contributions.

- The following table shows the most recent projected rate changes for the future:

PERS Employer Contribution	Current Rate	Effective 7-1-12	Effective 7-1-13	Effective 7-1-14	Effective 7-1-15
State Actuary Proj. Rates	7.07%	7.07%	10.14%	10.14%	11.59%

The City can expect substantial increases in future retirement contributions as the rate is projected to increase substantially to meet long-term actuarial needs. Employee contribution rates will also rise.

- **Health Benefits:** Preliminary information from the Association of Washington Cities (AWC) shows that they anticipate medical premium rates to increase by 9% for 2012, while dental and vision increases will be less. This equates to approximately \$110,000 within the City's operating budget. The AWC Board will finalize rates in late September.
- **Jail Activity:** The 2012 budget, along with future forecasts, is based on the new contract with Snohomish County. The projected 2012 cost is \$1.166 million. This is an increase of \$102,138 over 2011 projections. This is down significantly from 2010 actual costs of nearly \$1.5 million. This drop in costs is a result of efforts to maximize the use of the Snohomish County jail versus King County facilities.
- **Police Contract:** The 2012 projected police contract totals \$10.1 million. The contract with King County is projected to increase by 4.6%, \$458,875, from 2011 to 2012. 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 through 2012.
- **Human Service Funding:** Currently the 2012 preliminary budget includes the second year of allocation of the 2011-2012 Human Services Funding Plan approved by the City Council. The 2012 preliminary budget continues the additional \$18,000 in annual funding for the Senior Center.
- **Animal Control:** The 2012 budget will include the one-time start up costs for computer equipment, a vehicle, and animal cargo boxes totaling \$43,000 which will be required for the City to transition to the in-house provision of animal control services. The long-term forecast includes funding for the full in-house operation of Animal Control services beginning in 2013. The annual cost to provide this service is estimated to be approximately \$210,000 with annual revenues of \$170,000.

Long-Term Financial Assumptions

Staff will continue to monitor revenue and expenditure trends to identify any change in the assumptions for projecting the budget over the next five years. The following table summarizes the current budget projections and the base assumptions.

	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
Net Budget Surplus (Gap)	(63,131)	(171,473)	427,887	585,458	(464,032)
Assumptions:					
Inflation	2.10%	2.22%	2.26%	2.29%	2.39%
Annual Revenue Growth	3.04%	2.68%	3.57%	3.44%	0.28%
Annual Sales & Use Tax Change	0.28%	4.06%	4.40%	4.37%	4.16%
General Fees & Licenses Increase	1.68%	1.78%	1.81%	1.83%	1.91%
Investment Interest Rate	2.80%	3.60%	3.80%	3.90%	4.00%
Building Permit Activity Change	14.90%	13.50%	12.50%	9.40%	3.50%
Revenue Collection	100.00%	100.00%	100.00%	100.00%	100.00%
Annual Expenditure Growth	0.11%	2.98%	1.94%	3.06%	2.98%
PERS Employer Contribution Rate	9.07%	10.14%	10.87%	11.59%	11.59%
Health Benefit Escalator	7.50%	7.50%	7.50%	7.50%	7.50%
Regular Salary Escalator	2.49%	2.60%	2.63%	2.66%	2.75%
Police Contract Escalator	3.50%	3.50%	3.50%	3.50%	3.50%
Annual Jail Cost Increases	1.37%	2.55%	2.20%	2.61%	2.74%
Expenditure Percentage	100.00%	100.00%	99.00%	99.00%	99.00%
Contribution to Stabilization Fund	-	-	-	-	-
New Maintenance Costs for Completed Capital Projects	\$310,768	\$92,786	\$161,742	\$27,786	\$33,020

Long-Term Alternatives

Long-Term Sustainability

Although the City has a policy to use a six year financial planning horizon, the City Manager has initiated a plan to develop a 10 year financial sustainability plan (2012-2022). This will include options that assume no renewal of the City's levy lid lift. This will also include looking at various alternatives to bridging anticipated future budget gaps including expenditure reductions such as restructuring and reduced hours of service and revenue increases such as positive growth in commercial development. Staff anticipates that this will be a focus in 2012.

Economic Development

Long-term financial sustainability can be aided by economic development. One of the primary outcomes of economic development is new construction. New construction valuation adds to the City tax base beyond the normal 1% property tax limitation. For example a long-term goal may be to have new construction growth equal to two percent of assessed valuation a year which equates to approximately \$128 million of annual new construction. The level of new construction would result in \$190,000 of new property tax revenue annually plus any other increased revenues associated with the new residential or commercial activity.

