

2019-2024 Forecast Executive Summary

Council Discussion:

Staff will provide current financial information to inform the development of the budget and respond to Council questions. This provides information that informs the longer term financial discussion.

Executive Summary:

❖ **Revenues:** *The 2019-2024 general fund forecast projects modest revenue growth for 2019-2024 and includes the following:*

- *Sales tax growth forecasts continued modest growth through the forecast period, primary influences are:*
 - *Implementation of the Washington State 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 \$3.3 million in 2024 (\$2.6 million to the general fund).*
 - *Acknowledging the gradual slowing of construction activity in the mid-term (years 2020-2021).*
- *Business & Occupation (B&O) tax continues to perform well primarily due to large audits.*
- *Sales Tax Annexation Credit will expire in 2022 eliminating \$1M in revenue.*

❖ **Expenditures:** *The 2019-2024 general fund forecast continues funding for existing expenditure levels and it includes:*

- *The costs for opening and staffing of Fire Station (FS) #10 in 2022, including new apparatus, ongoing maintenance & operations, and 13 staff, at a cost of approximately \$3M annually.*
- *The forecasted depletion of the Law Enforcement Officers and Fire Fighters Plan I (LEOFF I) Medical Reserve, necessitating a "pay as you go" transfer to the General Fund at an estimated cost of \$2.3M annually.*
- *Starting with the 2018 Mid-Biennium, the City's forecast includes a modest assumption for a 0.3 percent growth in total expenditures for increase in demand for services based on the continued urbanization of the City. The estimate is based on a 5-year history of cost increases from 2013 to 2017.*

❖ **Reserves:** *The 2019-2024 general fund forecast continues to build reserves in the early years to better position the City to address the known events noted above. In the later years, the forecast shows a depletion of reserves as expenditures are forecasted to exceed revenues starting in 2021.*

