

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

<b>AGENDA TITLE:</b> 2004 Budget and City Financial Long-Term Projection Update
<b>DEPARTMENT:</b> Finance
<b>PRESENTED BY:</b> Debbie Tarry, Finance Director

**PROBLEM/ISSUE STATEMENT:**

Staff is currently in the process of developing the 2004 Proposed Budget. The purpose of this discussion will be to provide the City Council with an update of the financial projections for 2004 and beyond and some of the primary policy issues that will need to be addressed during the 2004 budget deliberations. This report focuses on the City's operating budget which includes the General Fund, City Street Fund, and the Development Services Fund, as the Council recently completed a review of the capital budget through the 2004-2009 Capital Improvement Program (CIP) process.

**FINANCIAL IMPACT:**

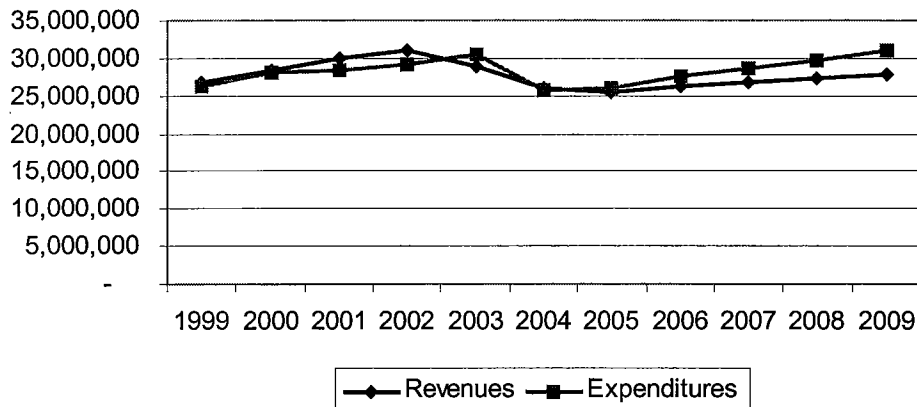
As of August 29, the City's operating budget is balanced, and in fact projected operating revenues slightly exceed operating expenses. This is still preliminary and subject to change as more revenue and expenditure information is gathered during the finalization of the proposed 2004 budget. Some of the significant changes that have occurred since the April 2003 update to the City's financial projections include the continued decline in jail activity, a lower bid on janitorial services and an employee committee recommendation to modify the City's health benefits policy. This recommendation will result in lower City paid health benefits than the existing policy.

Although the 2004 operating budget is balanced, if current trends and assumptions hold true, with no changes in expense or revenue levels, the City's operating budget would have annual operating budget deficits starting in 2005 and continue for each of the next five years. The most significant deficits are projected to begin in 2006 (\$1.3 million) and grow to \$3.2 million by 2009. It should be noted that the later years of any forecast are less certain than the earlier years.

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 begins to plan for 2005 and beyond, there will be a need to evaluate a variety of expenditure reduction and revenue enhancement scenarios that will allow for the long-term provision of public services.

The following chart shows the most recent projections of revenues and expenditures for 2004 through 2009.


**City Operating Budget Six Year Forecast  
10 Year Operating Budget Comparison**



Operating Fund Projections						
Expenditure Assumption	2004	100%	Others	99%		
Base Projections						
	2004	2005	2006	2007	2008	2009
Annual Revenues	25,853,169	25,421,124	26,209,303	26,746,282	27,243,034	27,742,000
Annual Expenditures	25,758,516	25,908,810	27,492,522	28,611,058	29,739,954	30,943,345
Annual (Deficit)/Surplus	94,653	(487,686)	(1,283,219)	(1,864,776)	(2,496,919)	(3,201,345)

**RECOMMENDATION**

No action is required by the City Council. This item is for informational purposes and to provide the City Council with preliminary 2004 budget information.

Approved By: City Manager  City Attorney N/A

## INTRODUCTION

Staff is preparing the 2004 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 2004 budget workshop reviews. The Council 2004 budget schedule is as follows:

Preliminary 2004 Budget Update	September 15
Transmittal of Proposed 2004 Budget	October 20
Public Hearing & Department Budget Review	October 27
Budget Review Workshop	November 3
Public Hearing on Revenue Sources & 2004 Property Tax Levy	November 10
Budget Review Workshop	November 17
Adoption of 2004 Property Tax Levy	November 24
Adoption of 2004 Budget	November 24

## BACKGROUND

During the April 2003 City Council retreat, staff provided Council with an update of the City's long-term financial projections. At that time, staff was projecting a \$400,000 operating budget deficit in 2004. Since that time staff has continued to evaluate revenue and expenditure trends and updated the City's long-term financial model. Also departments have submitted their 2004 budget requests and 2004 revenue estimates. Some of the major changes that have occurred since the April projections include:

