2021-2026 General Fund Forecast Executive Summary

Executive Summary

- The purpose of the forecast is to provide out year fiscal information to assist in informing current fiscal decisions.
- Even though the forecast indicates that economic recovery is occurring from the 2020 shut down of the economy, the out years continue to reflect those expenditures will outstrip revenues in 2023 and beyond, mainly due to the long-existing structural imbalance between revenue and expenditure growth. This is primarily due to a series of influences:
    - Revenue Imbalance: The current structure of property tax allows the city revenue to grow by 1 percent plus new construction annually. This increase does not keep pace with expenditures. Conversely, the city's most economically volatile revenue streams, sales tax and business & occupation (B&O) tax, historically have grown around 5 percent annually. The growth of the sales tax and B&O tax do not counterbalance the lack of growth in property tax.

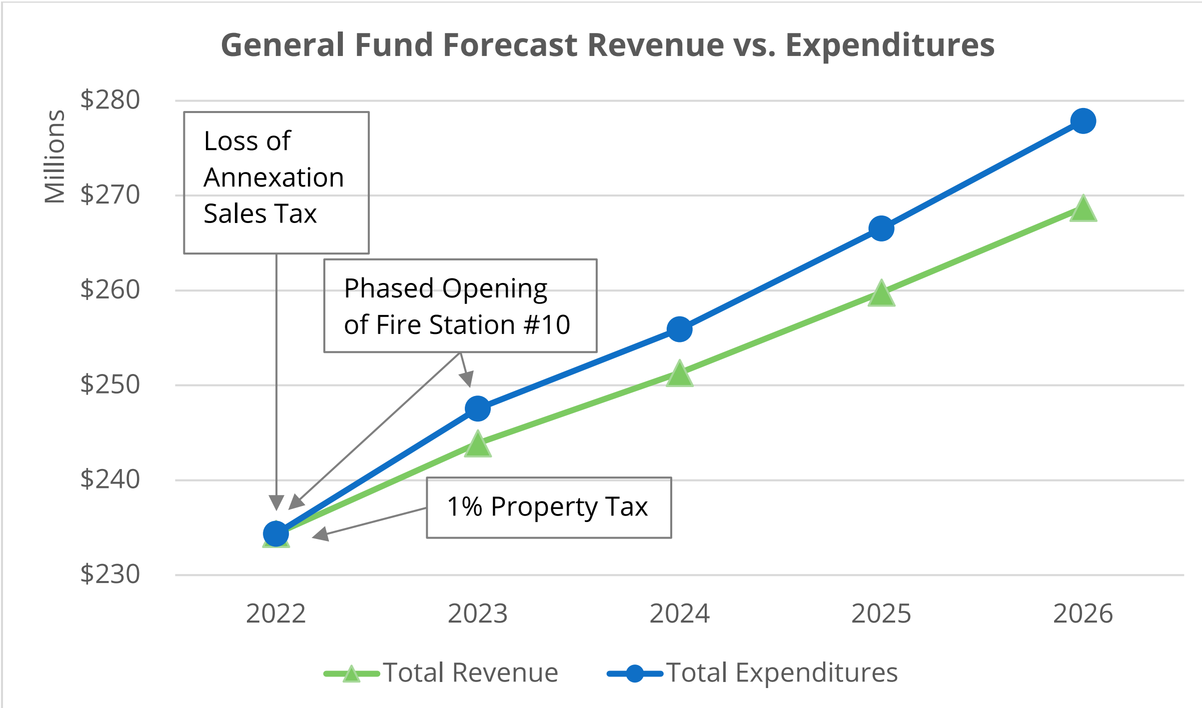
    - Urbanization and Growth: The city continues to experience substantial growth that over time will require more complex and urbanized services. In addition to known costs for opening Fire Station 10, the out-year forecast includes a modest 0.3 percent growth in total expenditures to reflect our growing community and the needs it generates.

    - Capital Investment Program (CIP) Maintenance and Operations: While major maintenance and renovation projects are contained within the CIP, minor maintenance is funded with operating funds. The City has a policy that addresses funding for minor maintenance on existing infrastructure. As the City builds new infrastructures, there are limited mechanisms to ensure additional maintenance and operations funding for those new facilities. As a result, the General Fund maintenance costs grow at a higher rate without a funding source, which is putting additional pressure on the operating fund.

- The forecast assumes that major development will continue for the next few years. Major development projects provide essentially one-time construction-related revenues. In the current market conditions, this revenue has partially stabilized the economic outlook as development continues at a historic pace within Downtown and the BelRed neighborhoods.

- High inflationary costs in 2022 diminish the impact of revenue gains as City bears increased personnel and operating costs.

Chart 1



Potential Risks

The future continues to remain uncertain with risks of:

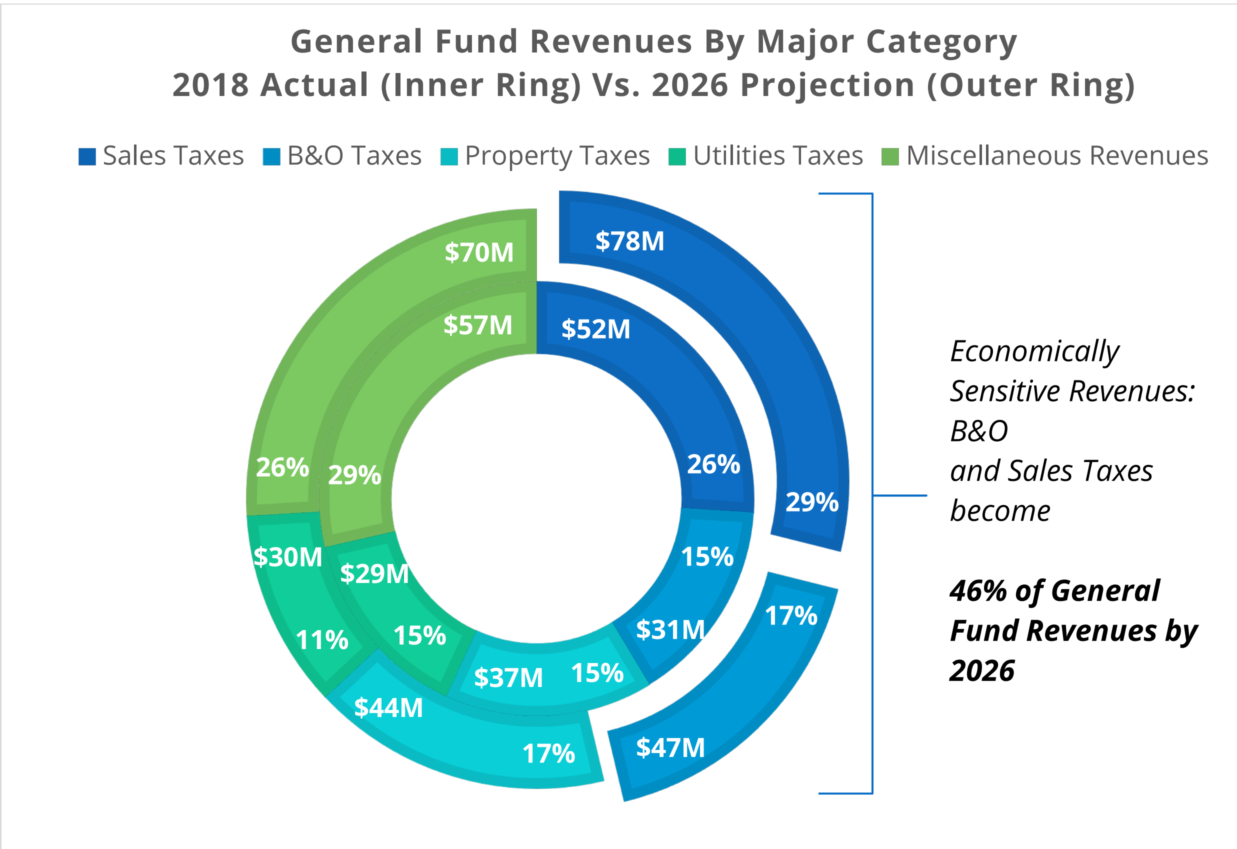
- The timing of economic recovery from COVID-19 related impact is highly uncertain.
- Impacts from worldwide events, such as COVID-19 and supply chain issues on the global economy, regional tourism tax base, and consumer confidence.
- Working from home policy places a near-term impact on downtown retail and dining sales, and a potential long-term impact on office vacancy and new construction.
- Uncertainty of inflationary and labor market effects on local businesses and the City in the near and long-terms.

General Fund Revenue Overview and Revenue Details

The City's mix of revenue consists of property tax, sales tax, business and occupation (B&O) tax, utility tax, and miscellaneous revenues. Within the last category are user fees, state-shared revenues, contract fees, grants, among many others.