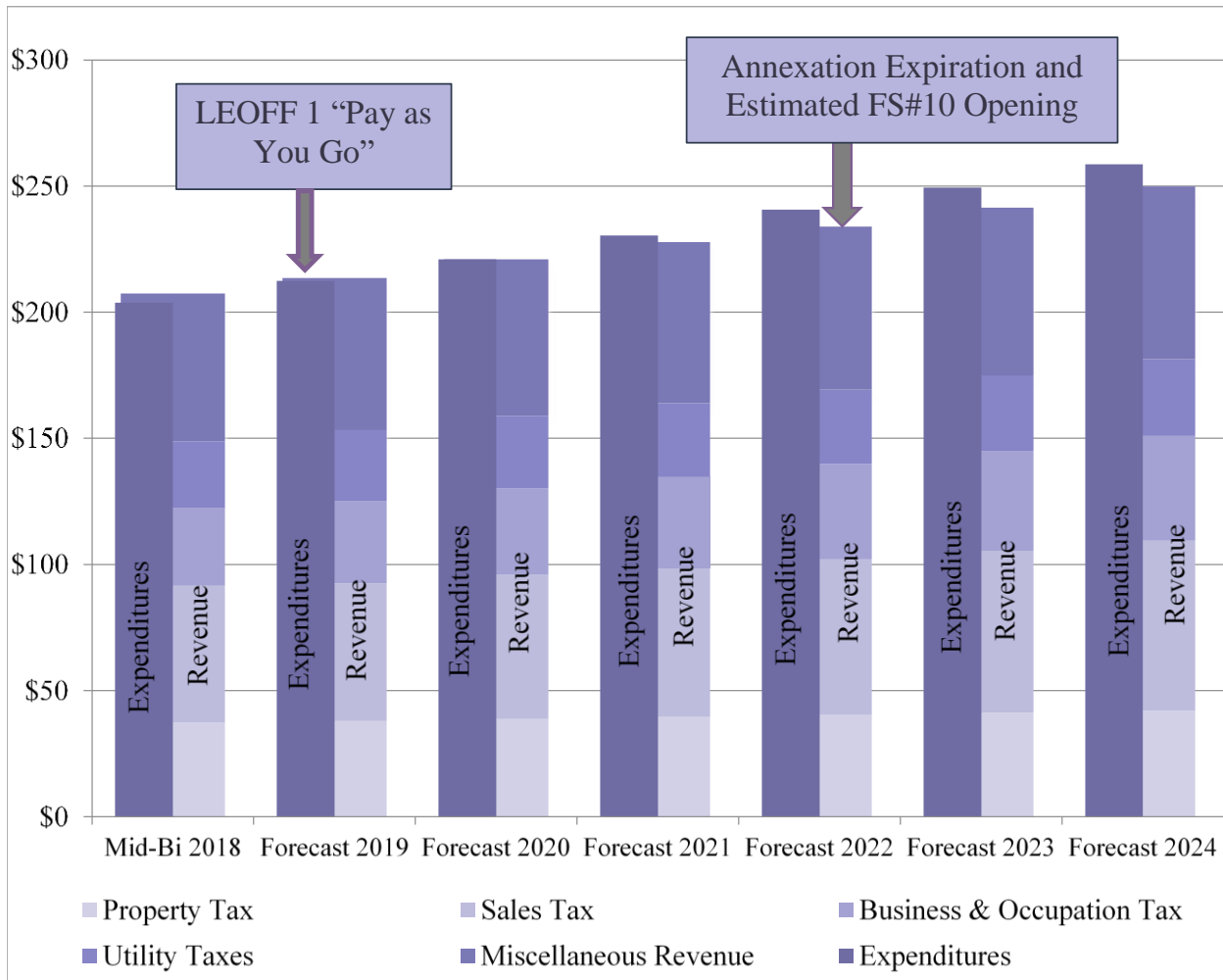
❖ **Conclusion:**

- *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.*
- *The forecast shows that by 2023, the projected ending fund balance is forecasted to be less than the 15% Council policy.*
- *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 2019 to 44 percent in 2024. An increased reliance on these streams adds a greater risk during economic downturns.*

2019-2024 Forecast Executive Summary

- The attachment labeled “Longer Term Options” is a companion documents for Council consideration and discussion regarding the out years of the forecast.
- 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 as forecasted, impacts from federal, state and county legislation, and economic recession.

General Fund Revenue versus Expenditures



2019-2024 General Fund Financial Forecast

General Fund Revenue Overview and Revenue Detail by Revenue Stream

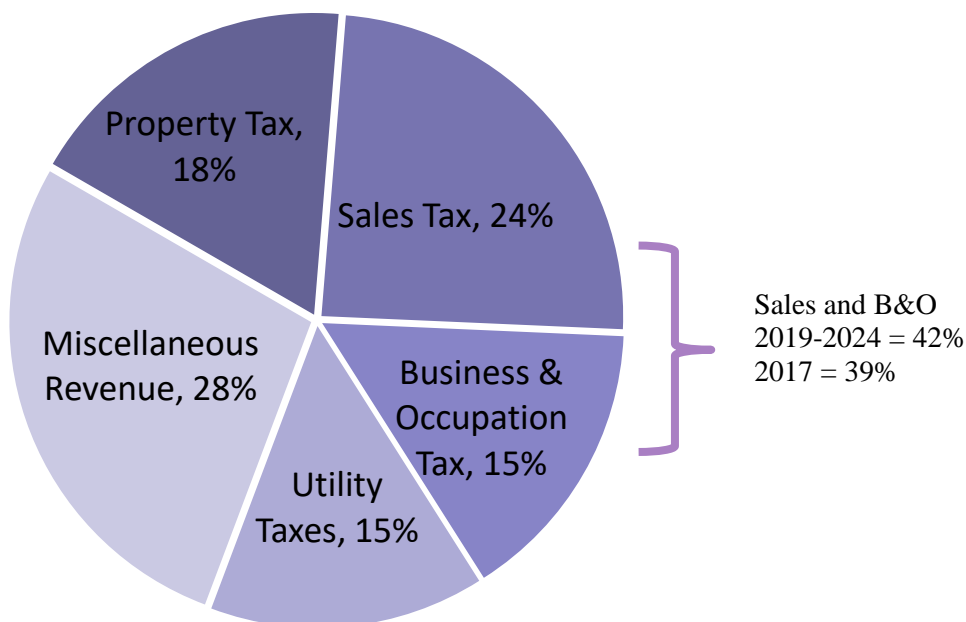
Overall, the City's General Fund forecast assumes a modest growth of tax revenue for the next few years, recognizing that the Puget Sound area economy will continue to grow, but at a slower pace than recent years. The City's mix of revenue consists of property tax, sales tax, business and occupation (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.

Sales and B&O taxes (most economically volatile revenue streams), combined, comprise an average 42 percent of total General Fund revenue in 2019-2024 (41 percent in 2019 growing to 44 percent in 2024). In 2017, Sales and B&O accounted for 40 percent of the City's actual general fund revenue. The increase in proportionate share is 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 traditional sales tax base and B&O 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 expenditure 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.

