

2018-2023 General Fund Financial Forecast

Executive Summary:

- ***Revenues:*** *The 2018-2023 general fund forecast projects modest revenue growth for 2018-2023.*
 - *The mid-biennium 2018-2023 forecast includes the proposed use of the councilmanic statutorily allowable 1 percent annual property tax increase in 2018 only.*
 - *Sales tax is strong, primarily due to new revenue from the state legislature passing the Marketplace Fairness Act which expands the sales tax base by instituting taxation on Out-of-State internet sales, increasing the city's total sales tax by \$1.3 million in 2018 (\$0.9 million to the general fund), growing to \$3.0 million in 2023 (\$2.2 million to the general fund). The new revenue increases the sales tax rate of growth in 2018 by 1.9 percent. Estimates are from the Washington State Department of Revenue.*
 - *Sales tax growth is forecast for 2018 and 2019 at 5.7 percent and 5.3 percent without marketplace fairness impact respectively, reducing to 4.5 percent by 2023.*
 - *Business & occupation (B&O) tax continues to perform well due to increased audit activity.*
- ***Expenditures:*** *The 2018-2023 general fund forecast continues funding for existing service levels.*
 - *Historically, the city's forecast did not include an assumption for an increase in demand for services based on the continued urbanization of the city. Based on a 5-year history of cost increases from 2013 to 2017, the forecast now includes a modest 0.37 percent growth in total expenditures (\$780,000 in 2019) continuing and growing annually to 2023.*
 - *The 2018-2023 forecast assumes new costs for the opening and staffing of Fire Station (FS) #10, including new apparatus, ongoing maintenance & operations, and 13 staff with assumption for open in 2022.*
 - *The forecast continues to build in the cost of converting Law Enforcement Officers' and Fire Fighters' (LEOFF) I to "pay as you go."*
- ***Reserves:*** *The 2018-2023 general fund forecast continues to build reserves in the early years to better position the city to address the known events of the conversion of LEOFF 1 to "pay as you go," the expiration of sales tax annexation revenue in 2021, as well as help protect the city in case of an economic downturn or if the new sales tax marketplace fairness revenue does not perform as estimated by the state.*
- ***Conclusion:***
 - *Assuming no change in revenues or expenditures, the current forecast shows the general fund continuing to build reserves through 2020 and then will be drawn on to balance the budget in the out years, which is not a long term financially sustainable strategy.*
 - *Sales and B&O tax, the most economically volatile revenue streams, continue to account for a growing portion of city revenues (partially due to new marketplace fairness revenue), from an estimated at 41 percent in 2018 to 44 percent in 2023. An increased reliance on these streams adds a greater risk during economic downturns.*
 - *Excluding any personnel in interfunds, personnel costs for existing staff accounts for 63 percent of total general fund costs. Growth in personnel are due to primarily medical and dental self-insurance rates, state pension contribution, and salaries.*

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General Fund Revenue Overview

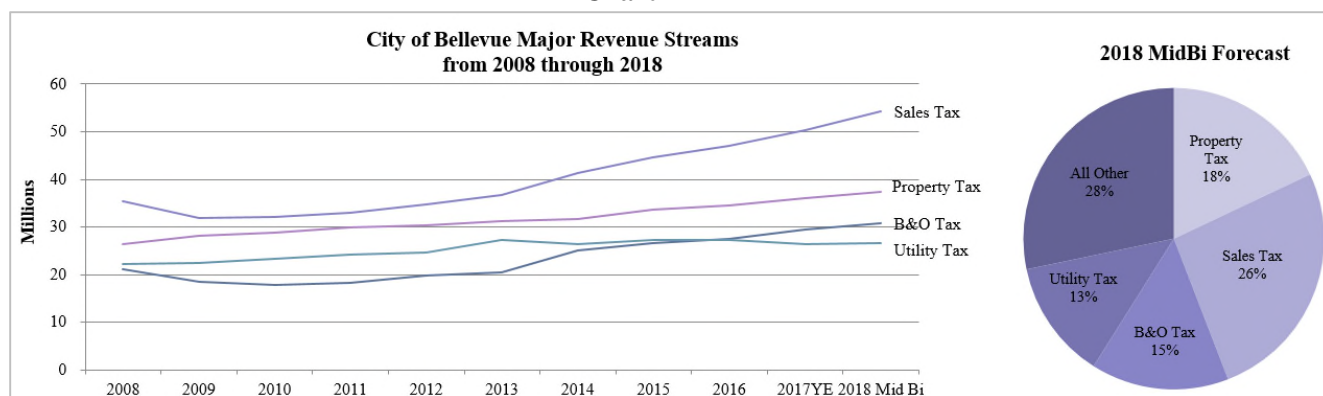
The city's mix of revenue consists of property tax, sales tax, business and occupation (B&O) tax, utility tax, user fees, state-shared revenue, as well as other smaller revenue sources. These revenue sources fall into essentially five categories: sales tax, B&O tax, property tax, utility tax, and all other revenue.