- **Jail Activity:** In 2002 the City saw a dramatic decline in jail activity. This trend has continued in 2003, in fact the 2003 activity through July is 5.6% below the 2002 level of activity. This has resulted in 2003 jail expenditures being 39% below projections at the end of the second quarter. Based on the activity levels over the last 18 months, staff has lowered its 2004 jail expenditures from \$1 million to \$800,000. This expenditure would allow for a 10% increase in activity above the current 2003 activity level.
- **Health Benefits:** Health benefit premiums have increased by an average of 8.5% annually since 1997. In 2002 the premium increase was 13.5% and 16.9% in 2003. Earlier this year the Association of Washington Cities (AWC) projected that health benefits would increase by 15% annually for the next five years. During the last two weeks, AWC has indicated that member cities should anticipate health benefit premium increases of 22 to 26% for 2004. Anticipating these large increases, the City Manager established a budget target for the City to limit future health benefit expenditure increases to an annual average of 7.5% over the next five years. An employee committee was established to review strategies that would meet this goal and make a recommendation to the City Manager.

The committee's recommendation to the City Manager resulted in a two tiered plan, in which the current practice of allocating a flat amount per employee would remain, but this amount would be capped through 2005 and future growth would be limited. Those employees who have health premiums in excess of this flat amount would be

eligible to receive additional City contribution to an amount not to exceed 95% of the premium allowance for a full-family. This recommended policy is estimated to reduce costs to the City by approximately \$160,000 in 2004, and approximately \$2 million over the next six years when compared to the existing policy.

The proposed 2004 budget will include a recommendation from the City Manager to change the existing health benefits policy to that recommended by the employee work group.

- **Public Employee Retirement System (PERS) Contribution:** Early indications were that the State would increase the employer contribution rates for PERS substantially starting in July 2003 due to a reduction in investment returns since 2001. The projected rate of 2.27% was built into the City's long-term projections. This did not occur as expected because the State modified their actuarial methods and the new contribution rates are only 1.4%. As a result of the lower increase, 2004 expenditures will be lower than originally projected. Even though this is the case, staff still believes that employer rates will need to increase in the future in order for the retirement system to meet its actuarial required balances. The average contribution rates over the last 15 years has been 4.65%, which is substantially higher than the current 1.4%.
- **Permit Revenues:** Permit revenues declined in 2001 and 2002. During 2003 we have seen an increase in permit activity, along with an increase in permit revenues. As of the end of the second quarter, permit revenues are 14% greater than the same period in 2002, with the major area of increase being plan check fees and miscellaneous permits such as mechanical and remodeling permits. With the increase in plan check fees we would expect an increase in building permit fees in the future. As a result, the outlook for permit activity has improved over the last six months.

Although it appears that the 2004 operating budget will be balanced with revenues slightly exceeding expenditures, the long-term financial projections continue to show operating budget deficits starting in 2005. Given the projected deficits and the City's financial policies, the Council and staff will need to make some decisions about the future financing of City services. Some of the key financial policies that will help guide this decision making process include:

- That on-going expenditures must be balanced with on-going revenues.
- That the City must maintain General Fund reserves equal to 10% of operating revenues.
- That the use of reserves should be limited to one-time expenditures, unanticipated emergencies, and only short-term economic downturns.

Evaluating future financing options will be key in determining any future service enhancements the City may consider. As part of the 2004 budget process, departments submitted service enhancement package requests. Although departments are well aware of the long-term financial projections, they still had some operational enhancement requests. These include:

- A request for additional staff to manage capital projects. This request is being reviewed to determine the optimum balance of contract services and internal staff.
- Increased funding to enhance the level of right-of-way maintenance throughout the City.

- A management analyst within the Parks, Recreation & Cultural Services Department
- Administrative support in the City Attorney's office.
- Emergency Operations support to facilitate the training and on-going development of emergency response and management capabilities throughout the City.
- Staff support for facilitating the review and implementation of the Central Sub-Area plan.

Given the City's long-term projections, it is not likely that any of these budget requests will be granted, unless expenditure reductions are made within existing programs or other revenue sources are found to support the new service.

The following table is the updated operating projections for the City for 2004 through 2009.

Operating Fund Projections						
Expenditure Assumption	2004	100%	Others	99%		
Base Projections						
	2004	2005	2006	2007	2008	2009
Annual Revenues	25,853,169	25,421,124	26,209,303	26,746,282	27,243,034	27,742,000
Annual Expenditures	25,758,516	25,908,810	27,492,522	28,611,058	29,739,954	30,943,345
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The long-term projections assume 100% expenditure levels in 2004 and 99% expenditure levels in future years. Traditionally the City has had an expenditure level of 96 to 97% of budgeted expenditures. A more in depth discussion of the City's long-term operating budget financial forecast and assumptions is included as Attachment A.