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

Chart 2

2017 Proportionate Share of General Fund Revenues



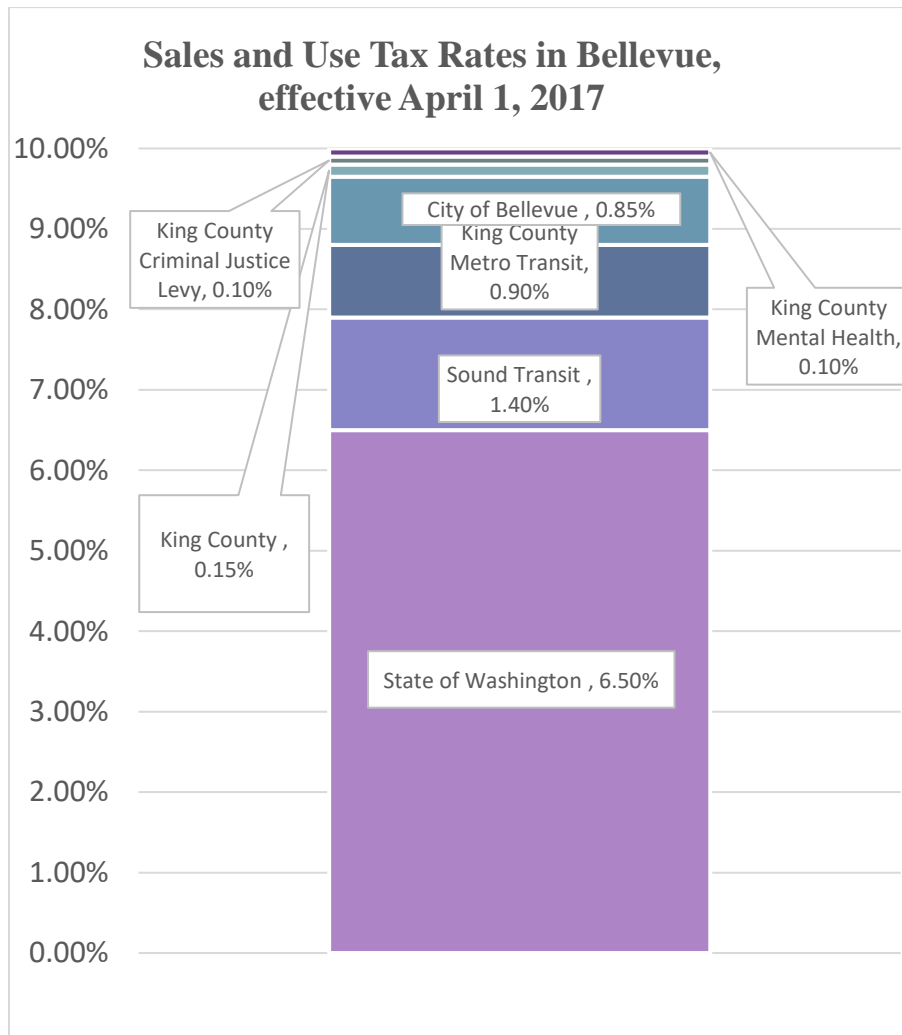
2019-2024 General Fund Financial Forecast

Sales and Use Tax

Background

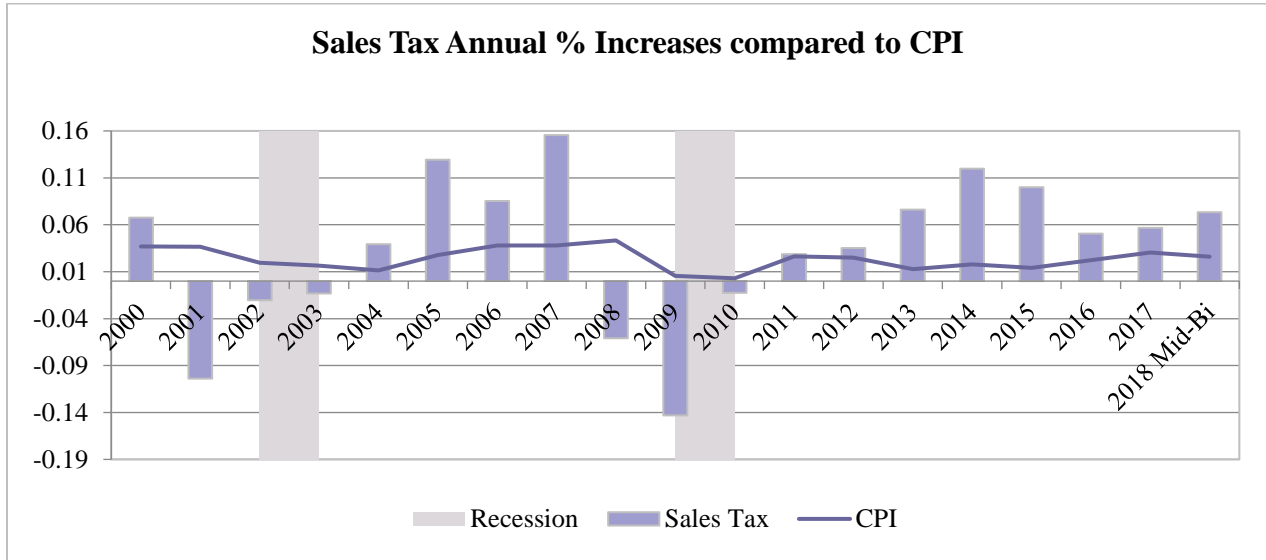
The retail sales and use tax (sales tax) is imposed on the sale of most goods and certain services in Bellevue. The tax is collected from consumers by businesses that in turn remit the tax revenue to the state. The state sends the City its share of this revenue monthly. The City collects 0.85 percent 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 3