Overall, the city's General Fund forecast assumes a modest growth of tax revenue for the next few years, recognizing that the Puget Sound area economy will continue to grow, but at a slowed pace from recent years. Each general fund revenue stream grows at a different rate; some very slowly like property tax (based on new construction), and some at a greater rate such as Sales and B&O taxes.

Sales and B&O taxes (most economically volatile revenue streams), combined, comprise an average 43 percent of total General Fund revenue in 2019-2023 (41 percent in 2018 growing to 44 percent in 2023). In 2016, Sales and B&O accounted for 39 percent of the city's actual general fund revenue. The increase in proportionate share is primarily due to new marketplace fairness revenue provided by Engrossed House Bill (EHB) 2163 that expands the sales tax base by instituting taxation of sales over the internet and through catalogs for out of state sellers beginning in January 2018, and the faster growth of sales tax compared to other revenue streams. The proportionate share increase is both a positive and negative – positive in that the continued growth is supporting the existing service levels in the city and assisting in building reserves in the near-term, and negative in that greater reliance on these streams has a higher risk to the city during economic downturns.

Chart 1 shows major revenue stream historical trends and the pie chart is based on the 2018 Mid-Biennium (Mid-Bi) forecast. The following sections provide details on each major revenue category.

Chart 1



* The 2018 sales tax forecast includes online sales tax expansion revenue estimated by Washington State Department of Revenue that result from the passage of Engrossed House Bill (EHB) 2163 in June 2017 as part of the state budget package.

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Sales and Use Tax

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 0.85 percent tax on retail goods and services. Chart 2 shows Bellevue's sales and use tax rate components. Sales tax revenue is the most volatile revenue the city's General Fund collects. During the Great Recession, sales tax collections fell 21 percent from its peak in 2007 to the trough of the recession in 2010. Chart 3 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 2