One challenge is that since incorporation the City has not experienced a single year in which it has new construction equal to two percent of the City's assessed value. The closest the City came to this target was in 2008 when the City had new construction equal to approximately 1.4% of assessed valuation. Other years have been significantly below this level.

To better understand what \$128 million in new construction would look like here is a list of some current commercial properties and their 2011 assessed valuation: Sky Nursery \$6,476,500; entire Gateway Plaza (excluding Bartell Drugs) \$11,338,400; Club Hollywood \$5,219,300, and Top Foods \$9,189,800. Combined, these four properties are valued at \$32.2 million. Some examples of multi-family developments include: Arabella \$9,650,000; Aegis at Callahan House (Senior Retirement) \$10,000,000; Sinclair Building at Echo Lake \$21,282,000; Stuart Building at Echo Lake \$11,675,000; and a 36 unit apartment complex at 1301 N. 175th Street \$9,500,000. Combined, these properties are valued at \$62.1 million.

Budgeting Options – Biennial Budget

State law provides that the City can adopt a biennial budget process that allows the Council to approve two-year budget appropriations. Cities are required to make the decision for a biennial budget by ordinance. The ordinance must be adopted at least six months before a biennium can start and a biennium must start on an odd numbered year. For instance, to begin using a biennial budget for 2013/2014, the City Council must adopt an ordinance choosing to use a biennial budget by June 30, 2012.

Reasons that cities have adopted a biennial budget include:

Saves Time: The most common reason for using a two-year appropriation seems to be to consolidate the amount of effort invested in the budget development and approval process. This includes staff preparation time and council review and adoption time. The savings in time is primarily during the “off” year when a full budget process is not required.

Longer Perspective: Another advantage for the use of a biennial budget is the longer perspective it gives the organization in its budgetary planning.

Potential Improvement in Policy View: A variation on the “longer perspective” argument is the substantial time available to the City Council to strategically address financial issues. When budgeting every year, it is easy for the focus to shift towards balancing each budget rather than an overall strategic plan.

Political Implications: Currently, an annual budget means that every other budget is developed in the context of elections. By design, the biennial budget is considered in non-election years, as the biennium must be started in odd-numbered years.

Reasons against using a biennial budget

Loss of Control: Some cities who have reverted back to an annual budget, after trying a biennial process, cite that they felt a loss of control either politically or administratively over the budget.

Difficulty in Forecasting: Two-year budgets require that all the estimates and forecasts, which were already difficult enough to do for twelve months, are now to be done for a 24-month period. Forecasting sales taxes, development activity, medical benefit costs, changes in contract costs, and many other variables in a budget can be tricky. It is more than twice as tricky for twice the period of time. Changes in the economy, in state and local laws, and other changes may further complicate the ability to develop accurate estimates for budget development.

Financial Software Capabilities: One often overlooked item is the ability of a city's financial software to support a biennial budget allocation and to support multi-year financial reporting. Shoreline's financial software is currently being upgraded for a variety of reasons, and the upgraded software will support a two-year budget allocation.

SUMMARY

During the Council retreat held in May of this year, Council indicated that they would like to have an earlier discussion regarding the 2012 operating budget, allowing the City Council to have earlier influence on the City Manager's proposed budget. This report contains options that the Council may want to consider in developing recommendations to the City Manager. The Council will continue to be faced with balancing the funding the priority programs within limited resources. This is true for 2012 and the years beyond. The City Manager will consider feedback received during tonight's discussion when finalizing her budget recommendations, and specifically would like Council's feedback on the following:

1. 2012 Property Tax Levy – Should the City's 2012 property tax levy increase by the change in CPI-U (3.15%) or something lower?
2. 2012 Cost of Living Adjustment
3. Health/Medical Plan Request for Proposal Results – The City Manager recommends that the City not pursue a plan change away from the AWC Trust at this time, but rather in 2012 explore alternatives within the Trust that may allow for a high deductible plan with a health savings account.
4. Supplemental Requests – Are there specific requests that the Council would like to have considered during the 2012 budget process?
5. 10-Year (2012-2022) Financial Sustainability Plan - Is the Council interested in further exploring a biennial budget process? Are there specific considerations that staff should include the development of a 10-year financial sustainability plan?

RECOMMENDATION

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2012 budget information. Staff anticipates that Council may provide additional budget direction to the City Manager as a result of this review.