The chart below depicts the change in revenue mix from 2018 to the forecasted 2026. In 2018, the City's most economically impacted revenues (sales tax and B&O tax) made up approximately 40 percent of the general fund overall revenue mix, by 2026 that percentage is anticipated to grow to 46 percent. The impact of that growth is twofold, first – the increase supports a growing economy, the second is that with greater reliance on the most economically sensitive revenues, in the event of a recession, the challenge to balance the budget will be greater.

Chart 2



Sales and Use Tax

Overview

The impact of on sales tax from the pandemic in 2020 was severe. The future remains uncertain as the impacts of the pandemic are continually changing. Overall, sales tax collection is forecasted to recover to 2019 levels by year end 2021. The increase is driven primarily by the high level of construction in the City. Construction sales tax for large developments is substantially a one-time funding stream as long as the construction demand continues. On the downside, dining and accommodation remains at 50 percent of 2019 levels. See discussions further in this document for additional details regarding the impact and economic recovery of COVID-19.

For years beyond 2023, sales tax is forecasted to grow by an average of 4.5 percent per year due to continued economic and business growth. Also, as noted, the adopted 2021-2022 budget includes a sales tax re-allocation of $3 million per year from the capital investment program to the general fund. The table below provides a comparison of the city's sales tax forecast to Seattle, King County, and Washington State. Bellevue's forecast is comparable with King County and Washington State. This forecast is based on the best information available at this point in time and, as the forecast extends to the out years, the margin of error increases. A high degree of uncertainty surrounds the effects of the pandemic and social distancing on economic activity and the pace of economic recovery. In prior forecasts, Bellevue's sales tax growth would exceed other nearby jurisdictions to reflect the city's growth. This forecast reflects lower year-over-year growth due to the historically high levels of construction activity in 2020 and 2021. This holds that historic level of construction through the duration of the forecast. The forecast does not grow construction beyond the 2021 permit value of $1.4 billion.

Bellevue Sales Tax Forecast Comparing to Other Jurisdictions

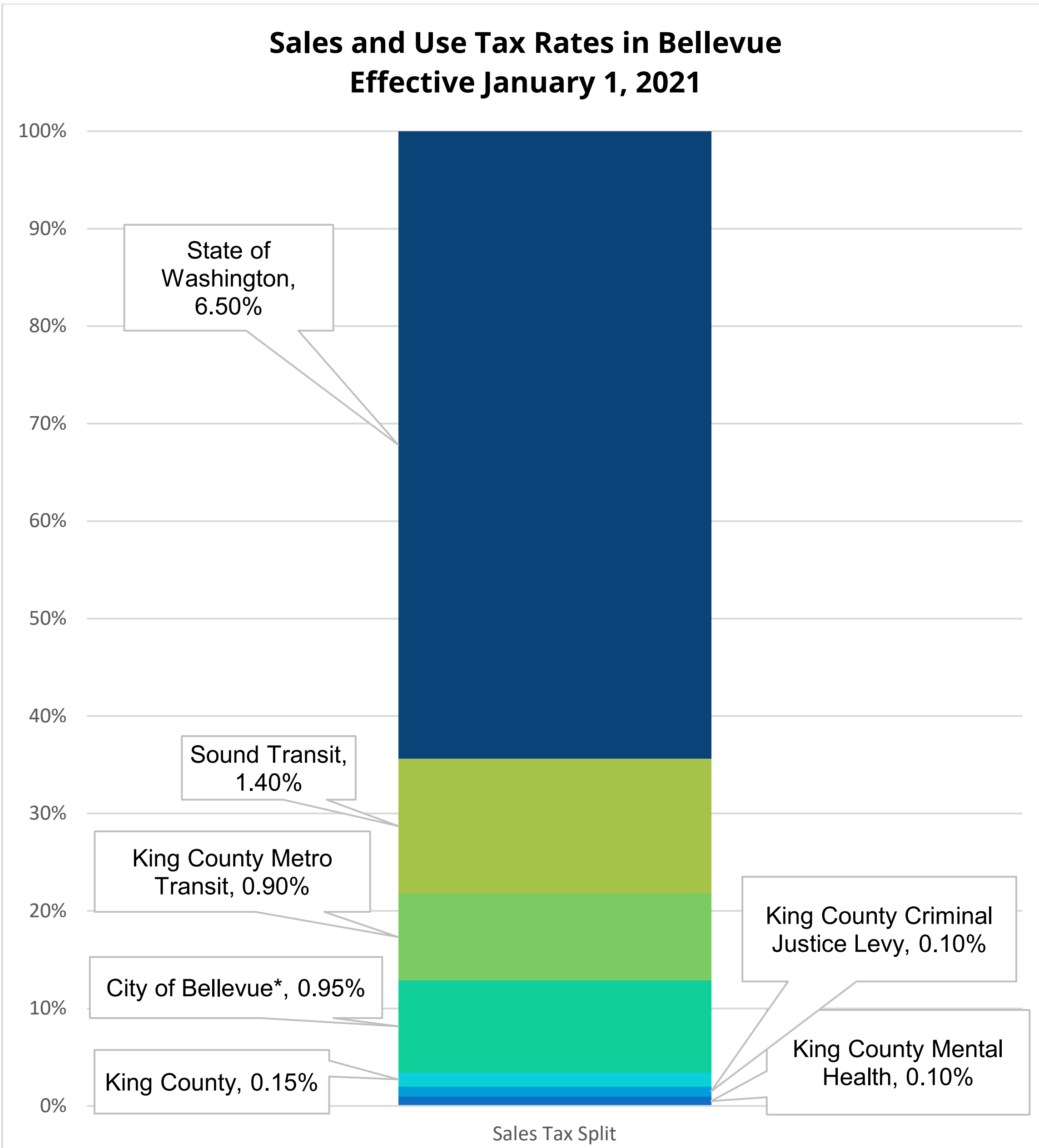
	2022	**2023**	**2024**	**2025**	**2026**
Bellevue	6.0%	5.6%	4.4%	4.7%	4.5%
Seattle	2.3%	N/A	N/A	N/A	N/A
King County	5.7%	5.7%	5.5%	5.7%	4.6%
State	4.0%	2.5%	3.5%	3.6%	N/A

Note: All growth rates include marketplace sales tax.
*Bellevue's sales tax growth is calculated by excluding the one-time Department of Revenue audit refund that has a negative impact on the sales tax revenue to show a comparison to the out years.
*Seattle sales tax growth rate is from the City of Seattle's 2022 Proposed Budget.
*King County sales tax growth rates are from King County August 2021 Forecast by King County Office of Economic and Financial Analysis.
*Washington State growth rates are from the June 2021 Revenue forecast by the Economic and Revenue Forecast Council.

Background

The retail sales and use tax (sales tax) is imposed on the sale of most goods and certain services in Bellevue. The tax is collected from consumers by businesses that in turn remit the tax revenue to the state. The State sends the City its share of this revenue monthly. The City collects a 0.95 percent tax on retail goods and services. Chart 3 shows Bellevue's sales and use tax rate components.

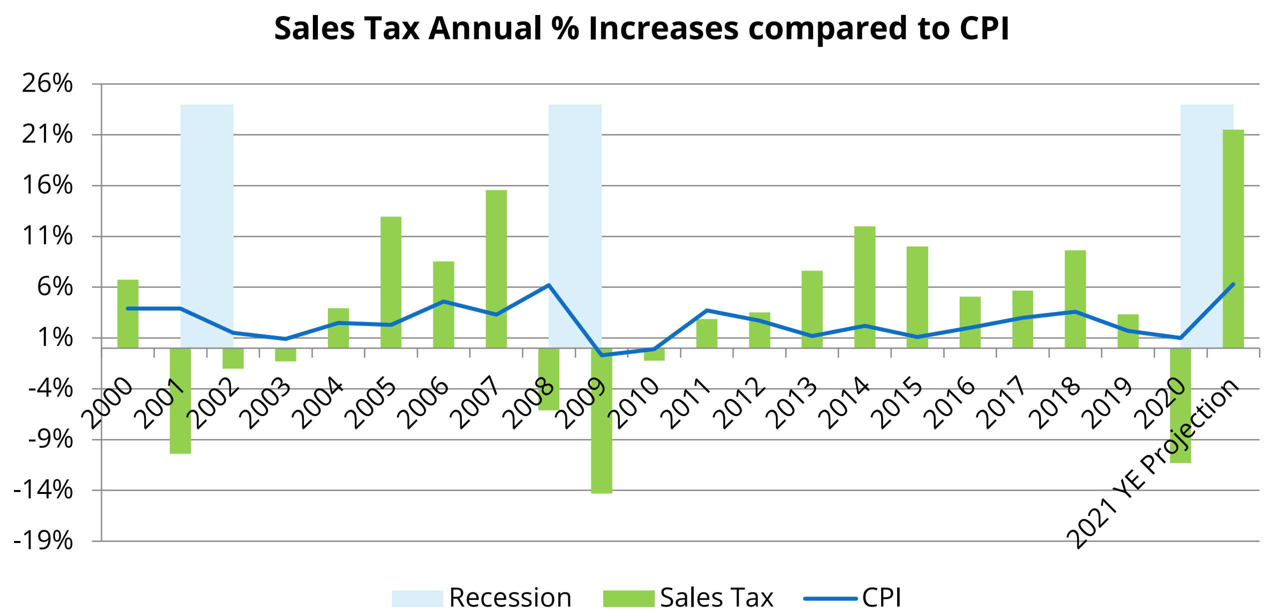
Chart 3



*Includes additional 0.1% for affordable housing as well as mental and behavioral health passed in Resolution 9826 on October 12, 2020 using authority granted by State House Bill 1590 increasing sales tax to Bellevue from 0.85% to 0.95%.