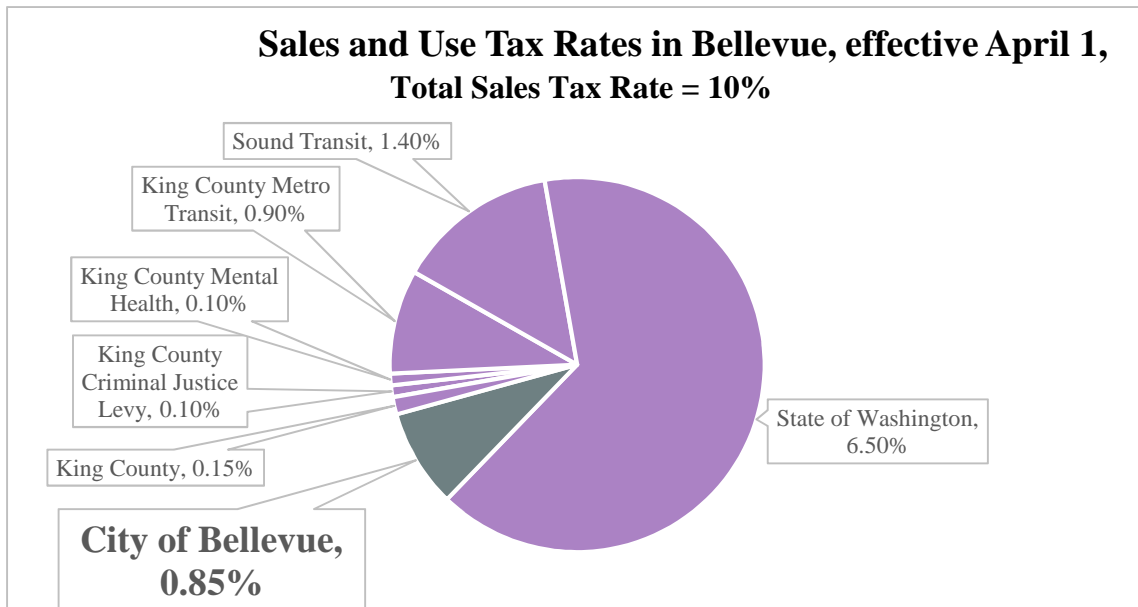
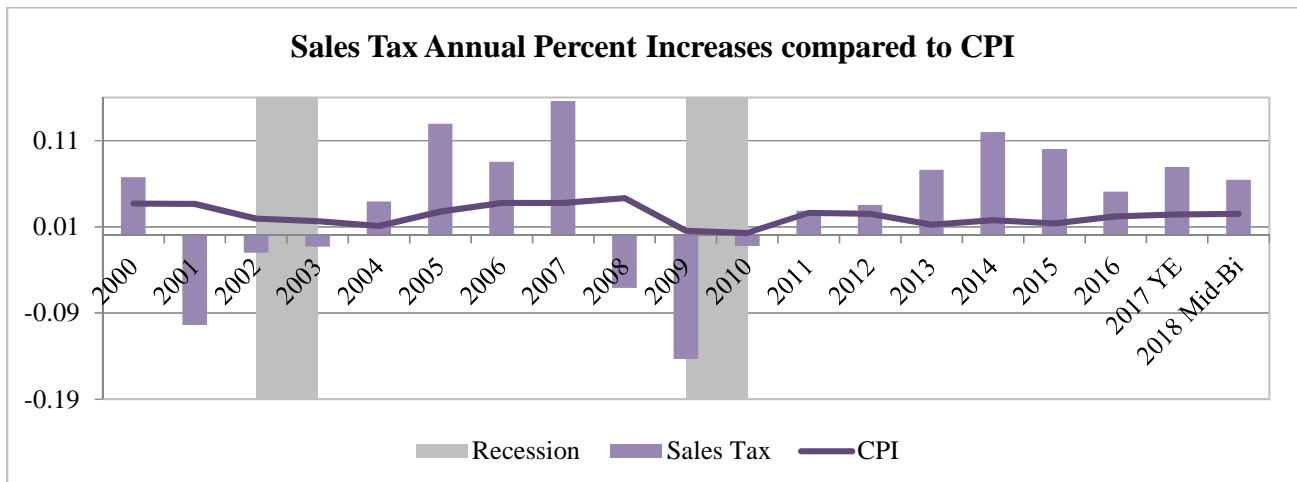


Chart 3



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Sales tax is reported to the city by sector. The major sectors for Bellevue are construction, retail sales, and auto sales, which together comprise 60 percent of sales tax revenue. All other retail sales tax sectors make up the remaining balance.

Construction

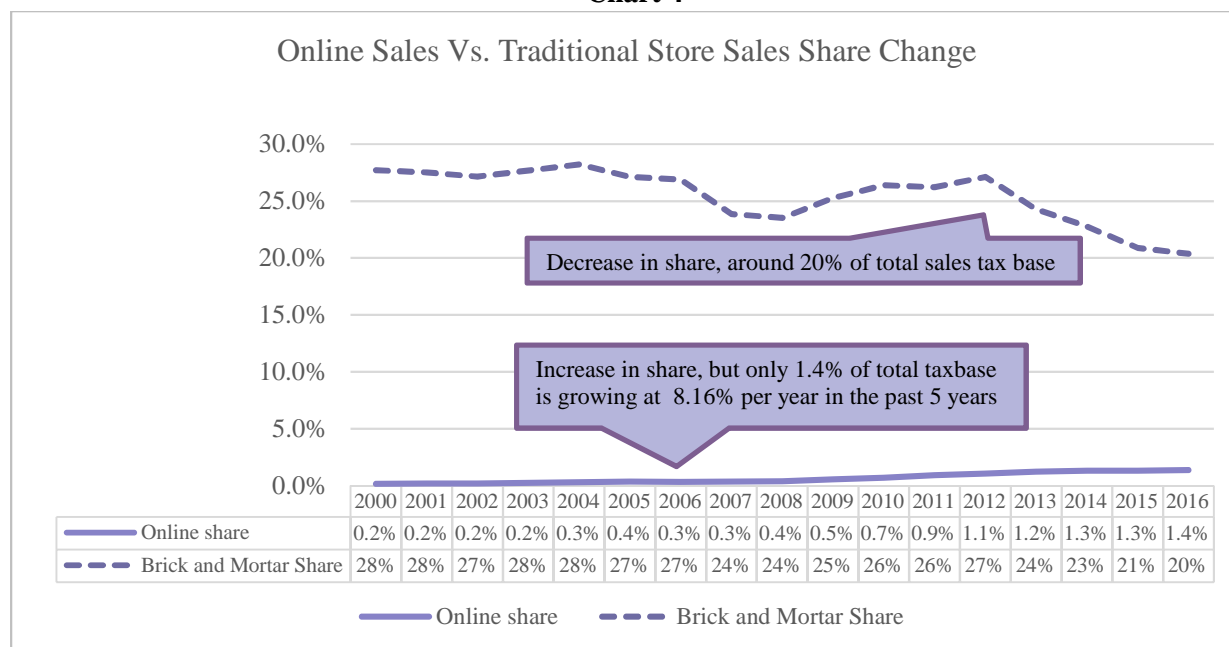
Due to the increasing level of growth, construction contributed 19 percent to the overall sales tax revenue in 2016. The forecast assumes a flattening of construction growth in the near term and a slight decline starting in 2020. These assumptions are in line with Development Services forecasts. As a general rule of thumb, sales tax is received on major construction projects between 9 months and 18 months post permit issuance.

