City of Shoreline, Washington
2009-2014 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.

Forecasts and the Budget

The purpose of the long-range financial forecast is to give an early indication of the budget position for the next few years. This forecast is the first step that staff takes in projecting the financial resources that will be available for providing services and for projecting the cost of the current levels of service. As more information is learned during the year and prior to the formal budget process, the forecasts will be updated and the information incorporated into the City's annual budget. The 2008 adopted budget serves as the base-line for making future year forecasts.

The 2009 through 2014 operating budget forecasts assume a "status-quo" baseline. In other words, the forecasts do not include any addition of staff or increased service levels. At the same time they do no include staff reductions or service eliminations either. They do include anticipated maintenance and operation impacts from completed capital projects or anticipated contract obligation changes that are projected to occur over the six year planning horizon.

The six-year forecast should be considered an estimate based on the best assumptions the City has at any given time. Assumptions may change over time as better information is provided or circumstances change. Staff fully anticipates that future forecasts may vary from this forecast, but anticipate that without significant changes in the baseline assumptions that the trends are fairly predictable.

2009-2014 Baseline Operating Budget Forecast

OPERATING BUDGET FORECAST
SIX YEAR FORECAST

	2009 Forecast	2010 Forecast	2011 Forecast	2012 Forecast	2013 Forecast	2014 Forecast
Beginning Fund Balance	**$ 5,168,621**	**$ 5,168,621**	**$ 4,206,628**	**$ 3,078,976**	**$ 1,084,694**	**$ (1,599,733)**
Revenues:						
Taxes:						
Property	7,402,313	7,518,517	7,634,670	7,750,804	7,866,954	7,983,151
Sales and Use	8,275,241	8,636,954	9,020,558	9,387,568	9,749,706	10,098,773
Gambling	2,251,500	2,238,900	2,233,230	2,227,844	2,222,726	2,217,865
Utility	4,055,693	4,150,533	4,242,201	4,334,395	4,429,580	4,526,541
Other	4,470	4,470	4,470	4,470	4,470	4,470
Franchise/Utility Contract Payments	3,457,854	3,534,230	3,608,079	3,682,358	3,759,017	3,837,101
Licenses and Permits	913,594	935,011	926,308	928,182	920,865	904,117
Intergovernmental	1,829,645	1,859,851	1,888,103	1,916,883	1,946,585	1,976,741
Charges for Services	1,639,270	1,676,641	1,690,519	1,712,091	1,727,510	1,736,221
Fines and Forfeitures	10,000	10,000	10,000	10,000	10,000	10,000
Interest Income	387,000	432,000	477,000	522,000	522,000	522,000
Miscellaneous Revenues	686,954	356,479	356,746	357,012	357,286	357,563
Total Revenue	30,913,534	31,353,586	32,091,882	32,833,607	33,516,698	34,174,544
Operating Expenditures						
Salaries & Benefits	12,079,487	12,654,326	13,071,950	13,636,583	14,232,111	14,855,778
Supplies	707,532	707,564	700,504	700,520	700,536	700,553
Services & Charges	6,559,729	7,193,313	7,246,771	7,683,133	7,842,126	8,004,910
Intergovernmental	11,010,060	11,551,516	11,998,631	12,589,477	13,210,144	13,862,046
Interfund	238,762	241,317	241,300	243,696	246,180	248,710
Debt Service	0	-	-	-	-	-
Other	0	-	-	-	-	-
Capital Outlay	62,050	70,050	69,350	69,350	69,350	69,350
Total Operating Expenditures	30,657,619	32,418,086	33,328,505	34,922,759	36,300,447	37,741,345
Revenue Over (Under) Expenditures	255,914	(1,064,500)	(1,236,623)	(2,089,152)	(2,783,749)	(3,566,802)
Other Financial Sources (Uses)						
Operating Transfers In	1,055,972	1,443,472	1,443,472	1,443,472	1,443,472	1,443,472
Transfers Out	1,311,887	1,340,965	1,334,500	1,348,602	1,344,150	1,341,250
Net Budget Surplus (Gap)	(0)	(961,993)	(1,127,652)	(1,994,282)	(2,684,428)	(3,464,580)
Ending Fund Balance	**$ 5,168,621**	**$ 4,206,628**	**$ 3,078,976**	**$ 1,084,694**	**$ (1,599,733)**	**$ (5,064,313)**