Sales tax revenue is the most volatile revenue that the City's General Fund collects. Chart 4 shows the sales tax growth since 2000 and is shown compared to the Consumer Price Index (CPI) to demonstrate the magnitude of growth and volatility.

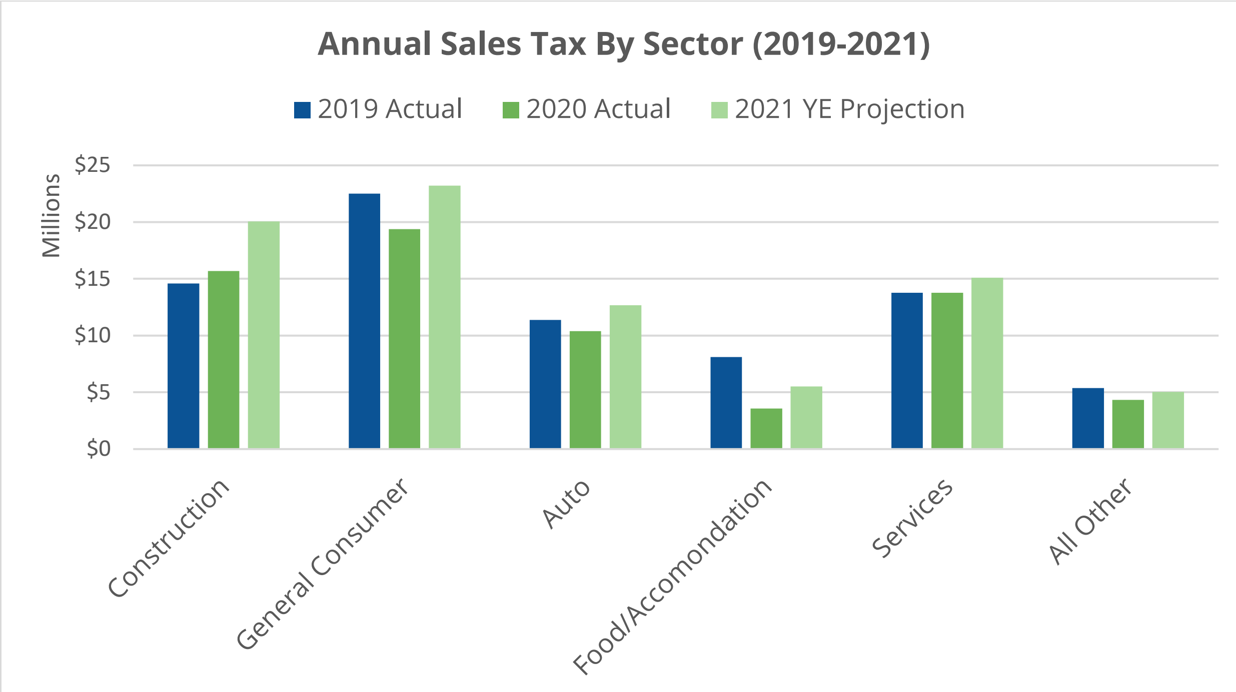
Chart 4



**One-time Department of Revenue audit refund issued in 2018 and 2019 was removed from growth rate calculation to show the trend. 2021 YE projection comes from Q2 monitoring.*

Since the Great Recession, total sales tax growth recovered at moderate speed due to the significant construction growth and the consistent recovery of food/accommodation. However, retail trade growth was recovering at a much slower speed due to the long recovery process of consumer confidence. This imbalanced growth in different sectors led to sales tax growth relying more and more on construction activities. In general, sales tax for construction is substantially one-time revenue for as long as the development cycle continues. See Chart 6. The risk to the greater reliance on construction is that at some point in time, the development cycle may reduce. Staff consistently watches the economy and development pipeline to anticipate and will return to council with any needed actions.

Chart 5



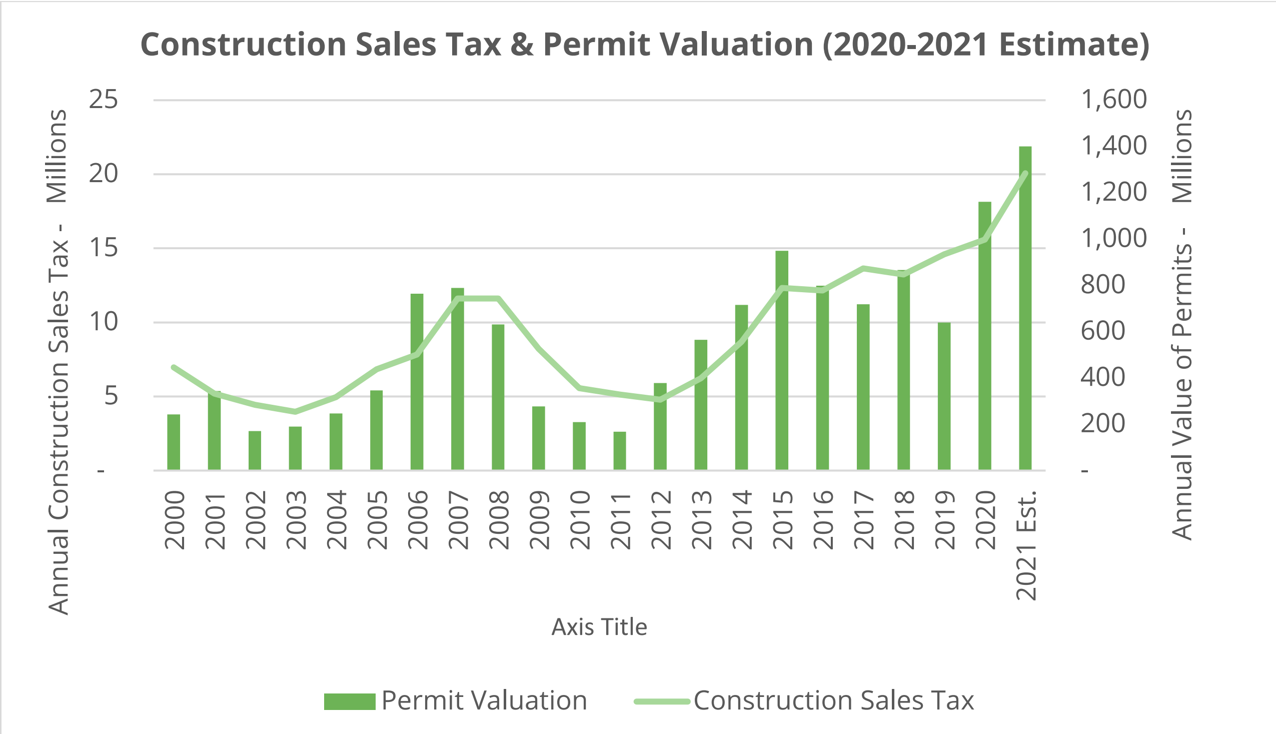
Construction

Construction activity is highly volatile and is dependent on several factors, such as the real estate market and the overall health of the economy. However, construction is essentially a one-time activity and eventually it will slow as demand diminishes. Chart 6 below shows the volatility of the construction sales tax over the previous 20 years as construction and economic cycles have ebbed and flowed within Bellevue. As a general rule, sales tax is received on major construction projects between 9 months and 18 months post permit issuance. This lag between permitting and the City capturing construction sales tax revenues can be seen in the Chart below.

Taking the Great Recession as an example, in 2007, the City permitted projects valued at $778.6 million, a historic high at the time. From 2008, through 2011 the City saw a 78.7 percent decrease in permit valuation finally bottoming out at $167.9 million in 2011. In the same period, the City saw construction-related revenues fall from a high in 2007 of $11.2 million to $4.9 million in 2011, a 56.2 percent decrease.