Retail Sales

Retail sales is a broad category that is comprised of both durable and non-durable goods. Personal income, employment rate, consumer spending, and inflation are all highly correlated with sales tax revenue. Personal income recovered more quickly than sales tax growth from 2009-2015 as a result of people's personal spending habits changing after the recession. Since 2016, retail sales tax has been growing closer to personal income growth which indicates a higher level of comfort with spending disposable income.

As the public's spending habits shift from purchases in retail store locations to online stores, the sales tax share for department stores decreased while the electronic shopping category of sales tax increased. However, as shown in Chart 4, online sales tax is only 1 to 2 percent of the total tax base. The higher growth rates of online stores per year in the past five years does not make up the decrease in brick and mortar stores.

Chart 4



Source: Washington State Department of Revenue sales and use tax database

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Auto Sales

Auto sales has grown an annual average of 7 percent since 2010. After a growth peak in 2012 and 2013 at 11 percent, growth slowed to around 5 to 8 percent per year from 2013 through 2016. Auto sales contributed 15 percent to the overall sales tax revenue in 2016. Sales are projected to grow at 5.2 and 5.7 percent in 2018 and 2019 respectively, and slow down starting in 2020. Auto sales is another revenue that is sensitive to the economic environment and is highly volatile considering the 18 percent and 9 percent decrease in 2008 and 2009 respectively.

Overall Forecast 2018-2023

The forecast incorporates marketplace fairness revenue gains that result from the passage of EHB 2163 in June 2017 as part of the state budget package. EHB 2163 expands the sales tax base by expanding the taxation of out-of-state internet and catalog sales beginning in January 2018. Expanding the taxation of remote sales will increase the city's total sales tax revenue by an estimated \$1.3 million (\$0.9 million to the General Fund) in 2018 growing to \$3.0 million by 2023 (\$2.2 million to the General Fund), according to estimates by the Washington Department of Revenue. The city budget staff will be watching the collections of the new revenue stream and will adjust the forecast if needed, based on actual collections.

Chart 5 below provides a comparison of the city's sales tax forecast to Seattle, King County, and Washington State. Bellevue is showing slightly stronger growth in the near term, and in the long run, 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.

Chart 5

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-----------------------|-------|-------|-------|-------|-------|-------|
| Bellevue* | 5.70% | 5.37% | 4.93% | 4.13% | 4.34% | 4.50% |
| Seattle** | 4.50% | 2.80% | N/A | N/A | N/A | N/A |
| King County*** | 5.64% | 4.48% | 3.42% | 3.77% | 4.11% | 3.77% |
| Washington State **** | 4.00% | 4.10% | 3.80% | 3.60% | N/A | N/A |