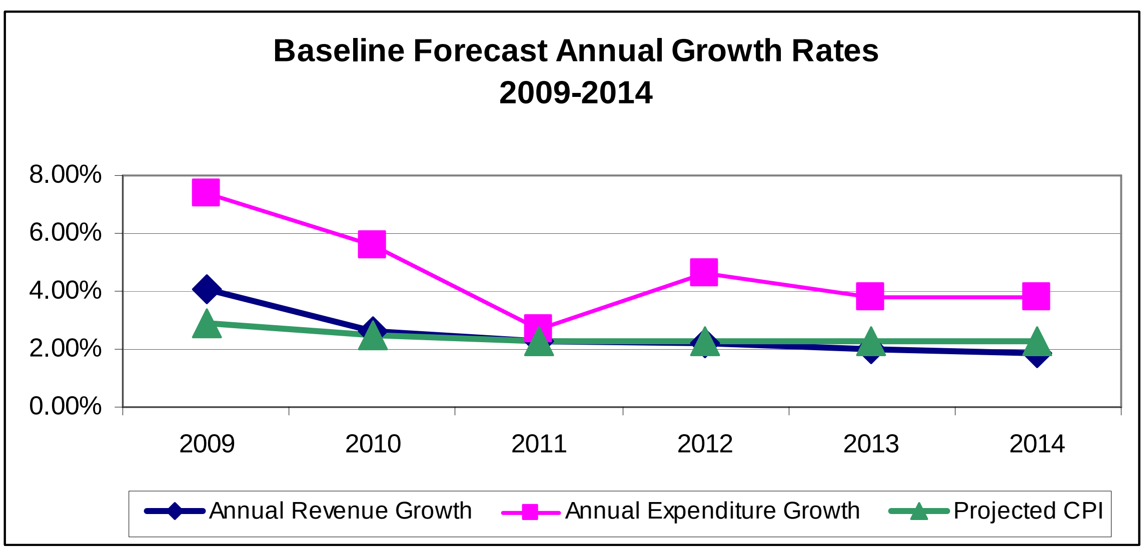
Assumptions						
Inflation	2.88%	2.50%	2.31%	2.25%	2.29%	2.28%
Annual Sales & Use Tax Change	3.30%	4.09%	4.28%	3.94%	3.71%	3.49%
General Fees & Licenses Increase	2.16%	1.87%	1.73%	1.69%	1.71%	1.71%
Investment Interest Rate	3.50%	4.00%	4.50%	5.00%	5.00%	5.00%
Building Permit Change	-4.80%	3.50%	-2.00%	-0.10%	-1.80%	-3.60%
Revenue Collection	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
PERS Employer Contribution Rate	8.71%	9.10%	9.11%	9.11%	9.11%	9.11%
Health Benefit Escalator	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
Regular Salary Escalator	4.59%	4.25%	4.08%	4.03%	4.06%	4.05%
Police Contract Escalator	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Expenditure Percentage	100.00%	100.00%	99.00%	99.00%	99.00%	99.00%
New Maintenance Costs for Completed Capital Projects	$ 203,000	$ -	$ -	$ 292,712	$ -	$ -

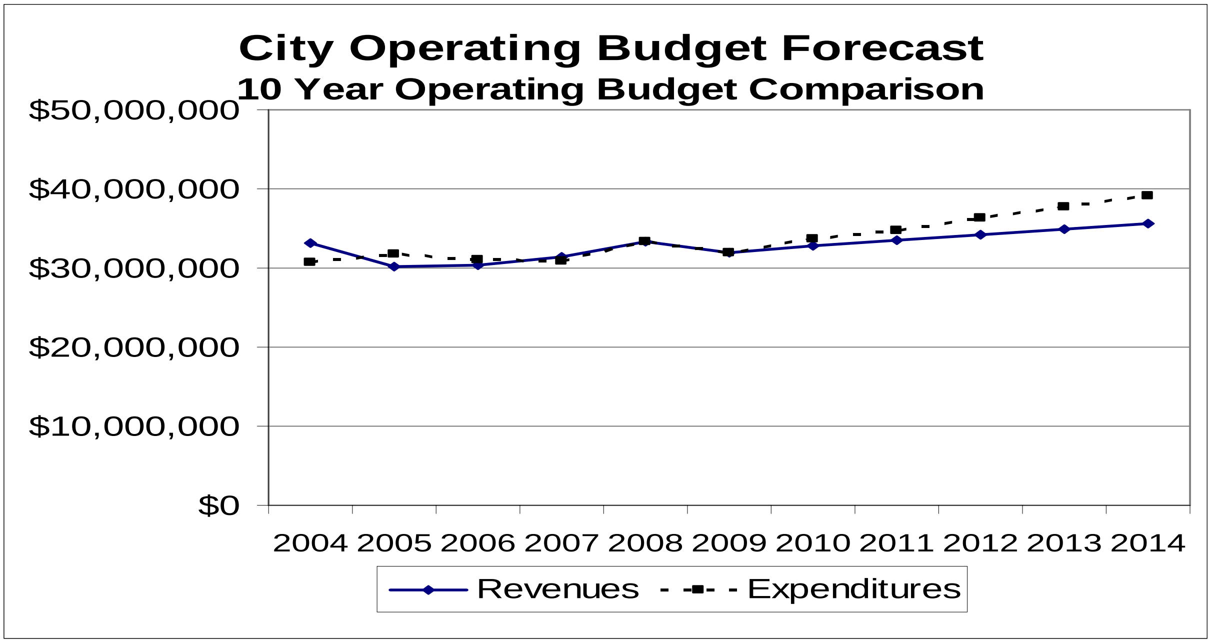
In 2007, the City Council adopted a strategy to address anticipated budget gaps in 2008 and 2009. This included some base budget reductions and revenue enhancement including an increase in the cable utility tax from 1% to 6% and an increase in the Seattle City Light (SCL) Contract Payment percentage. The SCL contract payment increase will be phased-in over a two year period with the contract payment going from 3% of electric revenues to 4.5% of revenues on April 1, 2008, and to 6% on January 1, 2009. These revenue enhancements will be passed on to the ratepayers. The anticipated impact of the cable utility tax increase on the average subscriber was $2.83 per month or $34 annually. The impact of the SCL contract payment increase on the average ratepayer is projected at $6 for 2008 and an additional $8 for 2009. The annual revenue generated to the City from the additional cable utility tax is estimated at $500,000 annually and from the SCL Contract payment increase $225,000 for each 1.5% increment.