Bellevue's construction activities tend to move with the region's trend but are somewhat unique due to the fast growth in the BelRed and downtown areas. As construction activities near their anticipated peak, other jurisdictions around Bellevue are also watching construction activities very closely. The 2021-2026 General Fund forecast incorporated the Development Services Department's forecast and assumed the construction activities in the city will maintain its current level in the near term. Land use design review application activity remains consistent with prior years indicating that interest in future development in Bellevue continues. With 4.2 million square feet of office space currently under construction in the Bellevue Central Business District and 495,614 square feet under construction in the BelRed area, construction activity is maintaining its high growth (Source: CBRE Research, Puget Sound Office Q2 2021).

Chart 6

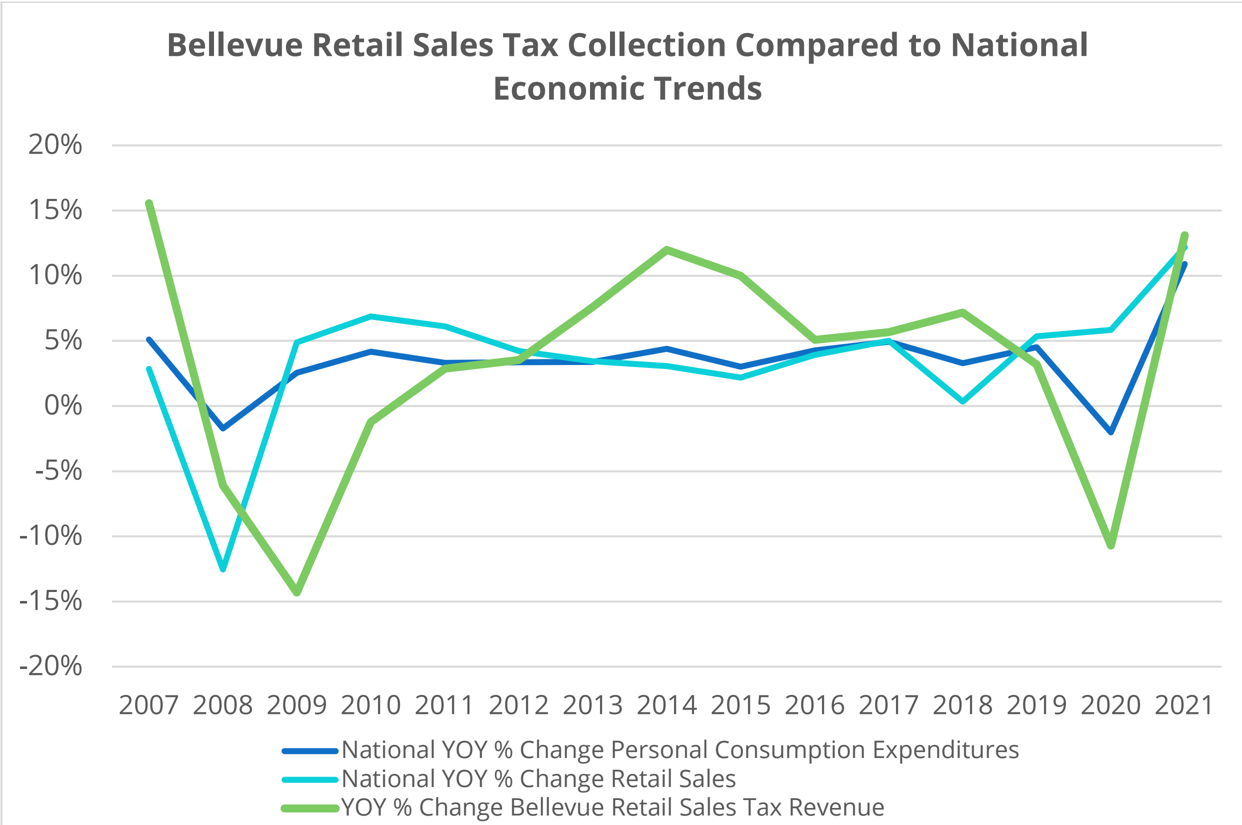


Retail Sales

Retail sales is a broad category that is comprised of sales tax generated by the sale of both store retailers operating fixed point-of-sale locations, located and designed to attract a high volume of walk-in customers and non-store retailers including electronic shopping and mail-order houses. Personal income, employment rate, consumer spending, and inflation are all highly correlated with retail sales tax revenue.

Personal income recovered more quickly than retail sales tax growth from 2009-2015 as consumers saved more than they spent during the immediate post-Great-recession. Since 2016, retail sales tax had been growing closer to personal income growth at 4.6 percent for the Seattle-Tacoma-Bellevue Metro area, which indicated a higher level of comfort with spending disposable income before COVID-19 (Source: U. S. Bureau of Economic Analysis). However, consumer spending has borne the brunt of COVID-19’s impact on the economy. U.S. retail sales saw a 3.6 percent drop in Q2 2020 (Source: U.S. Census Bureau).

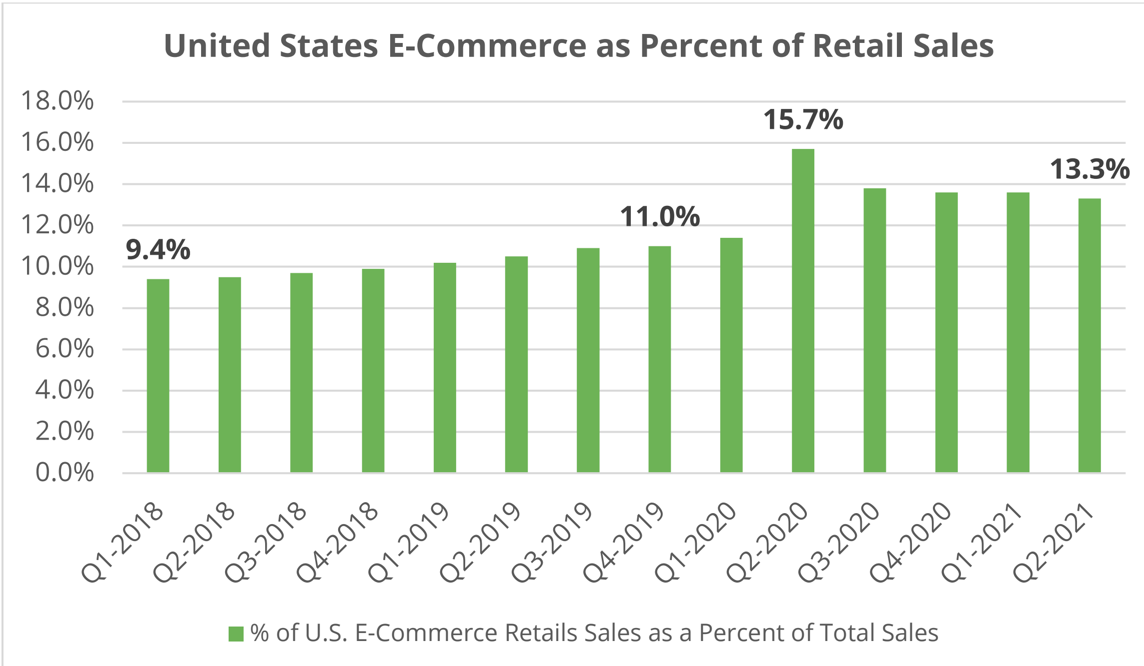
Chart 7



While the e-commerce tax base hasn't been nearly large enough to offset brick-and-mortar losses, it is mitigating the severity of the impact. The nation's e-commerce market continues to experience steady growth in its market share, making up 11 percent of total retail sales in Q4 2019, the last quarter unimpacted by the COVID-19 pandemic. The stay-at-home orders exacerbated the ongoing gradual shift to online purchases, with large retailers like Neiman Marcus recently declaring bankruptcy. U.S. e-commerce sales jumped to 15.7 percent in Q2 2020 due to the impact of the COVID-19 pandemic that forced more shoppers online. (See Chart 8) Online shopping's share of total retail spending increase in the first half of 2020 as much as it did in the prior five years combined, with Amazon having an estimated 38 percent of the U.S. e-commerce market according to eMarketer (Source: Seattle Times). Although e-commerce has grown strongly since the pandemic and stay-at-home order, brick-and-mortar sales have begun to gradually take a larger share of retail sales as physical retail locations are more readily available to consumers. While brick-and-mortar sales come back from pandemic lows, long-term outlook for physical retail remains uncertain.

Overall, retail sales tax collection will return to 2019 levels in 2021 and then grow at 4.4 percent on average from 2024 to 2026.