2019-2024 General Fund Financial Forecast

Chart 4



Sales tax is reported to the City by sector. The major sectors for Bellevue are construction, retail sales, and auto sales, which together comprised over 64 percent of sales tax revenue in 2017. All other sales tax sectors make up the remaining balance.

Construction

Due to the increasing level of growth, construction contributed 20.4 percent to the overall sales tax revenue in 2017, comparing to 10 percent to 12 percent the recession years from 2010 to 2013. The construction sales tax grew 12 percent in 2017 due to the increased construction activities in the City. The 2018-2024 forecast assumes an 8.2 percent construction sales tax growth in 2018, flattening in 2019-2021 and slow growth starting in 2021. These assumptions are in line with King County and Seattle's forecast. As a rule of thumb, sales tax is received on major construction projects between 9 months and 18 months post permit issuance.

Retail Sales

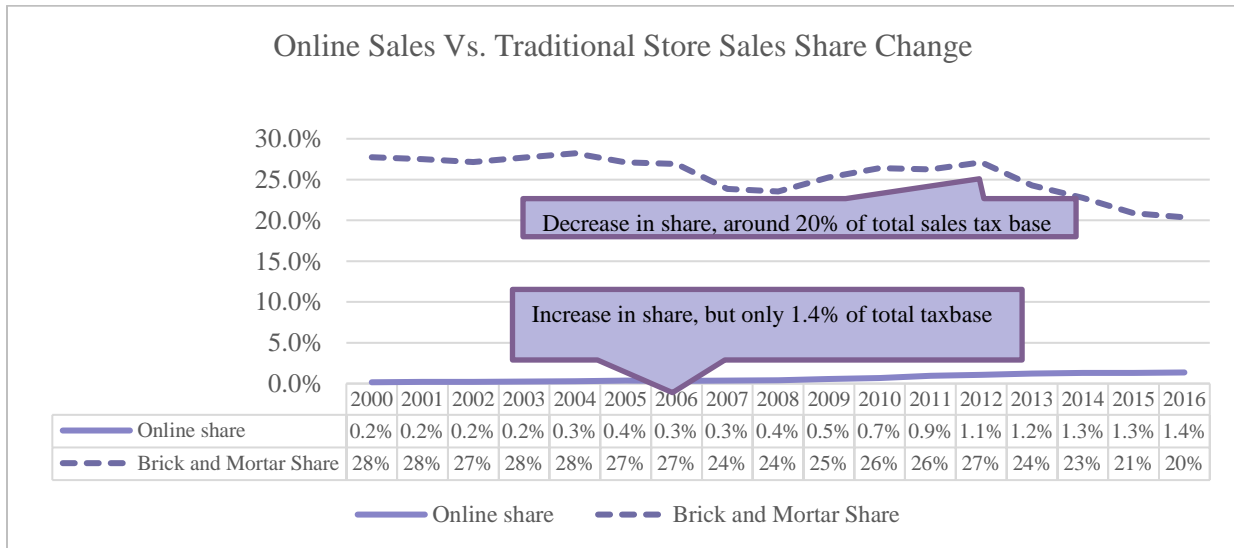
Retail sales is a broad category that is comprised sales tax generated by the sale of both store retailers operate fixed point-of-sale locations, located and designed to attract a high volume of walk-in customers and non-store retailers including electronic shopping and mail-order houses. Personal income, employment rate, consumer spending, and inflation are all highly correlated with retail sales tax revenue. Personal income recovered more quickly than sales tax growth from 2009-2015 as consumers saved more then spent during the immediate post-recession. Since 2016, retail sales tax has been growing closer to personal income growth at 4.6 percent for Seattle-Tacoma-Bellevue Metro which indicates a higher level of comfort with spending disposable income. (Source: U. S. Bureau of Economic Analysis)

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 rate of online stores per year in the past five years does not make up the decrease

2019-2024 General Fund Financial Forecast

in brick and mortar stores. This forecast assumed the average annual growth rate of total retail trade excluding marketplace sales tax to be 3 percent from 2019 to 2024. Department of Revenue assumed a 9 percent growth besides the compliance rate growth in the marketplace sales tax estimation due to the higher growth rate of electronic shopping, which is included in this forecast.