As a result of the steps taken by the City Council in 2007, the City does not anticipate future operating budget gaps until 2010. The six-year operating budget financial forecast shows an anticipated 2010 budget gap of approximately $961,000 or just under $1 million. The budget gap is projected to increase to $1.1 million in 2011 and to $3.5 million by 2014. This trend is reflective of previous forecasts.

The projected budget gaps indicate a long-term structural imbalance between revenues and expenditures. This is primarily because annual expenditure growth is projected to outpace annual revenue growth. Over the six-year period of 2009-2014 the operating revenues are projected to grow an average of 2.5% annually while expenditures are projected to grow an average of 4.65% annually. Inflation, as measured by the consumer price index, is projected to average 2.42% over the next six years.

	2009	2010	2011	2012	2013	2014	Average
Annual Revenue Growth	4.06%	2.59%	2.25%	2.21%	1.99%	1.88%	2.50%
Annual Expenditure Growth	7.38%	5.60%	2.68%	4.64%	3.79%	3.82%	4.65%
Projected CPI	2.88%	2.50%	2.31%	2.25%	2.29%	2.28%	2.42%





Historically the City has always balanced annual expenditures with annual revenues. Any surpluses that have resulted from previous years' revenues exceeding expenditures have been allocated for one-time expenditures such as capital projects. The previous graph provides both an historical comparison of revenues and expenditures along with the forecast for 2009 through 2014.

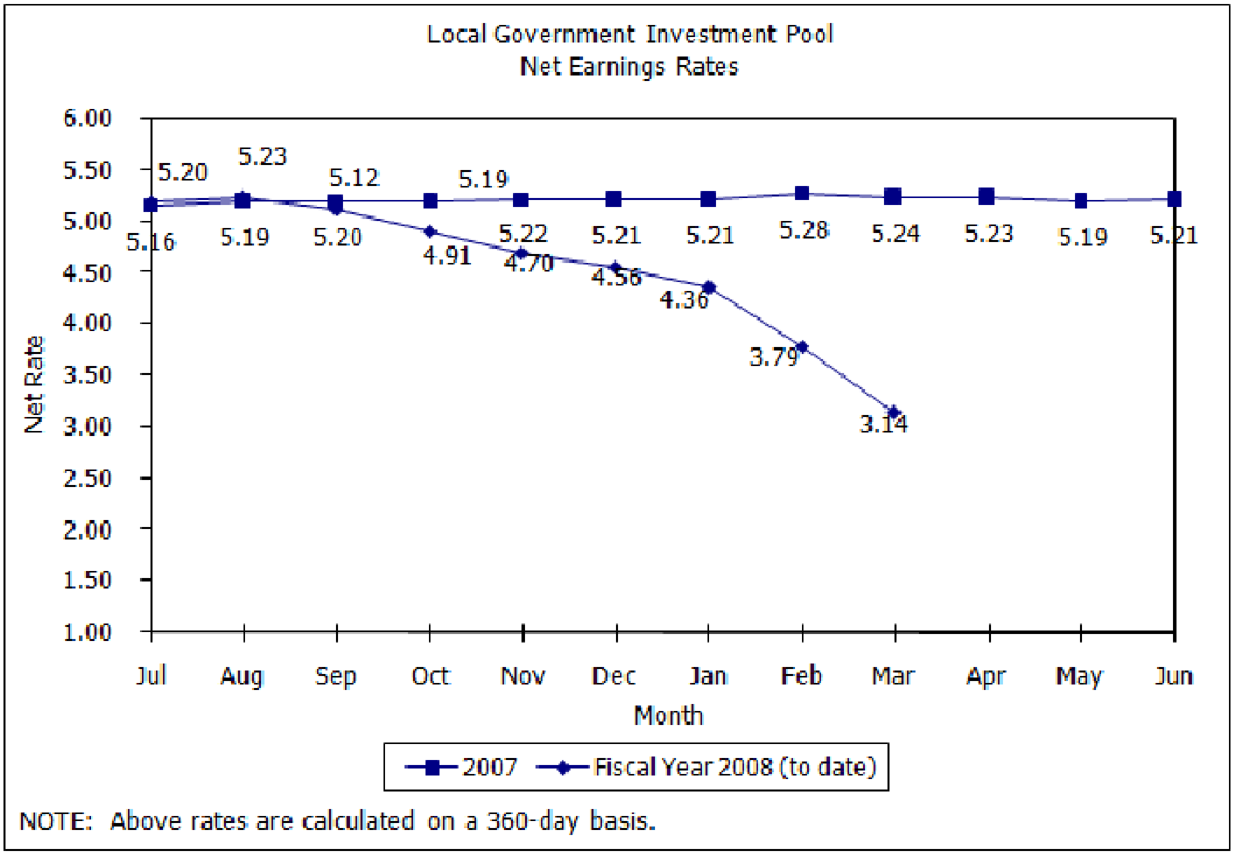
Changes Since the September 2007 Forecast