Chart 8



Auto Sales

Auto sales is the third largest component of sales tax, accounting for 15 percent of the total sales tax, and is another revenue that is highly volatile. Due to the COVID-19 pandemic and containment efforts, automotive domestic sales in the country fell over 58 percent year over year in April 2020. Auto sales in 2021 started to recover as the economy reopened, benefiting from pent-up demand and fiscal stimulus programs. Auto purchasing activity still faces uncertainty due to market disruptions and consumer demands caused by the pandemic, including but not limited to fewer miles driven due to remote work, shelter-in-place initiatives, supply chain and inventory issues.

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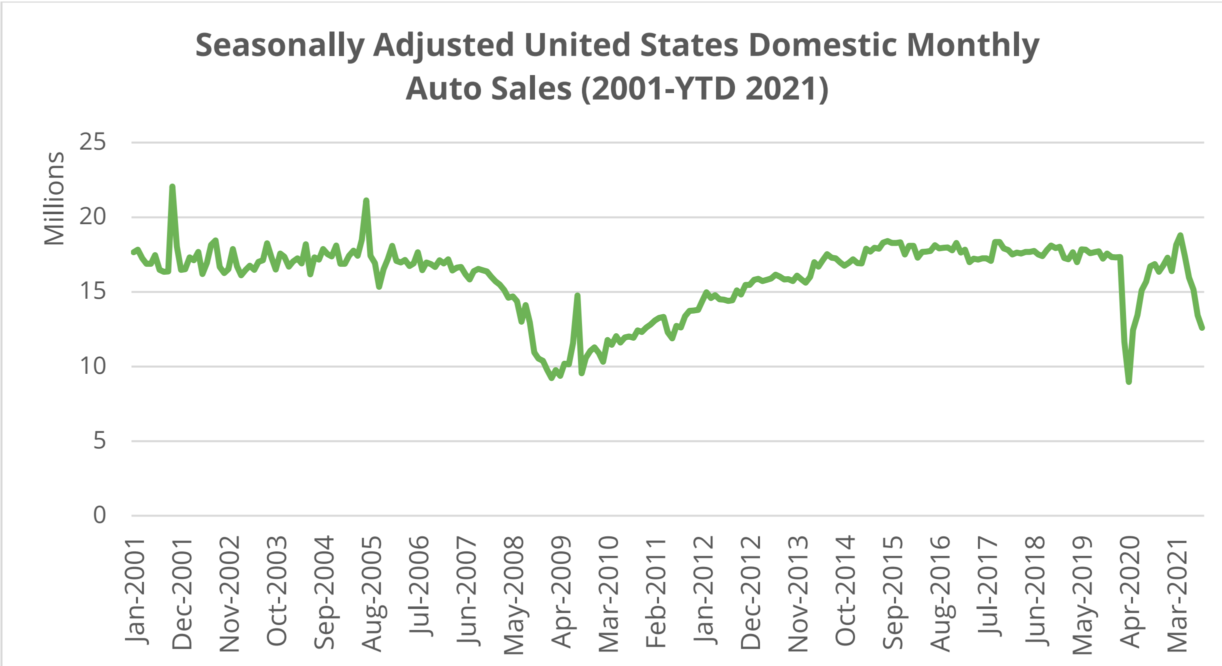
Chart 9

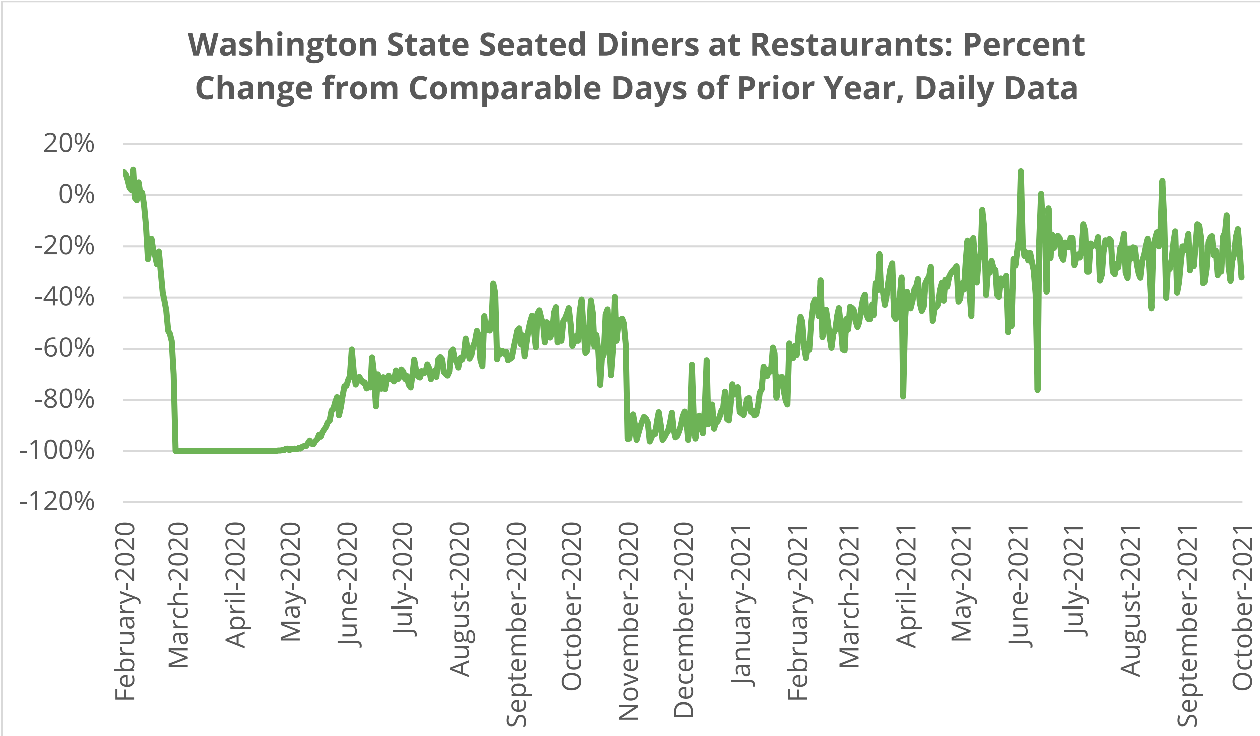


The current forecast anticipates on average 3.0 percent average annual growth, which is similar to historic average levels.

Food and Accommodation

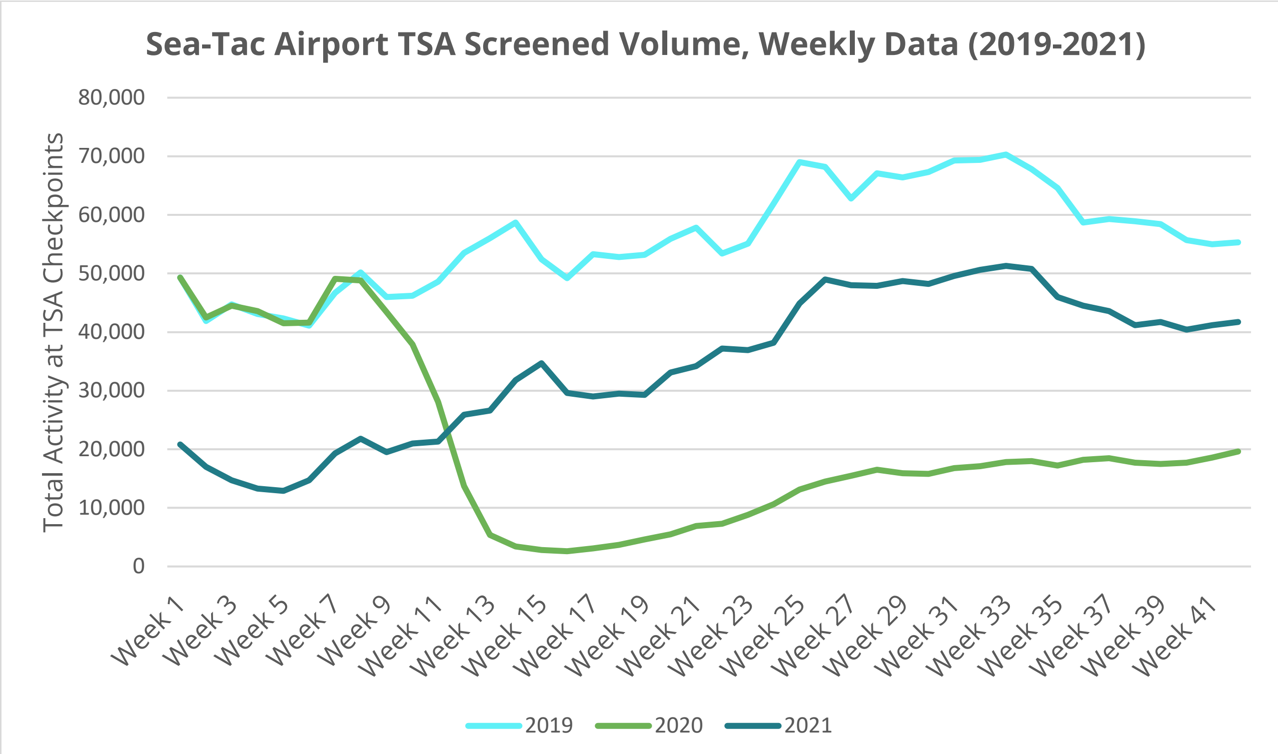
Business restrictions due to the COVID-19 were targeted toward restaurants and bars. The count of seated diners on the OpenTable platform drastically dropped to zero after the "Stay Home, Stay Healthy" order was issued. Restaurants and bars in Washington sustained themselves mostly on takeout during the economic shutdown until "Safe Start" was released. Seated dining has slowly been recovering as King County fully reopened to full capacity for indoor establishments on June 30, 2021. On October 25, 2021, King County required that people ages 12 and older will be required to show proof of full COVID-19 vaccination or a negative test result to enter certain indoor and outdoor event and establishments in King County including restaurants, bars, indoor recreation (collegiate sports, performing arts, gyms, music and movie venues, etc.), and outdoor events with 500 people or more. The impact of this vaccine mandate adds further uncertainty to food and accommodation sales tax. However, as of October 26, 71.4 percent of all King County residents had completed their vaccinations with a higher percentage 82.7 percent of the eligible (ages 12+) residents having completed their vaccine series according to King County data.