*Bellevue sales tax growth excludes the online sales tax expansion revenue

**Seattle sales tax growth rate is from Seattle's 2018 proposed budget

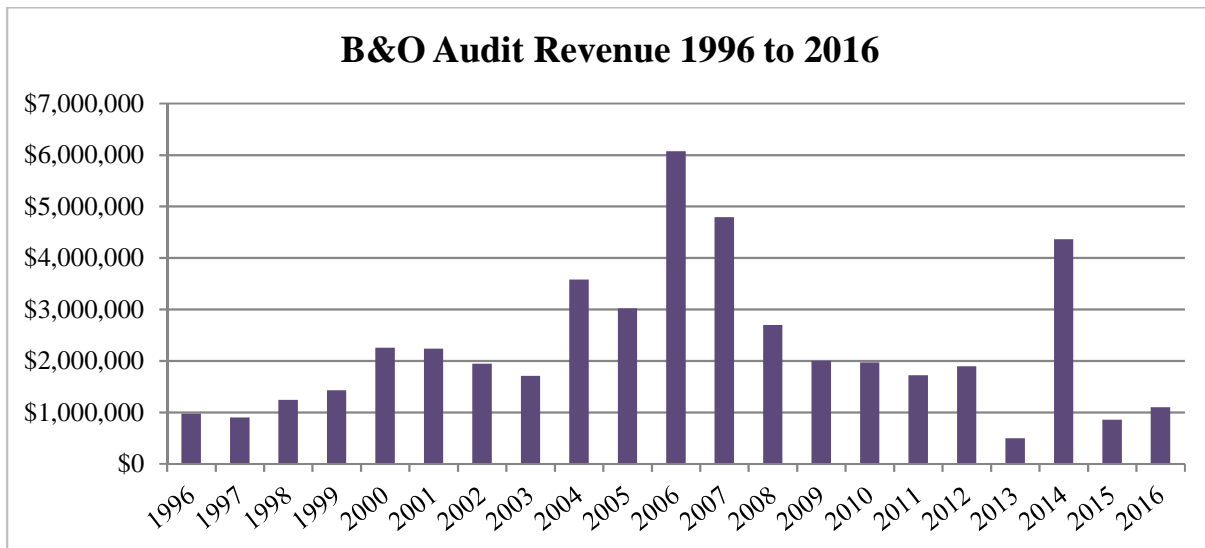
***King County sales tax growth rate from King County's August 2017 forecast

****Washington State Final September 2017 forecast published by Washington State Economic and Revenue Forecast Council

2018-2023 General Fund Financial Forecast**Business & Occupation Tax**

Business and occupation (B&O) tax is made up of two parts, gross receipts and square footage taxes. This revenue, like sales tax, is subject to volatility brought on by economic risk. During the recession, B&O tax collections fell 20 percent from the peak. Over the last 10 years, B&O tax accounted for 14 percent of the City's General Fund revenue. B&O tax returned to pre-recessionary levels in 2014. The forecast assumes average annual B&O tax growth of 4.6% from 2018-2023.

The city continually monitors the B&O tax base and as well as audit findings that may require either a refund to the tax payer or an additional payment to the city. Audit revenue (Chart 6) is highly volatile and has ranged from several hundred thousand dollars to nearly \$4.4 million. The 2018-2023 forecast assumes \$1.5 million in audit recoveries annually.