The September 2007 Base Forecast projected an $810,000 operating budget gap for 2010, with the annual budget gaps growing to $3.2 million by 2013. This base forecast projects a slightly larger gap for 2010, but the trend for growing budget gaps in the future remains. The gaps for future years is slightly lower in this forecast than the previous forecast, for example the September 2007 forecast projected a $3.2 million budget gap for 2013 and this forecast projects a $2.7 million gap. Although the trends continue to be the same between the two forecasts, there are some changes since September 2007. The changes include the following:

Revenue Changes

Property Tax: Property tax projections have been updated to reflect the final assessed valuation and new construction for 2008. The final new construction amount for 2008 resulted in an annual increase in expected property tax of approximately $50,000.

Investment Interest: Since the September forecast investment interest rates have fallen sharply. This can best be illustrated by looking at the most recent information from the Washington Local Government Investment Pool (LGIP).



Although the LGIP investments are short-term (average number of days to maturity is 50 days), it is an indication of what is happening in the long-term market also. As the City's investments mature, it is likely that we will be reinvesting monies at a lower rate of return. As a result this forecast lowers the expected average rate of return to 3.5% for 2009 with gradual increases through 2012.

Investment Interest Rates	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Projected Fund Balance to Be Invested	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000
Projected Interest Rate	3.50%	4.00%	4.50%	5.00%	5.00%	5.00%

Baseline Forecast Overview

Based on current trends and if there are no changes in revenue and expenditure forecasts, the City's baseline forecast projects an operating budget gap for 2010 and budget gaps continuing for each of the next four years. This trend has stayed consistent during the last few forecast updates. It should be noted that the later years of any forecast are less certain than the earlier years.

The following table and graph demonstrates the City's operating budget baseline financial forecast for 2009-2014

Expenditure Assumption		2009- 2010	100%	Others	99%	
			Operating Fund Projections			
			Base Projections			
	2009	2010	2011	2012	2013	2014
Annual Revenues	31,969,506	32,797,058	33,535,354	34,277,079	34,960,170	35,618,016
Annual Expenditures	31,969,506	33,759,051	34,663,006	36,271,361	37,644,597	39,082,596
Annual (Budget Gap)/Surplus	(0)	(961,993)	(1,127,652)	(1,994,282)	(2,684,428)	(3,464,580)

Other Scenarios

When there are assumptions that have a distinct possibility to be different than the assumptions in the base forecast, alternative forecasts may be developed. At this time the only assumption that could change the forecast significantly would be that of jail usage.

Operating Budget Description

The City's operating budget is defined as the combination of the City's General and City Street funds. Together, these 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 and Street Funds. The primary reason for combining these two funds is that they are dependent on general tax support. For example, the Street Fund is 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 the Street Fund to maintain a positive operating position. To balance the Street Fund, approximately $1.6 million a year in general revenue sources is required. Although from an accounting perspective we are required to maintain two separate funds, in order to simplify the long-term financial analysis of City operations, we have consolidated the two funds and eliminated the interfund transfer of monies.