## **DISCUSSION**

Some of the primary factors affecting the 2004 proposed budget and the 2005-2009 long-range forecasts include:

### **GENERAL FUND**

#### **Revenues**

General Fund operating revenues, excluding transfers from other City funds and the use of fund balance for one-time expenditures, are projected to increase by approximately 1.7% from the 2003 current budget to 2004. This is a \$368,000 increase.

A description of the most significant revenue trends for 2004 is discussed below.

*Property Tax Revenues:* Property tax revenues are projected to grow by 1.8% in 2004. Approximately .8% of this growth is a result of projected new construction within the City, which results in increased valuation. In November 2001, Initiative 747 was passed by a vote of the people in Washington State. This initiative limited property tax levy increases, beginning in year 2002, to 1% plus new construction without voter approval. The 1% increase in levy accounts for the remaining increase in property tax for 2004. The 1.8% increase in property tax revenue equates to approximately \$118,000.

*Sales Tax Revenues:* The nation and the Puget Sound Region went into recession during 2001. This has contributed to flat or negative growth in taxable sales throughout the State of Washington. The City of Shoreline had experienced 8.5% average annual growth in sales tax revenues for years 1996 through 2000. For years 2001 through 2003, the average annual growth was .8%, a significant drop from previous years, and below inflationary measures. The current projection for 2004 is for sales tax to grow by 2% over the 2003 budget levels, or \$103,000. Two of the primary reasons for this increased sales tax levels is the completion and opening of Top Foods and findings from on-going sales tax audits that Sears has not been correctly reporting their sales tax to the City of Shoreline related to their automotive repair line of business. Besides these two items, the City should see a slight increase in general sales tax as the economy is beginning to show some signs of recovery, be it a very slow improvement cycle. A recent release of the economic forecast for the Puget Sound Region projected taxable retail sales to grow by 5.5% in 2004.

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 have been below 2001 levels by nearly 10%. For this reason 2004 collections are projected to remain flat. Preliminary projections are for 2004 collections to remain at \$1,000,000.

*Utility Taxes & Franchise Fees:* Overall utility tax and franchise fee revenues are projected to grow by 1.8% from 2003 to 2004. The largest component of this change is the anticipated increase in sewer franchise fees, \$50,000 greater than 2003, from Ronald Wastewater District. This increase is in alignment with the agreement executed with the District in 2002. The other area of growth is anticipated to be as result of increased pricing for natural gas.

*Gambling Tax:* Gambling taxes have remained relatively flat over the last two years. Because of this trend the preliminary 2004 projections do not include any growth from this revenue source.

*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 liquor board profits are continuing to increase. Based on the revenue forecasts completed by the Municipal Research Services, the City is anticipating a \$50,000 increase in revenues from these two sources in 2004. This is nearly a 20% increase from current levels.

At the same time the City is anticipating increases from liquor related revenues, the City will see a decrease in revenue from two other state revenue sources: I-695 backfill monies and criminal justice funding previously distributed from Motor Vehicle Excise Tax. The State provided very minimal I-695 backfill monies (State assistance as a result of the elimination of the Motor Vehicle Excise Tax) for the 2004-2005 biennium. In 2004 the City will receive approximately \$55,000 and \$35,000 in 2005. This is a significant drop from the \$148,000 in 2003 and the \$1,485,138 received in 2002. The City anticipated this drop and has been treating the I-695 backfill monies as one-time revenues since the State Legislature never identified an on-going revenue source to fund these payments.

In line with this decrease the City continues to see a decline in criminal justice funding used for specific programs aimed to lower violent crimes, domestic violence, and troubled youth. The City anticipates a \$15,000 reduction in revenue from the State for these programs as compared to 2003. Total revenue anticipated in 2004 is approximately \$100,000.

*Recreation Revenues:* Recreation revenues are projected to increase by approximately \$55,000 in 2004 as compared to the 2003 budget. This is a combination of increased activity levels and budgeting at a higher confidence level than has previously been used. During the last two years we have seen recreation revenues exceed budget projections. As the Recreation Department developed their 2004 projections, staff assumed a 90 to 95% confidence level in their revenue assumptions. The most significant changes are in aquatics (\$7,000), park and facility rentals (\$28,000) and general recreation programs (\$19,000).