Chart 5



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

2019-2024 General Fund Financial Forecast

Auto Sales

Auto sales is another revenue that is sensitive to the economic environment and is highly volatile considering the 18 percent and 10 percent decreases in 2008 and 2009 respectively. Coming off the recession, auto sales have grown an annual average of 7 percent since 2010. After a growth peak in 2012 at 11 percent, growth has slowed in recent years to between 5 to 8 percent per year. Auto sales contributed 16 percent to the overall sales tax revenue in 2017. Sales are projected to grow at 5.7 and 5.1 percent in 2019 and 2020 respectively, and slow down starting in 2020 to around 4 percent.

Overall Forecast 2019-2024

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 \$1.3 million in 2018 (\$0.9 million to the general fund), growing to \$3.3 million in 2024 (\$2.6 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 6

	2019	2020	2021	2022	2023	2024
Bellevue*	4.4%	4.9%	4.0%	4.3%	4.9%	4.5%
Seattle**	2.8%	N/A	N/A	N/A	N/A	N/A
King County***	2.68%	2.16%	4.04%	3.53%	3.62%	4.00%
Washington State ****	5.60%	4.40%	4.30%	3.60%	3.20%	N/A

Note: All growth rates include marketplace sales tax.

*Bellevue sales tax displayed above are general fund sales tax growth rates, which will be different with total citywide sales tax growth rate due to the split to other funds.

**Seattle sales tax growth rate is from Seattle's 2018 Adopted Budget Book

***King County sales tax growth rates from King County March 2018 Forecast by King County Office of Economic and Financial Analysis.

**** Washington State February 2018 Revenue forecast by Economic and Revenue Forecast Council

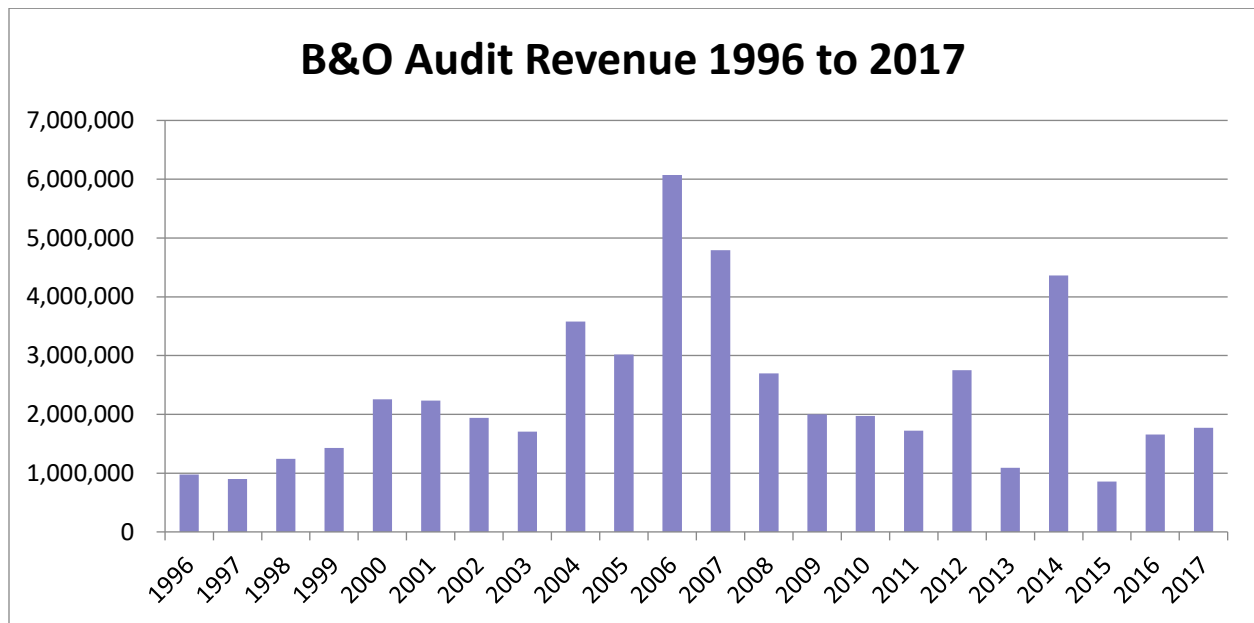
2019-2024 General Fund Financial Forecast

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 4.9 percent from 2019-2024.

The City continually monitors the B&O tax base as well as audit findings that may require either a refund to the taxpayer 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 2019-2024 forecast assumes \$1.5 million in audit recoveries annually.