Chart 10



Tourism, one of the industries hit hardest by COVID-19, was the state's fourth-largest economic driver before the pandemic (Source: The Seattle Times). Air travel remained stagnant and had negative impacts on Seattle tourism hubs. Many hotels were closed temporarily as they waited out the virus. The chart below shows a weekly dashboard of airport activity to track economic recovery following COVID-19 for SEA and the region. Passengers throughout at Seattle-Tacoma International Airport in the third week of October (week 42). Through this point in the year, 2020 activity levels were down 64 percent from 2019. In 2021, through the same period, activity at Sea-Tac is still 39 percent below 2019 levels according to data from the Port of Seattle. As an indicator of the hotel industry, the trends in air travel were only gradually improving, which implied lower hotel room occupancy. Hotels and tourist attractions in the Greater Seattle area were struggling to boost business while contending with social distancing capacity restrictions and weak demand. Food and Accommodation sales tax collection was hit hardest by COVID-19 in 2020 with a 56 percent decline from 2019 levels and is forecasted to gradually recover back to 2019 level until 2023. For years 2023 through 2026, it is anticipated that food and accommodation will grow at an average annual rate of 7.2 percent.

Chart 11



Service

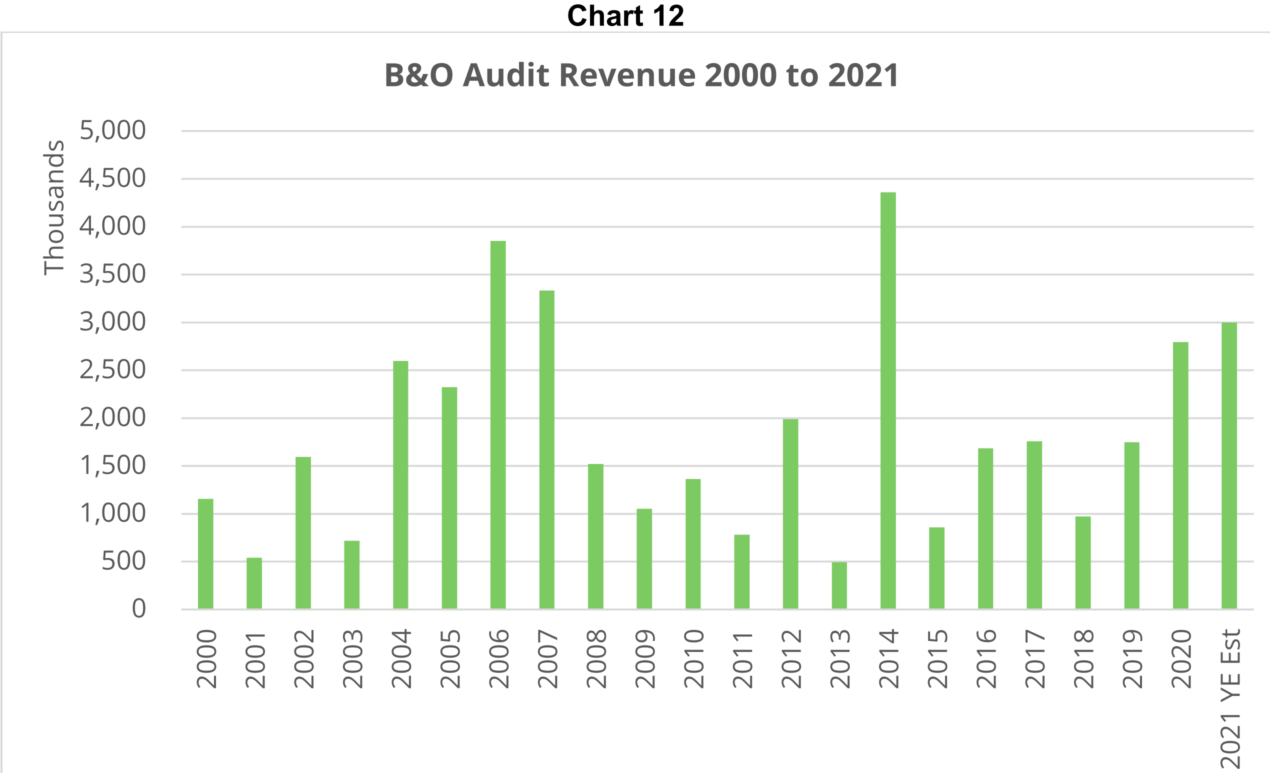
The service sector comprises various service industries including professional/business services, information services and financial services. Before COVID-19, the Greater Seattle metro area's job market expanded heartily in 2019. On the heels of strong in-migration and population growth, the majority of gains were in service sectors, especially in professional/business services, which expanded at a rapid pace of 3.9 percent year-over-year. The information services sector, the third-largest job creator, grew at a pace of 8.2 percent year-over-year as of December 2019 and was the fastest-growing employment sector. The financial services also had steady growth at 3.3 percent (Source: IHS Markit). Remote work, online education, telehealth and social distancing have created a demand for products and services delivered by the information industry. However, there is a loss in partnership opportunities and customers, as conference networking opportunities get canceled and customers are delaying purchases due to the global COVID-19 outbreak. The services industry is considered one of the less impacted industries among all sectors due to its ability to provide services remotely.

Business & Occupation Tax

Business and occupation (B&O) tax include two separate taxes including a B&O gross receipts tax which complies with the state model ordinance as well as a separate square footage tax that the City implemented in 1977.The B&O tax is the third-largest source of General Fund, accounting for 15 percent of General Fund revenue in 2019. Like sales tax, it is also economically sensitive and volatile. During the Great Recession, B&O tax collections fell 20 percent from the peak and did not return to pre-recessionary levels until 2014. Under the impact of COVID-19, B&O tax collection in 2020 is projected to be 15 percent lower than in 2019. Without audit revenue, the B&O tax collection is forecasted to grow stronger in 2021 with 10.4 percent year-over-year coming up from a deep loss in 2020, and at an average of 8.2 percent through 2023 supported by the major business movements. Without audit revenue, B&O is forecasted to grow by an average of 5 percent per year from 2024 to 2026 due to increased business growth in downtown Bellevue and the Spring District. B&O tax forecast is subject to a high degree of uncertainty due to incomplete knowledge about how the pandemic will unfold.

The city continually monitors the B&O tax base and performs audits as needed to ensure compliance with the City's B&O tax code. As noted in Chart 12, audit revenue fluctuates based on compliance with tax code.