*Public Safety Revenues:* In 2004 we anticipate two public safety related revenues to increase. The first is the contribution from the Shoreline School District for the School Resource Officer (SRO) program. Over the last three years the City has had a Community Oriented Policing Services (COPS) universal grant in the amount of \$41,667 annually to help offset the cost of the full-time High School SRO officer. This grant expires at the end of 2003. As a result the City's costs will increase by at least \$41,667. The City's interlocal agreement with the School District is to share the cost of the SRO program on a 50/50 basis. As a result, the School Districts contribution to the program will increase by a minimum of \$20,800 (50% of the \$41,667 increase). The other revenue increase is the receipt of a \$30,000 grant to help offset the development of the emergency operations mitigation plan. Both of these revenue increases are offset by expenditure increases.

*Investment Interest:* Investment interest has dropped significantly since 2001, as a result of dramatic decline in investment rates. In 2001 the City's General Fund received \$573,900 in investment interest, and in 2003, investment interest is only expected to be somewhere between \$200,000 and \$250,000. It should be noted that the General Fund cash balance invested increased during this time period. The City recently adopted new investment policies and staff has developed a diversified investment portfolio with the goal of getting a better investment return than the State Investment Pool currently used. The State Investment Pool primarily invests in very short-term investment instruments. Even though this is the goal, for budget purposes 2004 collections are expected to remain flat as compared to 2003 budget.

### **Expenditures**

Overall expenditures, excluding operating transfers between operating funds, are projected to decrease by approximately 5% in 2004 as compared to the current 2003 budget. One of the primary reasons for the decrease in expenditures is that in 2003, approximately \$1.8 million of one-time transfers from the General Fund to the Capital Projects fund for the City Hall project will occur. This is a result of revenues exceeding projections and expenditures being less than projected in 2002. The City Council approved the use of these funds during the 2004-2009 capital improvement program process.

A discussion of the most significant expenditure trends follows.

*Personnel:* Personnel expenditures represent approximately 27% of the General Fund budget. Excluding any changes in personnel levels, personnel costs are projected to increase by approximately 4.7%, \$310,000. This is primarily based on anticipated step increases for employees who are not at the top of their salary range, an anticipated market adjustment of 1.2%, and a projected 7% increase in the City's health insurance benefit costs. A 7% increase in insurance benefit costs is approximately \$160,000 less than the cost increases would have been if a change in health benefit policy for employees was not being recommended. In 2004, the entire City Council will be eligible for health insurance benefits and this change is expected to increase personnel related costs by approximately \$16,000. The City's long-term financial forecast projects personnel costs to increase by approximately 5% annually.

*Police Contract:* The police contract with King County is projected to increase by approximately \$300,000, 4.1%, in 2004. This is primarily a result of anticipated labor cost increases, a reduction in grant funding for the School Resource Officer, new charges to cities related to the equipping of the new County communication center and some increased service allocation of centralized services (i.e., communications center, canine, major crime unit, etc.).

*Jail:* Based on a second year of declining jail activity and the use of the Yakima jail, jail costs are projected to decrease by 11.6%, \$105,000, in 2004 as compared to the 2003 budget.

*Technology Plan:* The 2004 anticipated expenditures for technology improvements is estimated at \$350,000. This is a 58% reduction (\$486,000) compared to the 2003 budget of \$835,000. This reduction has been planned, as the City has installed most of the basic operational software systems by the end of 2003. Future technology improvements will focus on the ability to integrate and improve the ability to access information from these systems for management and performance measurement purposes. Also the City will focus on emergency back up systems and maximizing the use of existing systems. It is anticipated that the 2005 and 2006 technology plan expenditures will be \$300,000 annually.

*Capital Funding:* The City currently allocates approximately \$1.4 million of general fund revenues on an annual basis to fund capital projects and long-term road surface management. This policy may need to be evaluated in the future, as operating revenues will not be sufficient to support current service levels.

### **Fund Balance**

The General Fund currently has a healthy fund balance based on conservative budget planning by the City Council. The 2003 projected ending fund balance for the General and General Reserve Funds combined total \$9 million, nearly 35% of General Fund revenues. Although this fund balance is healthy, the City should not rely on the fund balance to balance it's operating budget over the long-term.



## **CITY STREET FUND**

The City Street Fund receives approximately 31% of its resources from Gas Tax, Right-of-Way fees and Vehicle License fees and the remaining 64% from General Fund Revenues. This is a shift from previous years to more general fund revenues as a result of the elimination of the vehicle license fees in 2002, with the passage of Initiative 776, and the decrease in fuel tax anticipated for 2004. The elimination of license fees resulted in a revenue loss to the City of nearly \$500,000 annually. Of this amount, street related operating maintenance services were reduced by \$180,000 in 2003. I-776 is still under review by the State Supreme Court to determine its constitutionality. If I-776 is found to be unconstitutional, the license fees will be reinstated. Fuel taxes are projected to decrease by approximately 3% in 2004. This is primarily a result of decreased gas sales throughout the state. The Street Fund maintenance does not include the long-term pavement management program.