Capital Improvement Program Impacts

Capital Improvement Program: This forecast focuses on the City's operating budget. Although this is the focus there is some interrelationship. Completion of capital projects many times leads to additional operating costs. For those projects within the current six-year Capital Improvement Program we have included operational impacts into our forecasts.

Forecast 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 a gap by comparing the annual projected revenues against the annual projected expenditures. There is no consideration given for available reserves, as reserves are not considered an on-going revenue source.

Revenue Assumptions

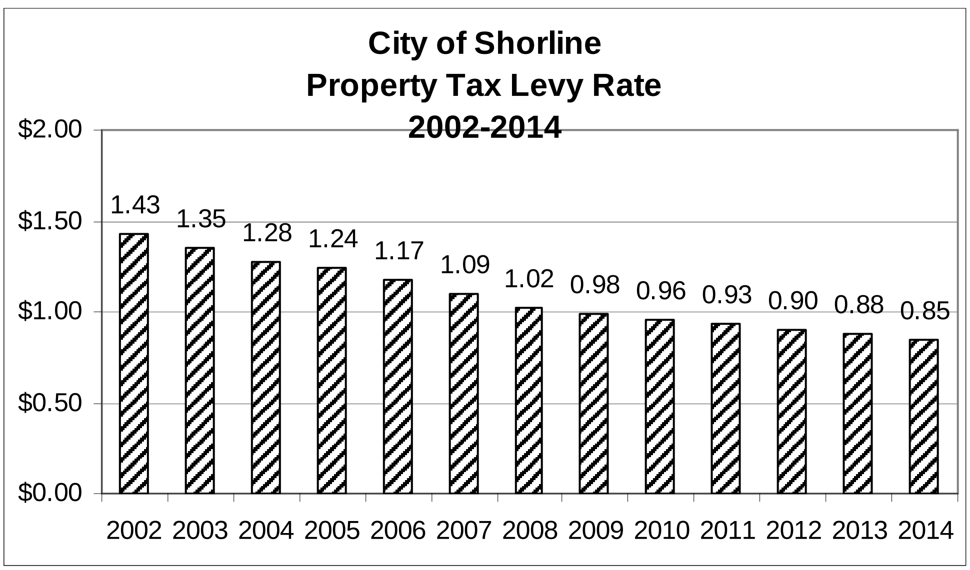
Baseline: Overall revenues are projected to grow by an average of 2.5% annually over the next six years.

The following is more specific information on the most significant operating revenue sources.

Property Tax

Baseline: This assumption does not include any impact of the possible passage of a future property tax reduction initiatives. Property tax growth is limited to an annual 1% levy increase (I-747 limitation) and an annual average of $43.5 million in new construction. This results in average annual real property tax revenue growth of 1.5%.

The City's property tax rate is projected to continue to fall over the next six years, as assessed valuation growth outpaces levy increases. The following graph provides the projected tax levy rate for the City through 2014. The City's maximum property tax levy rate is $1.60. The 2008 property tax rate is $1.02 and the rate is projected to fall to $0.98 in 2009.



Each additional 10 cents in property tax levy equates to approximately $722,000 in property tax revenue. At this time the City has approximately $.58 in property tax levy capacity equating to approximately $4.2 million in annual revenue.

Sales Tax

Baseline: Two prominent regional economists, Dick Conway and Doug Pederson, produce a quarterly publication *The Puget Sound Economic Forecaster*. Each year their March issue includes a 10 year Puget Sound economic forecast update. Staff relies on the work that these economists do to help project population, retail sales, and building permit trends. Traditionally Shoreline does not experience the full retail sales growth rates that may be experienced by other localities within the Puget Sound region during periods of growth, but neither do we experience the full decline in retail sales that these same places may experience during a recession. As a result, the City's long-range forecast projects Shoreline's growth at approximately 75% of the Puget Sound Region as a whole. The following chart compares the Economic Forecaster Puget Sound Region forecast for retail sales growth and the growth factors used in the City's 2007-2012 financial forecast.

	2009	2010	2011	2012	2013	2014
Economic Forecaster Projections March 2008 - Puget Sound Taxable Retail Sales	4.60%	5.50%	5.70%	5.30%	5.00%	4.70%
Economic Forecaster Projections March 2008 - King County Taxable Retail Sales	4.20%	5.40%	5.70%	5.20%	4.90%	4.60%
Shoreline's Projections	3.30%	4.09%	4.28%	3.94%	3.71%	3.49%

Gambling Tax

Baseline: This forecast assumes that card room gambling gross receipts are approximately 22% less in 2009 and beyond than they had been in 2005. This is reflective of the activity level that has been experienced in 2006 and 2007.