Chart 12



General Property Tax

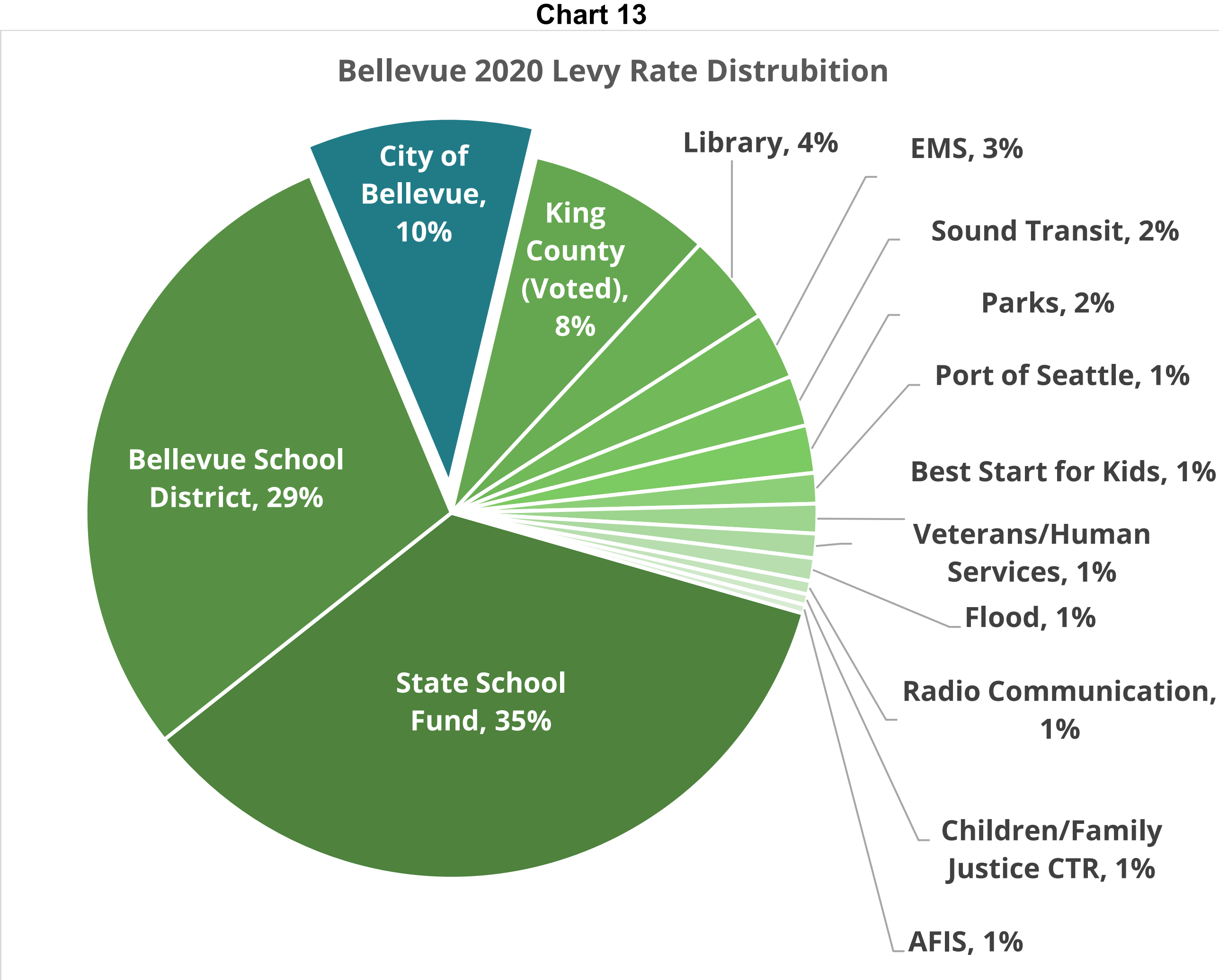
Property tax is applied to the assessed value (AV) of all taxable real and personal property located within the city, with several exceptions such as public structures (government buildings, roads, etc.), property owned by several types of non-profit organizations, personal property (up to a specified dollar value), and others.

Under Initiative 747, the regular levy can grow at a maximum of 1 percent annually or the rate of inflation, whichever is less plus additions for new construction, changes in the value of state-assessed utility property, and newly annexed property (referred to as “add-ons”). Inflation is defined as the increase in the implicit price deflator (IPD).

Bellevue’s property tax rate is one of the lowest in King County. The City’s 2021 property tax rate at $0.89 per $1,000 AV was roughly 10 percent of the most common total $8.85 rate paid by Bellevue property owners for all taxing jurisdictions such as King County, Washington State, and school districts. The 2021 property tax total and City of Bellevue tax obligations for a home of median assessed value ($961,000) in Bellevue is $8,501 and $855 respectively. Chart 13 shows the destinations of a typical Bellevue property owner’s property tax in 2021.

Due to the capped growth of property tax and its large share among all general fund revenues, the maximum of 1 percent plus new construction growth does not keep pace with the growth rate of expenditures. In 2022, the property tax 1 percent adjustment did not keep pace with the 6.3 percent inflationary growth. This forecast assumes a 1 percent statutorily available property tax adjustment in 2021 and another 1 percent in 2022. Bellevue currently has $9 million in banked capacity available.

Chart 13



Utility Tax

Utility tax is collected from eight types of utility services: electric, natural gas, garbage, telephone, cellular phone, water, sewer, and stormwater. The utility tax share to total general fund revenue decreased from 17 percent to 13 percent from 2013 to 2020 and is projected to decrease further in out years.

- In the last few years, electric and natural gas utility tax collections have flattened out due to mild weather patterns. The tax collections are forecasted to continue to be flat for out years.
- Telephone and cellular phone taxes have been on the decline and are expected to decline further during the forecasted period due to households abandoning landlines and wireless phone companies shifting the proportions of the bill more towards the untaxed data and away from voice service.
- Water and sewer utility taxes have increased in the past three years due to longer and hotter summers; the forecast assumes mild increases for water and sewer utility taxes.

In response to COVID-19, the city halted water service disconnections and waived late fees for non-payment in early March 2020. Business customers may be eligible for payment plans. Overall COVID-19 impact on utility tax is projected to be relatively small outside of the normal course of business due to the relatively stable demand for utility services. If the reopening of the economy takes longer, many of the temporary job losses could become permanent and utility tax assumptions would need to be revised.

Other Revenue

Other revenue consists of dozens of revenues collected from various sources, including excise taxes, penalty/interest delinquent tax, licenses and permits, intergovernmental – state and other cities, charges for goods and services, fines/forfeits, and other miscellaneous taxes and revenues. Intergovernmental revenues consist of revenues collected from other entities for services provided by Bellevue (e.g. Fire, Emergency Management Services, etc.). The early years of the forecast represent a bounce back in proceeds after COVID-19 for many charges for services and revenues including but not limited to Parks programing, red-light cameras and other fees. Growth in the out years (2024-2026) average 2.8 percent.

General Fund Expenditure Overview

The 2021-2026 General Fund forecast includes cost containment made in the 2021-2022 budget, then continues funding for expenditure levels in 2023 and the following impacts described below.

Urbanization

Starting with the 2018 Mid-Biennium, the City's forecast includes a modest assumption of 0.3 percent growth in total expenditures for an increase in demand for services based on the continued urbanization of the city. The forecast includes a modest 0.3 percent growth in total expenditures ($692,000 in 2023) continuing and growing annually to 2026.

Additionally, the forecast assumes new costs for the Fire Station 10 phased opening including 13 new staff as well as one-time and ongoing equipment, apparatus and, facilities costs. Of the 13 personnel included in the forecast, 7 Fire personnel are included in the 2021-2022 Adopted Budget and the remaining 6 are expected to be included in the 2023-2024 budget process to ensure that Fire Station 10 has a full complement of personnel as it serves downtown and the surrounding neighborhoods.

Inflation

Inflation is estimated using information from the King County Office of Economic and Financial Analysis, IHS Markit and, the City's prior recession history. In analyzing these sources, the City anticipates that inflation will be as follows:

2022	2023	2024	2025	2026
6.3%	3.70%	2.67%	2.48%	2.56%

Capital Investment Program Maintenance and Operations (CIP M&O)

While major maintenance and renovation projects are contained within the CIP, minor maintenance is funded with operating funds. The city has a policy that addresses funding for minor maintenance on existing infrastructure. As the city builds new infrastructure, there are limited mechanisms to ensure additional maintenance and operations funding for new facilities. Over time, this puts increasing pressure on the operating budget. In the 2021 to 2026 General Fund forecast, additional CIP M&O is assumed every year starting from 2023. The actual cost could vary depending on the actual completion date and maintenance cost.

In '000s	2023	2024	2025	2026
New Infrastructure M&O	$344	$351	$351	$351

General Fund Forecast

The 2021-2026 forecast includes the use of the councilmanic statutorily allowable 1 percent annual property tax adjustment in 2021 and 2022 only. Major tax components such as sales tax, business and occupation tax, or utility taxes are as forecasted in the sections above. Expenditures are forecasted as noted in the expenditure section above. The current forecast (see Chart 14) indicates that the General Fund ending fund balance will maintain at 15 percent in 2021 and 2022. If nothing is done, the forecast shows that it is likely that expenditures will outstrip revenues starting in 2023 resulting in ending fund balance or reserves to drop below the Council policy of 15 percent (see Chart 16).