Chart 6

2018-2023 General Fund Financial Forecast

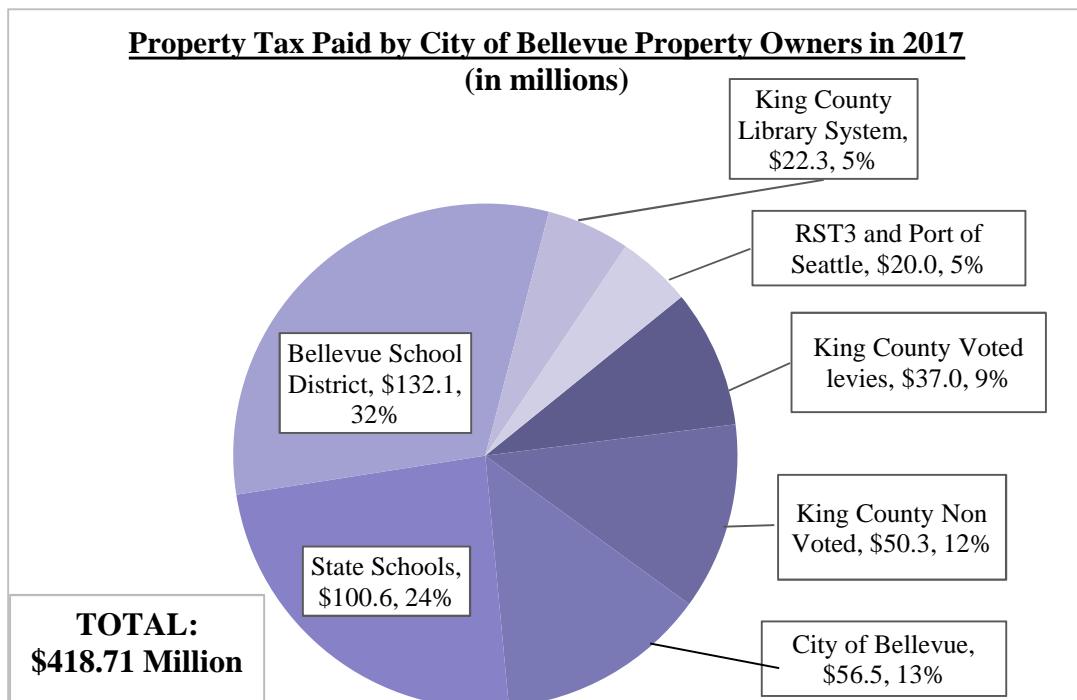
General Property Tax

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. Inflation is defined as the increase in the implicit price deflator (IPD), plus additions for new construction, changes in value of state-assessed utility property and newly annexed property (referred to as “add-ons”).

Bellevue’s property tax is one of the lowest in King County. The city’s 2017 property tax rate at \$1.14 per \$1,000 AV was roughly 13 percent of the most common total \$8.72 rate paid by Bellevue property owners for all taxing jurisdictions such as King County, the State, and school districts. The 2017 property tax total and City of Bellevue tax obligations for a home of median assessed value (\$687,000) in Bellevue was \$5,991 and \$784 respectively. Chart 7 shows the destinations of a typical Bellevue property owner’s property tax collected in 2017.

Chart 7



The 2018 mid-biennium forecast includes the proposed use of the councilmanic statutorily allowable 1 percent annual increase for 2018 only or an increase in property tax to the City of \$428,000. The forecast assumes no councilmanic property tax increase in the out years. Bellevue currently has \$9.1 million in banked capacity available.

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Utility Tax

Utility tax is collected from eight types of utility services: electric, natural gas, garbage, telephone, cellular phone, water, sewer and storm water. The utility tax's share to total general fund revenue decreased from 17 percent to 14 percent from 2013 to 2016, and is projected to decrease to around 13 percent in 2017 and 2018.

- In the last few years, electric and natural gas utility tax collections have flattened out due to conservation efforts and mild weather patterns.
- Telephone and cellular phone taxes have been on the decline and are expected to decline further 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.

Other Revenue

Other revenue consists of dozens of revenues collected from various sources, including excise taxes, sales tax annexation credit, 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.).

State funding, sometimes referred to as State-Shared Funds, consists of distribution from State taxes such as the liquor excise tax, liquor board profits, motor vehicle fuel tax, and marijuana excise tax. These revenues have been affected by State budget changes in the past and could be affected in future state budgets.

Liquor Excise Tax

A portion of the basic spirits sales tax on sales to consumers and restaurants are shared with eligible counties, cities or and towns. "Spirits" are any beverage which contains alcohol obtained by distillation, except flavored malt beverages, but including wines exceeding 24 percent of alcohol by volume. Based on the budget suggestions published by Municipal Research and Services Center (MRSC), the per capita rate for city distributions in 2018 is estimated to be \$4.92, multiplied by the city's 2017 population of 140,700 estimated by the Office of Financial Management (OFM), or \$690,000 in 2018.

Liquor Board Profits

Liquor board profits consist of the difference between revenue generated by the Washington State Liquor Control Board and the board's expenditures, and a portion of these liquor profits goes to cities, counties, and border jurisdictions. Based on the budget suggestions published by MRSC, the per capita rate for city distributions in 2018 is estimated to be \$8.29, multiplied by the city's 2017 population of 140,700 estimated by OFM, or \$1.17 million in 2018.

Motor Vehicle Fuel Tax (MVFT)

Washington State shares fuel tax with local jurisdictions on a per capita basis. Fuel taxes in Washington are assessed as cents per gallon. Fuel tax revenue depends on the number of gallons sold, not the dollar value of the sales. Counties, cities, and towns receive a share of the multi-modal funds and the increase in fuel tax as a result of Second Engrossed Substitute Senate Bill 5987. The legislation provided for direct distributions to be phased in over the 2015-17 and 2017-19 biennium. The result is a combined annual

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distribution to counties, cities, and towns, starting with the state fiscal year 2018. These direct transfers are split equally between cities and counties, with the distribution to cities based on population. Based on the budget suggestions published by MRSC, the per capita rate for city distributions in 2018 is estimated to be \$21.72, multiplied by the city's 2017 population of 140,700 estimated by OFM, or \$3.06 million in 2018. The MVFT revenue is split between general fund and CIP at 48 percent (\$1.47 million) and 52 percent (\$1.59 million) respectively.