The card room tax rate is assumed to remain at 10% for the six year forecast period. All forecast scenarios assume the continuation of the Council's policy to allocate card room gambling tax revenues generated over a 7% tax rate towards capital. This results in approximately 30% of the City's gambling tax being allocated for capital purposes. Primarily the allocation towards capital funds the pavement management program and contributes towards the City's sidewalk program.

The following chart shows the annual projected card room gambling tax, the amount transferred for capital purposes, and the amount that remains in the General Fund for operational purposes.

	2009	2010	2011	2012	2013	2014
Projected gambling tax revenue	2,251,500	2,238,900	2,233,230	2,227,844	2,222,726	2,217,865
Transfer for Capital Purposes	637,500	637,500	637,500	637,500	637,500	637,500
Amount Used for Operational Purposes	1,614,000	1,601,400	1,595,730	1,590,344	1,585,226	1,580,365

Pull-tab related gambling tax revenue has been declining annually. This forecast assumes that this decline will continue over the next few years.

Utility Tax and Franchise Fees

Baseline: 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 approximately 2.28% annually over the next six years.

	2009	2010	2011	2012	2013	2014
Private Utility, Tax-Gas	963,026	982,286	1,001,932	1,021,971	1,042,410	1,063,258
Private Utility, Tax-Garbage	408,649	416,297	423,499	430,661	438,047	445,522
Private Utility, Tax-Cable	615,240	630,594	645,140	659,686	674,770	690,124
Private Utility Tax-Telephone, Cell, Pager	1,881,000	1,927,943	1,972,415	2,016,887	2,063,006	2,109,948
Utility Tax-Storm Drainage	187,779	193,413	199,215	205,192	211,347	217,688
Franchise Fee - Cable	610,317	625,548	639,978	654,407	669,371	684,602
Franchise Fee - Water	577,216	588,020	598,193	608,309	618,741	629,300
Franchise Fee - Sewage	695,521	716,386	737,878	760,014	782,815	806,299
Total	5,938,747	6,080,487	6,218,249	6,357,125	6,500,507	6,646,743
Annual Change		2.39%	2.27%	2.23%	2.26%	2.25%

Seattle City Light Contract Payment

Baseline: The Seattle City Light (SCL) contract payment is made based on 6% of the electric revenue generated from Shoreline rate payers.

	2009	2010	2011	2012	2013	2014
City of Seattle - SCL Contribution	1,574,800	1,604,276	1,632,030	1,659,628	1,688,091	1,716,899

Permit Revenue

Baseline: The long-term financial forecast is based on the long-term permit activity forecast for King County from the Puget Sound Economic Forecaster. Over the next few years building permit activity is projected to decline slightly. We will continue to monitor to determine if projections for King County are reflective of Shoreline activity levels.

	2009	2010	2011	2012	2013	2014
Permits-Building & Structures	452,200	468,027	458,666	458,208	449,960	433,761
Permits-Build/Strict - Plumbing	12,138	12,563	12,312	12,299	12,078	11,643
Mechanical Fees/Permits	62,142	64,317	63,030	62,967	61,834	59,608
Land Use Fees/Permits	217,050	217,050	217,050	217,050	217,050	217,050
Fire System Fees/Permits	11,591	11,996	11,756	11,745	11,533	11,118
Inspection Service-Plumbing	75,208	77,840	76,283	76,207	74,835	72,141
Plan Check Fees	321,966	333,235	326,571	326,244	320,372	308,838
Environmental Review (SEPA/EIS)	31,159	31,743	32,292	32,838	33,401	33,971
Total	1,183,454	1,216,771	1,197,961	1,197,558	1,181,063	1,148,131
March 2008 Economic Forecaster King County	-4.80%	3.50%	-2.00%	-0.10%	-1.80%	-3.60%

Transfers Into the General Fund

The City receives approximately $550,000 annually from the capital and surface water funds for overhead charges. The overhead charges represent the capital and surface water share of facility, administration, finance, information technology, legal, and city clerk related charges.

In 2009 and beyond the transfers into the general fund include $775,000 annually in real estate excise tax (REET) to go towards the debt service payment of City Hall.

Expenditure Assumptions:
Overall expenditures are projected to increase an average of 4.65% annually over the next six years. The six-year forecast assumes that the City will maintain current services and service levels.

Expenditure Rate:
Baseline: 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 2007 the General Fund expenditure rate was 98.5% of projected expenditures. The long-term forecast assumes a 100% expenditure rate for 2009 and 2010 and 99% for the remaining years.

Inflation
Baseline: Inflation is projected to average 2.42% annually over the next six years. Inflation is used to project expenditure increases related to salaries, professional service contracts, and intergovernmental contract increases. The following chart reflects the inflationary projections for the next six years.