2021-2026 General Fund Financial Forecast

Chart 14
2021-2026 General Fund Forecast
(in $000)

	Q2 Forecast 2021	Forecast 2022	Forecast 2023	Forecast 2024	Forecast 2025	Forecast 2026
Beginning Fund Balance	$43,918	$46,063	$46,063	$42,426	$37,840	$31,088
Revenue						
Property Tax	$40,317	$41,318	$42,122	$42,757	$43,407	$44,082
Sales Tax	$57,863	66,463	$68,117	$71,173	$74,568	$77,977
Business & Occupation Tax	$33,805	38,487	$41,010	$42,806	$44,688	$46,898
Utility Taxes	$27,607	27,732	$28,234	$28,589	$29,192	$29,843
Miscellaneous Revenue	$57,546	60,361	$64,437	$66,012	$67,937	$69,928
Total Revenue	$217,137	$234,360	$244,389	$252,020	$260,692	$269,856
%∆ Total Revenue	10.3%	5.3%	4.1%	3.0%	3.4%	3.4%
Expenditures						
Personnel	$131,791	$143,126	$153,250	$158,809	$165,095	$160,291
Maintenance & Operations	$83,201	$91,235	$94,306	$97,115	$101,448	$106,168
Total Expenditures	$214,992	$234,360	$247,556	$255,924	$266,543	$277,885
%∆ Total Expenditures	6.8%	9.0%	5.6%	3.4%	4.1%	4.3%
Revenue Less Expenses	**$2,145**	**$0**	**($3,637)**	**($4,586)**	**($6,752)**	**($9,157)**
Ending Fund Balance	$46,063	$46,063	$42,426	$37,840	$31,088	$21,930
EFB as a % of Revenue	**21.2%**	**19.7%**	**17.4%**	**15.1%**	**12.0%**	**8.2%**

As displayed in Chart 16 on the following page, the City's ending fund balance is forecasted to be below 15 percent by 2025. Council financial policies require a 15 percent minimum ending fund balance.

As with all forecasts, this is the best estimate of the future, representing the collection of all fiscal information known as of October 2020. State law requires that the City adopt a balanced budget each year. Over time, as the City takes actions that impact the ongoing financial condition in the early years, the deficit in the out years will decrease.

The forecast is updated three times per year, in March (early look for the next year), in July (post final CPI-W announcement), and in September/October (as related to the Preliminary Budget or Mid-Biennium Update before the council).

Notes:

- This forecast includes Fire Station 10 impact and New Infrastructure M&O
- Includes 1% property tax adjustment in both 2021 and 2022.
- Assumes major construction projects continue at the current high level of activity.
- 2022 CPI-W is 6.3% as released by the Bureau of Labor Statistics.

2021-2026 General Fund Financial Forecast

· Assumes Inflation is estimated using information from the King County Office of Economic and Financial Analysis, IHS Markit and, the City's prior recession history ranging from 2.48% to 3.57%.
· Includes an urbanization factor of 0.3% of the total expenditure.

Chart 15

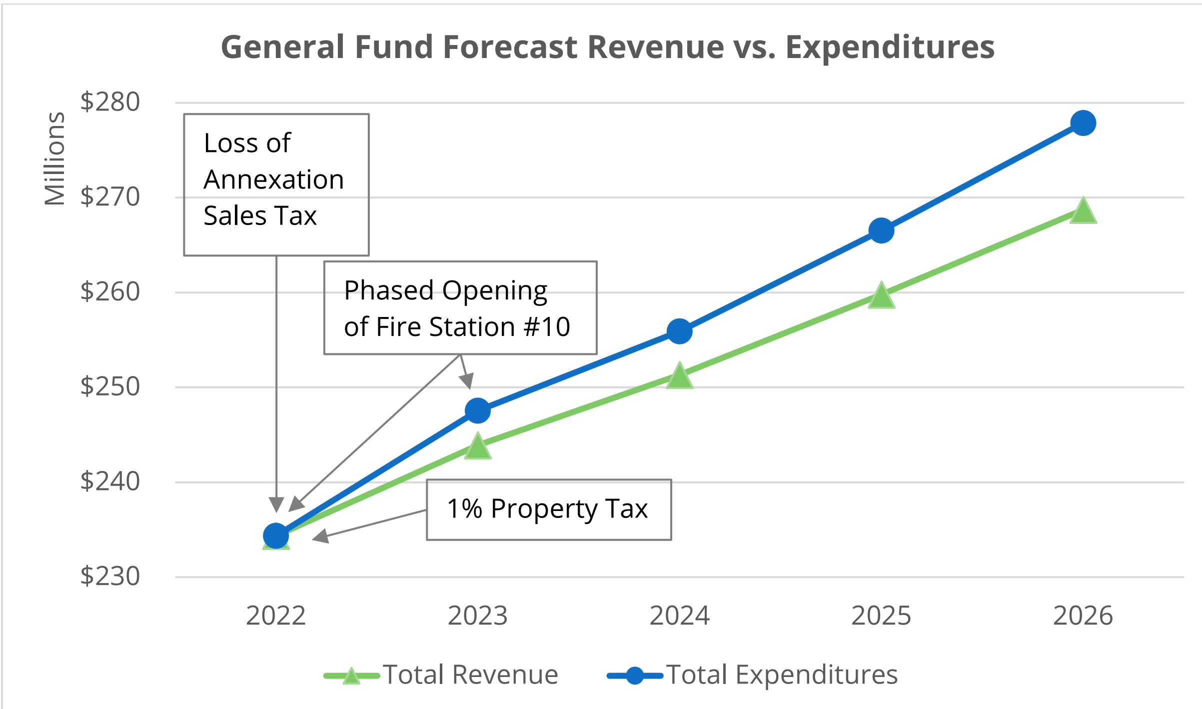
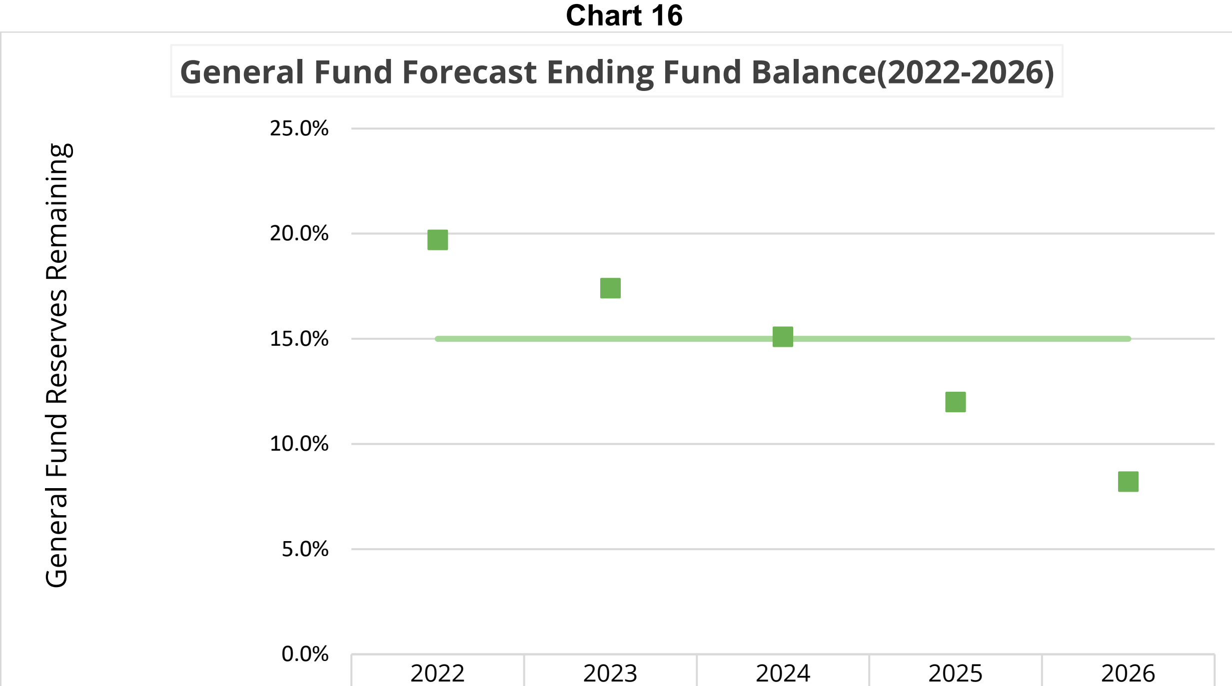


Chart 16



	2022	2023	2024	2025	2026
Ending Fund Balance	19.7%	17.4%	15.1%	12.0%	8.2%
15% Reserve	15.0%	15.0%	15.0%	15.0%	15.0%