The long-term projections for this fund indicate that either the City will need to allocate additional general fund revenues for street operations or develop alternative revenues to maintain service levels, especially as some of the capital projects are completed and increased service levels are required to adequately maintain the improvements. In the absence of these options it is likely that service levels will need to be reduced. For the short-term the fund has adequate reserves.

## **DEVELOPMENT SERVICES FUND**

The Development Services Fund receives approximately 60% of its revenues from fees and 40% from General Fund revenues. Fee collections related to building permits and plan check fees have been dropping since 2001. This corresponds with the timing of the recession and may be indicative of the changes in the Development Code that required larger lot sizes for single family home development. Historically economic slumps have resulted in three year down turns in permit activity followed by five to seven years of expansion. Currently the City has a policy to maintain a minimum fund balance within the Development Services Fund of 5%. Due to the direct correlation between permit revenue and economic cycles, staff may recommend that this minimum be increased to 15% in order to build reserves for an economic downturn. The current reserve levels are at 35%.

Staff will need to continue to monitor development activity during the next year, to see if the current increase in permit activity continues.

## **2005 AND BEYOND**

During the April 2003 Council Retreat, the City Council reviewed a variety of strategies that could be used to address future anticipated budget deficits. These strategies included:

- Expenditure Reductions
- Reduction of Operating Revenues Used for Capital Expenditures
- Short-term Use of Reserves
- Property Tax Levy Lid Lift
- Collection of Franchise Fee on "Distribution" Portion of the Electricity Utility Rates
- Adopting Alternative Revenue Sources

The proposed 2004 budget will include expenditure reductions in areas where staff have found more efficient ways to provide services and policy changes that result in a reduction of future costs, such as the health benefit policy recommendation.

During the 2004 Council Retreat, a major item of discussion will be addressing the City's long-term financial plan and developing the strategies that the City will use over the next two or three years to provide public services.

### **SUMMARY**

Although the 2004 operating budget is balanced, if current trends and assumptions hold true, with no changes in expense or revenue levels, the City's operating budget would have annual operating budget deficits starting in 2005 and continue for each of the next five years. 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 begins to plan for 2005 and beyond, there will be a need to evaluate a variety of expenditure reduction and revenue enhancement scenarios 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 2004 budget information.

### **ATTACHMENTS**

Attachment A – 2004-2009 operating Budget Financial Forecast

***City of Shoreline, Washington***  
***2004-2009 Operating Budget Financial Forecast***

**Background & Purpose**

The National Advisory Council on State and Local Budgeting (NACSLB) has endorsed the forecasting of revenues and the forecasting of expenditures in their Recommended Budget Practices. The Government Finance Officers Association (GFOA) recognizes the importance of combining the forecasting of revenues and the forecasting of expenditures into a single financial forecast. GFOA recommends that each government entity have a financial planning process that assesses long-term financial implications of current and proposed policies, programs, and assumptions that develop appropriate strategies to achieve its goals. The forecast should extend at least three to five years beyond the budget period and should be regularly monitored and periodically updated. The forecast, along with its underlying assumptions and methodology, should be clearly stated and made available to participants in the budget process.

A key component in determining future options, potential problems, and opportunities is the forecast of revenues and expenditures. Revenue and expenditure forecasting does the following:

- Provides an understanding of available funding;
- Evaluates financial risk;
- Assesses the level at which capital investment can be made;
- Identifies future commitments and resource demands; and
- Identifies the key variables that cause change in the level of revenue.

As with any forecasting process, assumptions are made based on historical experience, current trends, and known future changes. Forecasts are usually based on conservative assumptions in that revenues should not be forecast based on maximum growth potential and expenditures should not be forecast based on the minimum growth in expenditures.

The City's financial policies and state law require that the City adopt a balanced budget. This being the case, even though forecasts may project budget deficits, the City would not be able to operate in a budget deficit position on an on-going basis. This is one of the reasons for long-term forecasts, to plan for changes that must occur in order to maintain a balanced budget.