Chart 7



2019-2024 General Fund Financial Forecast

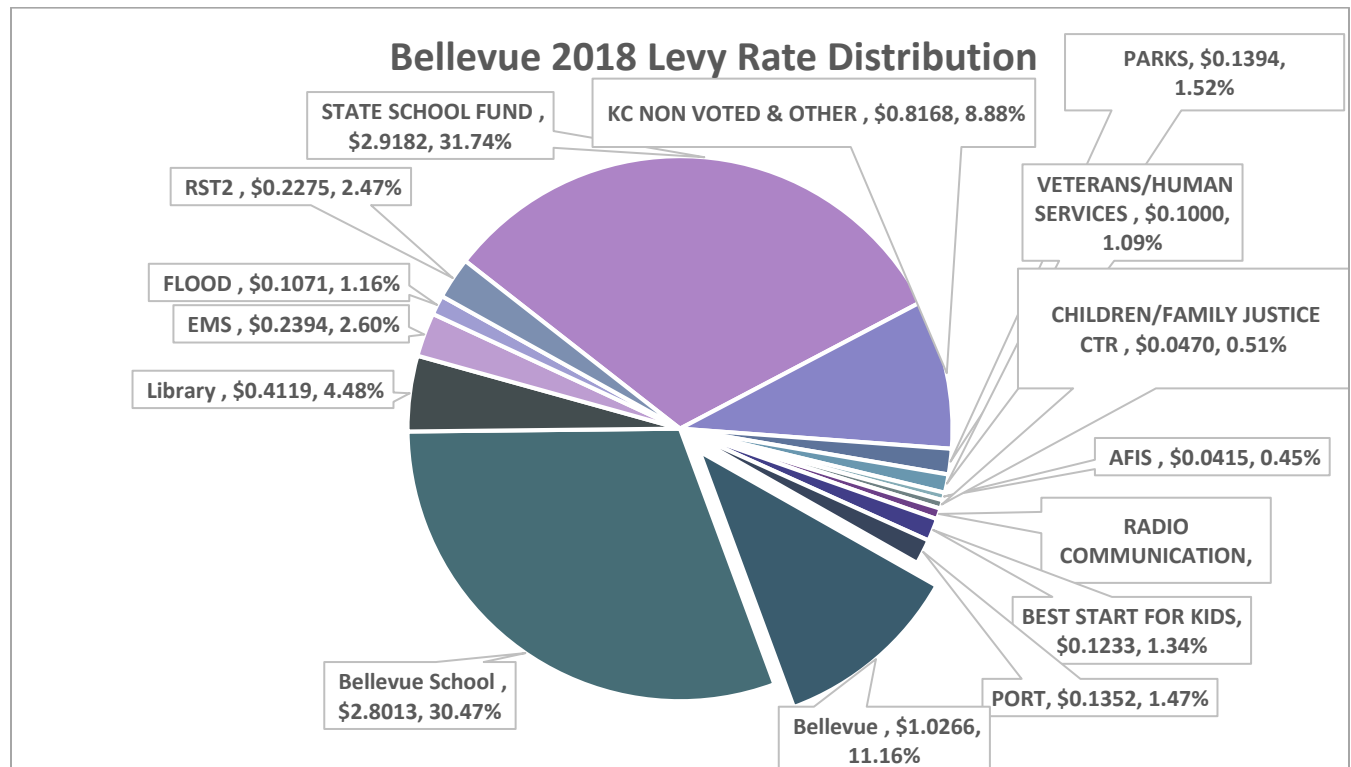
General Property Tax

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 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 is one of the lowest in King County. The City’s 2018 property tax rate at \$1.03 per \$1,000 AV was roughly 11 percent of the most common total \$9.19 rate paid by Bellevue property owners for all taxing jurisdictions such as King County, the State, and school districts. The 2018 property tax total and City of Bellevue tax obligations for a home of median assessed value (\$791,000) in Bellevue is \$7,073 and \$812 respectively. Chart 7 shows the destinations of a typical Bellevue property owner’s property tax in 2018.

Chart 8



This forecast assumes no councilmanic 1 percent statutorily available property tax increase in years 2019 to 2024. Bellevue currently has \$9.1 million in banked capacity available.

2019-2024 General Fund Financial Forecast

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 2017, and is projected to decrease to around 13 percent from 2019 to 2024.

- In the last few years, electric and natural gas utility tax collections have flattened out due to 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. Water and sewer utility tax have increased in the past three years due to longer and hotter summers, the forecast assumes mild increases for water and sewer utility taxes.

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 and/or towns. "Spirits" are any beverage which contain 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 the Municipal Research and Services Center (MRSC), the per capita rate for city distributions in 2019 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 2019.

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 2019 is estimated to be \$8.29, multiplied by the City's 2017 population of 140,700 estimated by OFM, or \$1.17 million in 2019.