	2009	2010	2011	2012	2013	2014
Seattle-Tacoma-Bremerton Consumer Price Index	2.88%	2.50%	2.31%	2.25%	2.29%	2.28%

Salaries
Baseline: Market rate adjustments are forecasted at 90% of inflation. It is assumed that 50% of staff positions will be eligible for step increases (4% annually) over the next six years, as currently 45% of our regular employees are at the top of their salary range. This also assumes that there will be some turn-over in current staffing and replacement staff may start lower in the salary range than long-term employees.

Benefits
Baseline: The major changes in benefits are expected to occur in health and retirement benefits. This forecast accounts for an annual increase of 7.5% in health benefit costs for the next six years. Budgeted health premium costs for 2008 were 3.6% greater than the 2007 budget.

The employer contribution for the Public Employee Retirement System (PERS) is based on the rates approved by the State Legislature. This chart shows the anticipated employer contribution rates through 2014.

	2009	2010	2011	2012	2013	2014
PERS	8.71%	9.10%	9.11%	9.11%	9.11%	9.11%

Public Safety
Baseline: The police contract is projected to increase by an average of 5% annually over the next six years. Jail costs have been projected based on historical and recent jail bed usage data. The following table summarizes the data used to forecast jail costs over the next six years.

	2009	2010	2011	2012	2013	2014
KC Misdemeanor Bookings (Last 4 Year Avg)	710	710	710	710	710	710
KC Misdemeanor Maintenance Days (Last 4 Year Avg)	4,399	4,399	4,399	4,399	4,399	4,399

	2009	2010	2011	2012	2013	2014
Yakima Misdemeanor Maintenance Days (3 yr Avg)	6,930	6,930	6,930	6,930	6,930	6,930
Unused Bed Days	0	0	0	0	0	0
Issaquah Misdemeanor Maintenance Days (2006/2007 Avg)	1,025	1,025	1,025	1,025	1,025	1,025
$ Cost of KC Misdemeanor Bookings	$220.77	$233.58	$247.13	$261.46	$276.62	$292.67
$ Cost of KC Misdemeanor Maintenance Days	$115.43	$122.12	$129.21	$136.70	$144.63	$153.02
$ Cost of Yakima Misdemeanor Maintenance Days	$78.80	$82.74	$86.88	$91.22	$95.78	$100.57
$ Cost of Issaquah Misdemeanor Maintenance Days	$77.18	$81.03	$85.09	$89.34	$93.81	$98.50

Capital

City Hall: All forecast scenarios assume that the debt service payments fro City Hall will begin in 2009. It is expected that the 2009 payments will be approximately 50% of the projected annual cost because of the timing of the debt issuance. Full year debt service payments are expected in 2010 and beyond. The debt service payments are projected to last 30 years. Currently we are estimating annual occupancy costs (debt service/maintenance & operations) to total between $1.4 and $1.5 million dollars annually. As approved by the City Council, $775,000 of Real Estate Excise Tax will be dedicated towards the debt service costs for City Hall starting in 2009.

Operating Transfers Out

Baseline: The 2009-2014 continues to implement Council Policy by allocating a portion of the City's general revenues to fund capital improvements. The forecast also continues insure that the Revenue Stabilization Fund is maintained at 30% of operating revenues that are considered economically sensitive. In addition to these allocations, general revenues are allocated for equipment replacement, anticipated unemployment claims and funding for the major maintenance of the City's facilities. This allocation of funds is done through an operating transfer from the General Fund to the fund that accounts for the corresponding types of expenditures. The table below shows the operating transfers that are part of the 2009-2014 forecast.

Transfer To:	2009	2010	2011	2012	2013	2014
Transfer to Unemployment	$5,000	$5,000	$5,000	$5,000	$5,000	$5,000
Equipment Replacement	100,000	100,000	100,000	100,000	100,000	100,000
Roads Capital - Gambling Tax Equivalent	637,500	637,500	637,500	637,500	637,500	637,500
Revenue Stabilization Fund	168,120	183,539	177,086	177,864	159,771	153,183
Roads Capital - Sidewalk & Street Overlay	146,640	150,300	153,767	157,234	160,829	164,488

Transfer To:	2009	2010	2011	2012	2013	2014
Long-Term Repair & Replacement	80,000	90,000	100,000	110,000	120,000	120,000
Lease Revenue	45,000	45,000	45,000	45,000	45,000	45,000
Athletic Field - Soccer Fields	129,627	129,627	129,627	129,627	129,627	129,627
Operating Transfers Out	$1,311,887	$1,340,965	$1,347,980	$1,362,224	$1,357,727	$1,354,798

*It should be noted that the summary forecast on page 2 of this documents shows operating transfers for years 2011 through 2014 at 99% of the total. This reflects the anticipated expenditure rate.