**Overview**

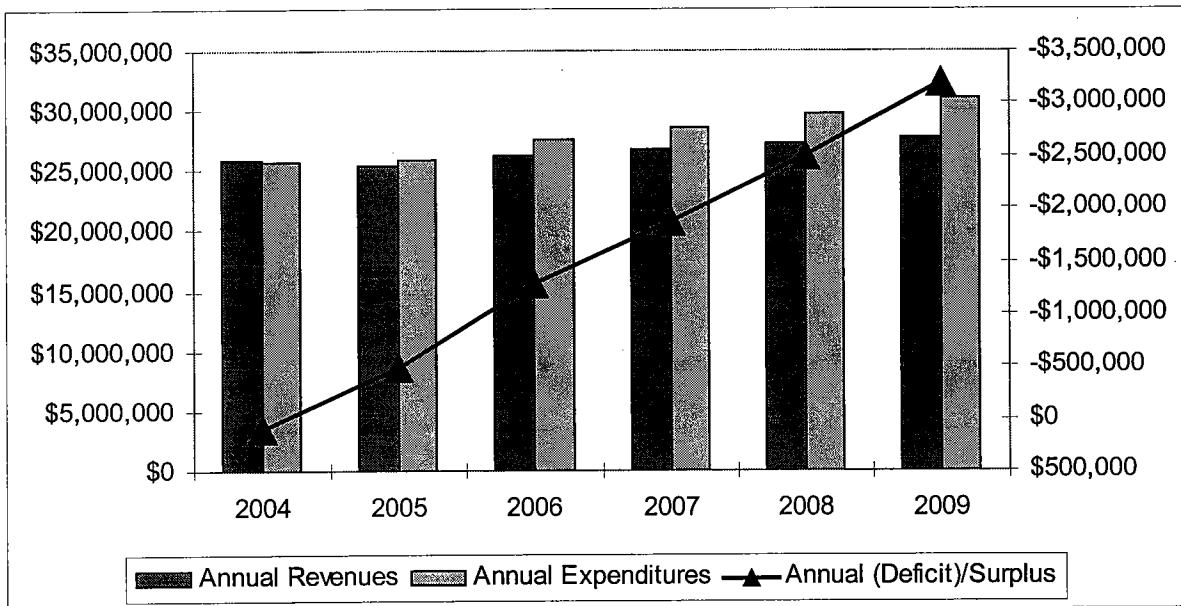
If current trends and assumptions hold true, with no changes in expense or revenue levels, the City's operating budget would have annual operating budget deficits starting in 2005 and continue for each of the next five years. The most significant deficits are projected to begin in 2006 (\$1.3 million) and grow to \$3.2 million by 2009. It should be noted that the later years of any forecast are less certain than the earlier years.

As of January 1, 2003, the City has operating reserves of approximately \$9.2 million. This is equivalent to approximately 37% of the projected annual operating revenues for 2004. Although reserves can be used to help ease "short-term" economic changes, they cannot be used to balance the City's operating budget for the "long-term". In fact, the City's financial policies state that the budget needs to balance on-going expenditures with on-going resources. Reserves are not considered "on-going resources".

## ATTACHMENT A

The following graph demonstrates the City's operating budget financial forecast for 2004-2009.

Operating Fund Projections						
Expenditure Assumption	2004	100%	Others	99%		
Base Projections						
	2004	2005	2006	2007	2008	2009
Annual Revenues	25,853,169	25,421,124	26,209,303	26,746,282	27,243,034	27,742,000
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### Operating Budget Description

The City's operating budget is defined as the combination of the City's General Fund, Street Fund and Development Services Fund. The combination of these three funds support the general operations that the City provides to its residents and business operators on a daily basis. These include public safety, enforcement of local codes, park and facility maintenance, recreation and cultural activities, street and right-of-way maintenance, planning and community development, development plan review and building construction inspection, community communications, and support services.

Since the operating budget includes multiple funds, there may be questions as to the reasoning for combining the General, Street, and Development Services Funds. The primary reason for combining these funds is that they are all dependent on general tax support. For example, the Street and Development Services Fund each are charged for General Fund overhead support (facility space, support services, utilities, etc.) and at the same time the General Fund allocates a portion of general revenues to these funds to maintain a positive operating position. To balance

## ATTACHMENT A

the Street Fund approximately \$830,000 a year in general revenue sources is required. In the Development Services Fund, direct costs are generally supported by permit revenues, while the overhead charged to the Development Services Fund is pretty much offset by the contribution of general fund resources. Although from an accounting perspective we are required to maintain the three separate funds, in order to simplify the long-term financial analysis of City operations, we have consolidated the three funds and eliminated the interfund transfer of monies.

### Assumptions

The City's budget policies require that on-going expenditures be balanced with on-going revenues. For this reason the six-year financial projections show either a budget surplus or deficit by comparing the annual projected revenues against the annual projected expenditures. There is no consideration given for available reserves, as reserves are not considered as on-going resources.

#### *Revenue Assumptions:*

*Overall revenues are projected to grow by an average of 1.5% annually over the next six years. The following is more specific information on the most significant operating revenue sources.*

*Property Tax:* Property tax growth is limited to an annual 1% levy increase (I-747 limitation) and an annual average of \$35 million in new construction. This results in average annual property tax revenue growth of 1.6%.