Marijuana Excise Tax

The State distributes a portion of the marijuana excise taxes to the Liquor and Cannabis Board (LCB) and various state agencies and programs on a quarterly basis. As part of the State's 2016 budget, marijuana related tax revenues are being shared with local jurisdictions for public safety purposes. Only those cities in counties that have legalized marijuana sales will receive excise tax distributions based on both their jurisdictions proportion of marijuana related sales as well as a per capita basis. The State distributes 30 percent of the total marijuana excise tax to cities and counties with a cap at \$15 million in 2018 and 2019 then \$20 million each year thereafter; 70 percent of the distribution will be on a per capita basis with 60 percent going to counties, and the remaining 30 percent will be based on the proportional share of the total marijuana revenues generated. Based on the budget suggestions published by MRSC, the per capita rate for city distributions in 2018 is estimated to be \$0.35, plus another 30 percent based on the marijuana sales in Bellevue. The city is projecting to receive \$700,000 in 2018.

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General Fund Expenditure Overview

Demand for Services

The 2018-2023 general fund forecast continues funding for existing service levels. Historically, the city's forecast did not include an assumption for the any increase in demand for services based on the continued urbanization of the city. Based on a 5-year history of cost increases from 2013 to 2017, the forecast now includes a modest 0.37% growth in total expenditures (\$780,000 in 2019) continuing and growing annually to 2023.

Fire Station #10

The forecast assumes new costs for the opening and staffing of fire station #10 including new apparatus and 13 staff starting in 2021. The chart below breaks down the best estimate today for total cost of fire station #10 by year for the forecasting period. Since fire station #10 will not open until 2022, staff has assumed a contingency of 25 percent of non-personnel costs. As final design is developed, these costs will be reviewed and updated. These are best estimates as of today.

| Fire Station 10 Expenditure Impact Estimation as of October 2017: | | | |
|--------------------------------------------------------------------------|---------|---------|---------|
| (In \$000s) | 2021 | 2022 | 2023 |
| Personnel (1 captain, 2 lieutenants, 3 engineers, and 7 firefighters) | \$595 | \$2,176 | \$2,266 |
| Apparatus | 894 | | |
| All other costs (including 25% contingency on non-personnel costs) | 615 | 781 | 799 |
| Fire Station 10 Expenditure impact | \$2,204 | \$2,957 | \$3,065 |

Inflation

Inflation is estimated by Puget Sound Economic Forecaster's CPI-W index as follows:

| 2019 | 2020 | 2021 | 2022 | 2023 |
|------|------|------|------|------|
| 2.5% | 2.4% | 2.4% | 2.2% | 2.2% |

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 places increasing pressure on the operating budget. In the 2018 to 2023 General Fund forecast, an additional CIP M&O of \$625,000 in 2019 and \$75,000 in 2021 is included in the M&O expenditure line for projects that are expected to complete in 2018 and 2020. The actual cost could vary depending on the actual completion date and maintenance cost.

LEOFF1

The Law Enforcement Officers and Firefighters Plan 1 (LEOFF 1) medical reserve, which set aside funding to pay for the city's liability, is forecasted to be fully depleted in 2019. The city will begin to pay for its liability as a "pay as you go" option, increasing the city's General Fund exposure by an estimated \$2.3 million annually. This increase is included in the out year General Fund forecast.

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Other

The forecast also includes estimated employer impact to the General Fund of \$200,000 per year starting in 2019 for Senate Bill 5975 - Paid Family and Medical Leave. The actual cost could change as detailed analysis and implementation of the SB 5975 is done.

General Fund Forecast

The General Fund forecast is projecting revenues to exceed expenditures in the near term (2018-2020); the out-year forecast reflects the reverse. The mid-biennium 2018-2023 forecast includes the proposed use of the councilmanic statutorily allowable 1 percent annual property tax increase for 2018 only. All other rates for major tax components such as sales tax, business and occupation tax, or utility taxes stay the same. Expenditures are forecasted as noted in the expenditure section above.

As displayed in Table 1 on the following page, the city's ending fund balance for 2017 year-end is estimated to be 20.8 percent based on second quarter 2017 monitoring reducing to 12.1 percent by 2023. The Council financial policies adopt a 15 percent minimum fund balance requirement.