General Reserve Fund

Baseline: 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 $0.375 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 general fund revenues to the reserve fund. The long-term forecast continues this policy and an annual average of $123,000 of operating resources are transferred from the operating budget to the General Reserve Fund. The projected 2006 ending fund balance for the General Reserve fund is $2.3 million. The General Reserve fund is not adequate to hedge the City against an economic downturn and/or unexpected emergencies.

General Fund Reserve Levels:

The 2009 projected beginning fund balance for the General Fund is $5.2 million. This reserve level primarily represents the cash flow and budget reserves required by the City’s adopted reserve policy. The minimum General Fund cash flow reserve is $3 million and the budget reserves are $850,000. The remaining $1.1 million represents the reserve level within the City Street Fund.

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". This being the case, the City would not use reserves to balance the operating budget on a long-term basis, but the $5.2 million in reserves would cover the annual budget gaps through 2012.

As was stated earlier, the long-term forecast does not assume the use of reserves to close operating budget gaps. If reserves were used to close the projected gaps, the City would have enough to balance the operating budget for the next five years. Since reserves are not considered recurring revenues, the City would be in a very precarious financial situation beginning in 2013 with a budget gap projected at nearly $2.7 million and no general fund reserves. The real purpose of the reserves is to cover cash flow needs which alleviates the need for short-term borrowing. Reserves are available to provide the City with more operating flexibility.

The level of reserves is not mandated by law, but rather is a decision that each jurisdiction makes based on the elasticity of their revenue sources, their cash flows, and their local economy.

Moody's Investors Service, who provides bond ratings to many cities and counties throughout the State of Washington, have reported that their clients have reserve levels that range from the teens to close to 50%. Bond issuers outside of the State of Washington often have reserves at significantly higher levels.

Revenue Stabilization Reserves

In addition to the General Fund reserves, the City maintains a revenue stabilization reserve. This reserve is approximately $6.1 million. The reserve level approximates 30%of the City's economically sensitive operating revenues. The economically sensitive revenues include such things as gambling taxes, sales tax, development related revenues, and some "optional" related utility revenues such as cable and telephone.

Balancing Prior Year Budgets

In light of the long-term forecasts, our focus over the last few years has been on cost containment, expenditure reductions and improving service efficiencies. Some of our successes include:

- In 2003 an employee group developed an alternative health benefit policy. As a result of this policy change, the City's health benefit costs in 2006 were $313,000 less than would have been budgeted under the previous policy.
- We have initiated agreements with Yakima County and Issaquah to house prisoners at a lower rate than is charged by King County.
- We have changed the way we pay for Police Department canine services by purchasing this on a call-out basis instead of having a dedicated unit. This has resulted in annual savings of $100,000.
- Departments absorbed $167,000 in baseline budget reductions in 2005 and an additional $169,000 in baseline reductions for 2007. This was done by reviewing historical expenditure practices and eliminating budget authority that had not been spent in consecutive years.

Since 2003 these changes have equated to $730,000 in annual expenditures that have been reduced from the City's baseline budget.

In addition to these cost saving measures the City has developed more efficient service delivery methods without increasing budget costs, while enhancing service levels. Examples include:

- In-house athletic field maintenance as opposed to continuing with contract services.
- In-house provision of street sweeping services versus private and County contract.

In 2007 the City Council approved two increases in existing revenue sources: the cable utility tax (from 1% to 6%) and the Seattle City Light contract fee.

Balancing Future Budgets

Staff will continue to update assumptions and the City's long-range operating forecast throughout the year as more information is available. This may result in some changes in the long-range forecasts, but it is unlikely that these changes will significantly change the trend of expenditure growth outpacing future revenue growth.

In order to balance future budgets it will be necessary to either reduce expenditures, increase revenues or some of both. During recent years some general operating expenditure reductions have been made, and many of the City's operating costs have been held constant over the last few years. At this time it appears unlikely that additional operating expenditure reductions could be made without either eliminating a specific service or reducing levels of service.

Conclusion

Based on the assumptions described above, the City's operating budget is projected to have budget gaps starting in 2010 and into the future. Although the City's long-term projections reflect annual operating gaps, 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, the 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 budget gaps is basically a result of the long-term expenditure growth outpacing long-term revenue growth. 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 projected to be less than inflation for four out of the next six years.

Staff will continue to update the long-range forecast as the City starts its annual budget process. The forecast should be considered a dynamic process as it may change as additional information becomes available. As the City Council considers priorities for the next year and the long-term, the development of a strategy to maintain the City's long-term financial stability must be considered.