*Sales Tax:* Sales tax for the Puget Sound Region is forecast to grow by 5.5% annually starting in 2004. There is nothing to indicate, at this time, that Shoreline's sales tax growth will be this strong, therefore our long-term forecasts are for sales tax to grow by an average of 2.5% over the next six years.

*Gambling Tax:* Based on the relatively flat or negative growth in gambling tax over the last few years we are projecting no growth in gambling tax over the next six years.

*Utility Tax and Franchise Fees:* Utility tax and franchise revenue increases have been linked to projected inflationary increases. Usually utilities structure their rates to recapture inflation related increases. These increases average 2% annually over the next six years. The long-term financial forecast also takes into account the new provisions of the franchise agreement with Ronald Wastewater District.

*Permit Revenue:* The long-term financial forecast does not account for any activity level increases (increased number of permits), but does project increases in revenue related to valuation increases. The valuation increases average 2% annually over the next six years.

*Local Motor Vehicle License Fee:* Revenues generated from this fee are not included in the long-term projections as they were repealed with the passage of Initiative 776 (I-776). The constitutionality of this initiative is still to be decided.

#### *Expenditure Assumptions:*

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*Overall expenditures are projected to increase an average of 3% annually over the next six years. The six-year forecast assumes that we will maintain our current services and service levels. The forecast does include operating cost increases associated with the completion of capital projects that have been authorized through the City's adopted Capital Improvement Program. The following is more specific information about the major expenditure categories.*

*Inflation:* Inflation is projected to average 2.3% annually over the next six years. Inflation is used to project expenditure increases related to salaries, professional service contracts, and intergovernmental contract increases.

*Salaries & Benefits:* Various rate changes are projected to affect salaries and benefits over the next six years. These include:

- *Salaries:* Market rate adjustments are forecasted at 90% of inflation. It is assumed that 50% of staff positions will be eligible for merit increases (4% annually) over the next six years, as currently one-third of our regular employees are at the top of their salary range.
- *Benefits:* The major changes in benefits are expected to occur in health and retirement benefits. The most recent forecasts we have received from the Association of Washington Cities is that health insurance premiums are projected to increase an average of 15% annually over the next five years. This is lower than the projected industry increases of 20% annually. Anticipating that these large increases would occur, the City Manager requested that an employee workgroup review health benefit options and develop a recommendation that would limit the City's health benefit cost increases to approximately one-half of the anticipated future increases. This recommendation will come forward as a component of the 2004 proposed budget. It is anticipated that the City's health benefit costs will increase by approximately 7% in 2004, and the long-term projections contain an annual increase of 10%.

The City participates in the State of Washington retirement system (PERS). Over the last couple of years we have seen both the employer and employee contribution rates drop significantly as a result of significant investment earnings. As we are all aware, the market has changed and no longer are retirement systems able to make the same level of investment earnings. As a result, we fully expect for employer contribution rates to increase to the historical averages of 5% during the next few years. The employer contribution rate for 2003 is approximately 1.4%.

*Public Safety:* The **police contract** is projected to increase by an average of 5% annually over the next six years. The **jail contract** is projected using the average usage (number of bookings, number of jail days, etc.) for the last three years (2000-2002) at the projected rates in the current contract with King County and Yakima. It should be noted that the activity in 2002 was significantly lower than prior years and significantly lower than the three year average. This trend has continued during the first half of 2003. Since the trend has continued, the 2004 projections for jail costs have been modified to account for a lower activity level. If at the end of 2003 it appears that jail activity will remain at a lower level, then jail costs for years later than 2005 may be projected higher than will actually occur. At this time, there is nothing in the long-term forecasts to account for any change in the **district/municipal court** contract.

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*Capital:* The long-term forecast includes anticipated operating budget expenditure increases as a result of the completion of projects that are included in the City's 2003-2008 Capital Improvement Program (CIP). The operating budget impacts are projected by staff when developing CIP projects. The long-term forecast assumes that the City will occupy a new City Hall in 2006. The forecast includes \$1 million annually for total occupancy costs (debt service/maintenance & operations) starting in 2006. As approved by the City Council, with the adoption of the 2003-2008 CIP, \$400,000 of Real Estate Excise Tax will be dedicated towards the debt service costs for City Hall starting in 2006. It should be noted that the 2004 budget includes approximately \$600,000 in expenditures related to occupancy of City Hall and the annex.

The long-term forecast continues the current policy of the City Council to allocate an amount equal to the gambling tax that is collected in excess of a 7% tax rate. This equates to approximately \$1 million annually of general operating resources that are allocated for capital purposes.