As with all forecasts, this is a best estimate of the future, representing the collection of all fiscal information known as of October 2017. 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 Council).

Conclusion

Assuming no change in revenues or expenditures, the current forecast shows the general fund continues to build reserves through 2020 and then will be drawn down to balance the budget in the out years which is not a long term financially sustainable strategy.

There are several out-year risks which city staff will continue to watch carefully such as if the new marketplace fairness revenue does not perform according to the data provided by the State Department of Revenue, health and dental rates, and economic recession.

2018-2023 General Fund Financial Forecast**Table 1**

| | Mid-Bi 2018 | Forecast 2019 | Forecast 2020 | Forecast 2021 | Forecast 2022 | Forecast 2023 |
|----------------------------------|------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Beginning Fund Balance | \$40,981 | \$44,636 | \$47,315 | \$48,389 | \$45,268 | \$38,370 |
| Revenue | | | | | | |
| Property Tax | \$37,312 | \$38,132 | \$38,953 | \$39,765 | \$40,586 | \$41,418 |
| Sales Tax | 54,216 | 57,511 | 60,546 | 63,154 | 65,982 | 69,045 |
| Business & Occupation Tax | 30,733 | 31,851 | 33,411 | 35,070 | 36,726 | 38,571 |
| Utility Taxes | 26,519 | 26,719 | 26,995 | 27,338 | 27,641 | 27,980 |
| Miscellaneous Revenue | 58,626 | 60,405 | 61,983 | 63,686 | 64,369 | 65,950 |
| Total Revenue | \$207,406 | \$214,618 | \$221,889 | \$229,013 | \$235,305 | \$242,964 |
| %Δ Total Revenue | 5.3% | 3.5% | 3.4% | 3.2% | 2.7% | 3.3% |
| Expenditures | | | | | | |
| Personnel | \$124,033 | \$130,817 | \$137,721 | \$146,945 | \$155,104 | \$162,905 |
| Maintenance & Operations | 79,718 | 81,122 | 83,095 | 85,189 | 87,098 | 89,035 |
| Total Expenditures | \$203,751 | \$211,939 | \$220,816 | \$232,134 | \$242,202 | \$251,940 |
| %Δ Total Expenditures | 5.1% | 4.0% | 4.2% | 5.1% | 4.3% | 4.0% |
| Revenue Less Expenses | \$3,655 | \$2,679 | \$1,073 | (\$3,121) | (\$6,898) | (\$8,976) |
| 1% Prop. Tax for Fire Station 10 | \$428 | \$431 | \$433 | \$435 | \$437 | \$440 |
| Ending Fund Balance | \$44,636 | \$47,315 | \$48,389 | \$45,268 | \$38,370 | \$29,394 |
| EFB as a % of Revenue | 21.5% | 22.0% | 21.8% | 19.8% | 16.3% | 12.1% |

Notes:

- This forecast includes the sales tax marketplace fairness impact estimated by DOR, Fire Station 10 impact, and 1% property tax increase in 2018 only.

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Sales Tax Marketplace Fairness | \$969 | \$1,406 | \$1,672 | \$1,847 | \$2,013 | \$2,195 |
| Fire Station 10 Expenditure impact | | | | \$2,204 | \$2,957 | \$3,065 |
| 1% Prop. Tax increase in 2018 impact | \$428 | \$431 | \$433 | \$435 | \$437 | \$440 |

- This forecast assumes a net zero impact for ACA, we are watching national events for further information.
- LEOFF 1 Medical "Pay as You Go" begins in 2018 (\$462k) and 2019 (\$2.3m/year), contained within M&O Expense Line.
- Annexation sales tax mitigation of approximately \$1m/year within Miscellaneous Revenue expires in 2022.
- Assumes construction sales tax decrease in 2020.
- 2018 CPI-W is 3% as released by the Bureau of Labor Statistics on July 14, 2017.
- Assumes 2019-2023 CPI-W growth by Puget Sound Economic Forecaster's CPI index forecast (2.2% to 2.5%).
- Includes estimated employer impact to General Fund of \$200k per year starts in 2019 for SB 5975 - Paid Family and Medical Leave. As the new law is analyzed and implemented, this assumption will be revised.
- Includes Council amendments (TIFIA, Levies, etc.) through November 6.
- Beginning Fund Balance is based on 2017 Q2 year-end projection.
- M&O includes additional CIP M&O of \$625k in 2019 and \$75k in 2021.

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Chart 8

General Fund
Revenue versus Expenditures