2019-2024 General Fund Financial Forecast

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 distribution to counties, cities, and towns, starting with the state fiscal year 2019. 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 2019 is estimated to be \$21.72, multiplied by the City's 2017 population of 140,700 estimated by OFM, or \$3.06 million in 2019. 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 2019 and 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 2019 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 2019.

2019-2024 General Fund Financial Forecast

General Fund Expenditure Overview

Urbanization

The 2019-2024 general fund forecast continues funding for existing expenditure levels. 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. Based on a 5-year history of cost increases from 2013 to 2017, the forecast now includes a modest 0.3 percent growth in total expenditures (\$634,000 in 2019) continuing and growing annually to 2024.

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.

Fire Station 10 Expenditure Impact Estimation as of March 2018:				
(In \$000s)	2021	2022	2023	2024
Personnel (1 captain, 2 lieutenants, 3 engineers, and 7 firefighters)	\$595	\$2,176	\$2,266	\$2,363
Apparatus	894			
All other costs (including 25% contingency on non-personnel costs)	615	781	799	818
Fire Station 10 Expenditure impact	\$2,204	\$2,957	\$3,065	\$3,180

Inflation

Inflation is estimated by combining the inflation forecast by Puget Sound Economic Forecaster, King county and Global Insight's index forecast:

2019	2020	2021	2022	2023	2024
2.5%	2.6%	2.7%	2.4%	2.3%	2.4%

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, these place increasing pressure on the operating budget. In the 2019 to 2024 General Fund forecast, an additional CIP M&O of \$625,000 in 2019, \$200,000 in 2020 and \$75,000 in 2021 is included in the M&O expenditure line for projects that are expected to complete in 2019 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

2019-2024 General Fund Financial Forecast

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.

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 (2019-2020); the out-year forecast reflects the reverse. The 2019-2024 forecast does not include the use of the councilmanic statutorily allowable 1 percent annual property tax increase or any other rate or tax increase. 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.

As displayed in Chart 9 on the following page, the City’s ending fund balance is forecasted be below 15% 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 March 2018. 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.

Risks

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, impacts from federal, state and county legislation, and economic recession.

2019-2024 General Fund Financial Forecast

Chart 9

Early look March 2018 for 19/20 Budget General Fund Forecast (in \$000)

	Forecast 2018	Forecast 2019	Forecast 2020	Forecast 2021	Forecast 2022	Forecast 2023	Forecast 2024
Beginning Fund Balance	\$45,696	\$46,445	\$47,564	\$47,740	\$45,623	\$39,472	\$32,075
Revenue							
Property Tax	\$37,102	\$37,922	\$38,741	\$39,552	\$40,372	\$41,203	\$42,053
Sales Tax	\$52,316	54,633	57,288	59,604	62,104	64,773	67,966
Business & Occupation Tax	\$31,092	32,502	34,421	36,177	37,860	39,594	41,538
Utility Taxes	\$27,805	28,206	28,725	29,101	29,483	29,906	30,354
Miscellaneous Revenue	58,511	60,330	61,973	63,921	64,696	66,591	68,608
Total Revenue	\$206,826	\$213,593	\$221,149	\$228,355	\$234,515	\$242,066	\$250,518
%Δ Total Revenue	3.7%	3.0%	3.5%	3.3%	2.7%	3.2%	3.5%
Expenditures							
Personnel	\$125,000	\$130,650	\$136,242	\$142,791	\$150,244	\$156,317	\$162,699
Maintenance & Operations	81,077	81,823	84,731	87,681	90,422	93,147	95,987
Total Expenditures	\$206,077	\$212,473	\$220,973	\$230,472	\$240,666	\$249,463	\$258,686
%Δ Total Expenditures	5.9%	4.2%	4.0%	4.3%	4.4%	3.7%	3.7%
Revenue Less Expenses	\$749	\$1,119	\$177	(\$2,117)	(\$6,151)	(\$7,397)	(\$8,168)
Ending Fund Balance	\$46,445	\$47,564	\$47,740	\$45,623	\$39,472	\$32,075	\$23,907
EFB as a % of Revenue	22.5%	22.3%	21.6%	20.0%	16.8%	13.3%	9.5%

Notes:

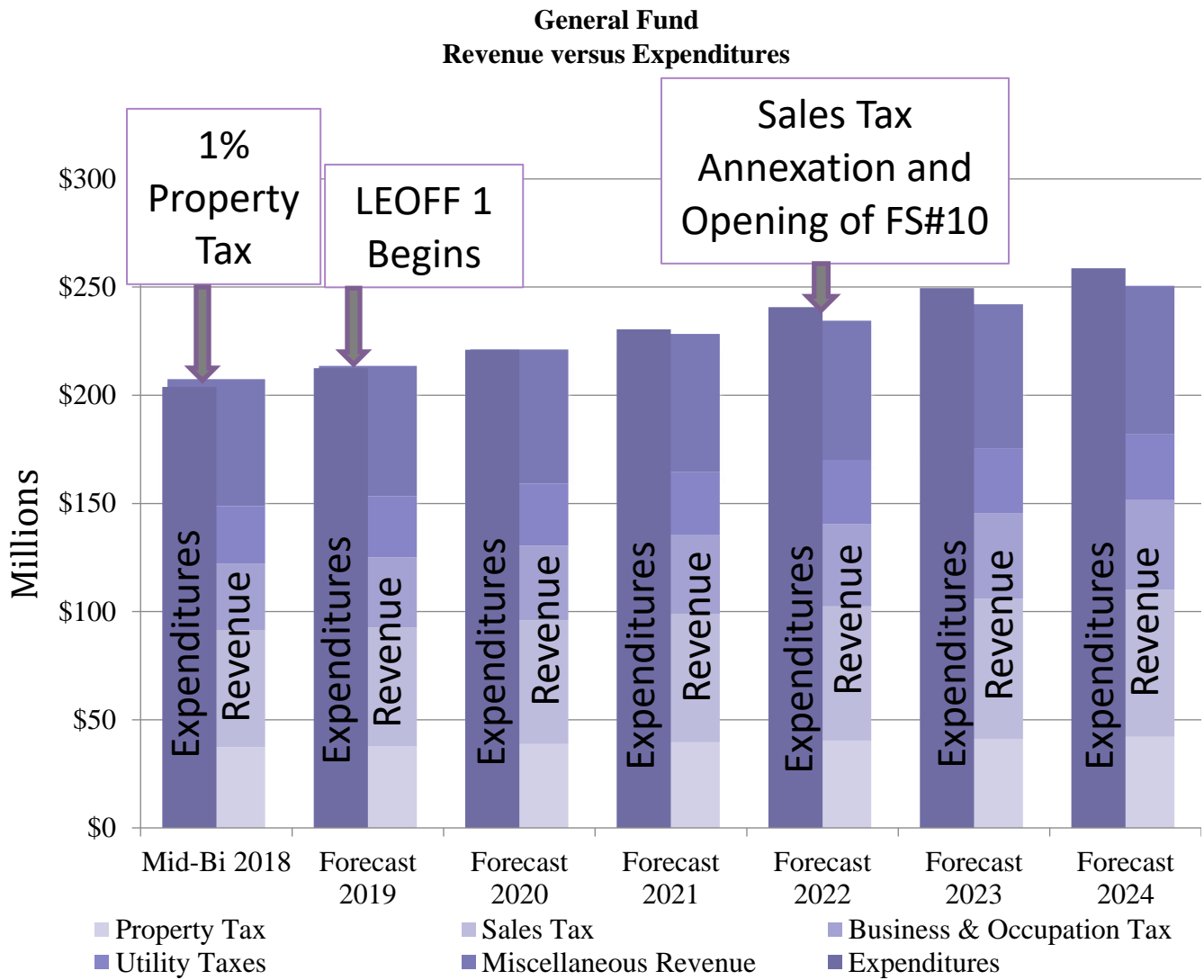
- This forecast includes the Sales Tax Marketplace Fairness impact estimated by DOR (2018-2023 estimated by DOR, then grows by 9% annually starting in 2024) and Fire Station 10 impact.

Sales Tax Marketplace Revenue	\$969	\$1,406	\$1,672	\$1,847	\$2,013	\$2,195	\$2,392
Fire Station 10 Expenditure impact				\$2,204	\$2,957	\$3,065	\$3,180

- This forecast assumes a net zero impact for ACA, staff 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.
- M&O includes additional CIP M&O of \$625k in 2019, \$200k in 2020 and \$75k in 2021.
- 2018 CPI-W is 3% as released by the Bureau of Labor Statistics on July 14, 2017.
- Assumes 2019-2025 CPI growth by Puget Sound Economic Forecaster, King county and Global Insight's CPI index forecast (2.3% to 2.7%).
- Includes estimated employer impact to General Fund of \$200k per year starts in 2019 for SB 5975 - Paid Family and Medical Leave.

Chart 10

2019-2024 General Fund Financial Forecast



*This forecast includes the Sales Tax Marketplace Fairness impact estimated by DOR as below:

	2018	2019	2020	2021	2022	2023	2024
Total Online Sales Tax	\$1,325,718	\$1,923,154	\$2,287,696	\$2,526,966	\$2,754,264	\$3,002,148	\$3,272,341
General Fund Online Sales Tax	\$969,100	\$1,405,826	\$1,672,306	\$1,847,213	\$2,013,368	\$2,194,571	\$2,392,082