*General Reserve Fund:* The General Reserve Fund was established to accumulate monies to be used for emergencies or to moderate economic changes. The amount of reserves that can be accumulated in this fund are limited by state law to \$.375 per \$1,000 of assessed valuation. Since the City's assessed valuation has continued to increase, and this trend is projected to continue, the amount of the reserve has continued to increase. The reserve increases by transferring operational resources to the reserve fund. The long-term forecast continues this policy and an annual average of \$130,000 of operating resources are transferred from the operating budget to the General Reserve Fund.

*Expenditure Rate:* As has been the City's experience, it is highly unlikely that 100% of the City's operating budget will be expended in a given year. In 2002 the General Fund expenditure rate was 96% of projected expenditures. The long-term forecast assumes a 100% expenditure rate for 2004 and 99% for the remaining years.

### **Conclusion**

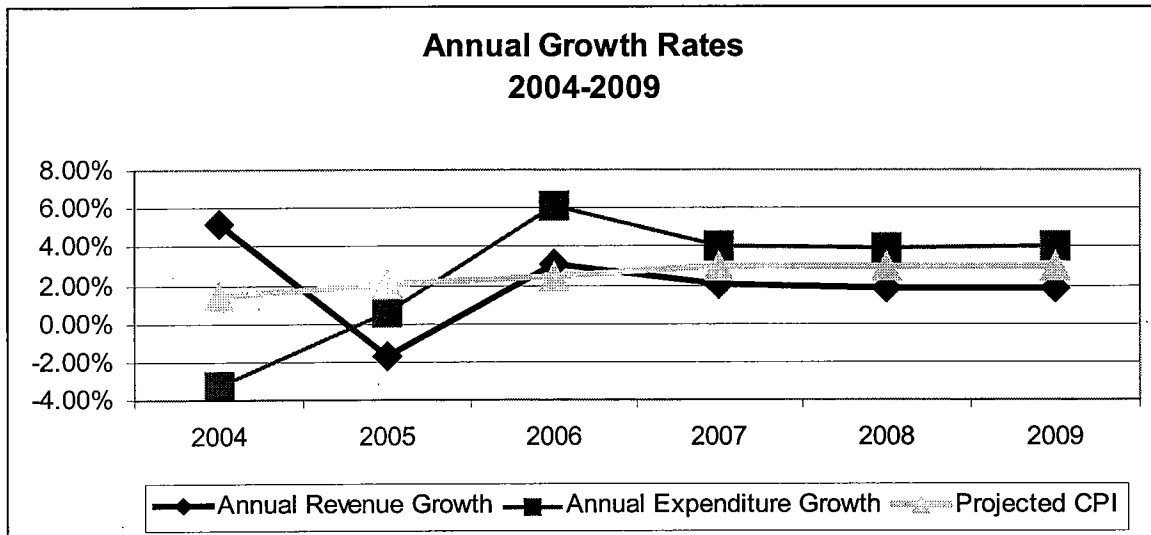
Based on the assumptions described above, the City's operating budget could have annual deficits starting in 2005. The deficit for 2005 is approximately \$487,000, and beginning in 2006 the annual deficit increases significantly to \$1.3 million and grows to \$3.2 million in 2009.

Although the City's long-term projections reflect annual operating deficits, this does not mean that the City will actually operate in a deficit position. Rather the long-term projections help staff and the City Council anticipate the need to develop long-term solutions to bring the annual operating budget into balance. Although reserves can be used to help ease short-term budget deficits, our projections show that the operating budget has long-term issues that need to be addressed in order to balance the budget on an on-going basis.

The reason for the deficits is basically a result of the long-term expenditure growth outpacing long-term revenue growth. The following graph summarizes the expected operating revenue and expenditure growth rates for 2004-2009.

## ATTACHMENT A

	2004	2005	2006	2007	2008	2009	Average
Annual Revenue Growth	5.16%	-1.67%	3.10%	2.05%	1.86%	1.83%	2.05%
Annual Expenditure Growth	-3.25%	0.58%	6.11%	4.07%	3.95%	4.05%	2.59%
Projected CPI	1.40%	2.10%	2.50%	3.00%	3.00%	3.00%	2.50%



Although operating expenditures are projected to increase modestly over the next six years, the growth is slightly greater than projected inflation and greater than projected revenue growth. Revenue growth is not projected to keep pace with inflation and in fact will average less than 2% annually over the next six years.

### Summary

The City is currently in good financial condition. As we look to the future we are anticipating that the ability to maintain the current level of services will not be possible without increasing the resources to provide those services or finding significant efficiencies to modify the ways that services are provided. This is especially true as we approach 2005 and beyond. As the Council plans for these future years and develops their goals it will be necessary to develop a long-term strategy to address our future financial challenges.