City of Bellevue

05/18/2020

CITY COUNCIL STUDY SESSION

Impact of COVID related events on city finances

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DIRECTION NEEDED FROM COUNCIL

INFORMATION ONLY Tonight, staff will provide Council with information regarding the fiscal impact of the economic shutdown and social distancing.

RECOMMENDATION

N/A

BACKGROUND & ANALYSIS

Background

On February 29, 2020, Governor Inslee issued a proclamation declaring a state of emergency across Washington in response to the outbreak of COVID-19. In the weeks following the declaration, stay-at-home measures were ordered to slow the spread of the virus. These measures and associated social distancing requirements resulted in an abrupt closure of the economy.

Earlier this month, the Governor began implementation of a 4-phase plan to re-open the economy, which will incrementally reduce restricted activities within the state. There remains a high level of uncertainty of the total economic impact of the closure and reopening steps in response to COVID-19. Based on current data and projections, the Puget Sound economy is experiencing an economic shock that is different from all previous recessions. Many industries have been negatively affected including the most vulnerable sectors of food and drink, leisure and hospitality, retail trade, health care, and aerospace. Since early March, when COVID-19 job losses began, a total of 1,428,775 initial unemployment claims have been filed with the state of Washington during the pandemic, and a total of 810,538 distinct individuals have filed for unemployment benefits.

The city is in unchartered territory. The closing of the economy has had a swift and substantial impact on the city's finances, especially the sales and business & occupation (B&O) taxes. Economic recovery projections largely depend on the predictability to control of the virus, which is highly uncertain.

Impact to City's Major Tax Streams

The shutdown of the economy has reduced revenue collections, with the largest impact on sales tax and Business & Occupation tax (B&O). Sales tax and B&O are the most economically volatile revenue streams to the city. With the temporary closure of many businesses, the most impacted sectors include retail, restaurants, accommodations, construction, and auto sales. Current analysis indicates that the combined loss of revenues in sales and B&O tax is $31 million (sales tax $21 million and B&O $10 million). See Charts 1 and 2 below. These projections are best estimates using the currently available known data and projections. With each new announcement or event in the pandemic, the analysis of the financial impact is likely to shift. Staff will continue providing updates as new information is available.

As a reminder, both sales and B&O are split between the general fund (~75%) and the Capital Investment Program (CIP) (~25%) per Council policy, therefore, of the $31 million total reduction, roughly $23 million will be in the general fund, and $8 million in the CIP. Following this section, additional analysis on the general fund and CIP is provided.

Chart 1

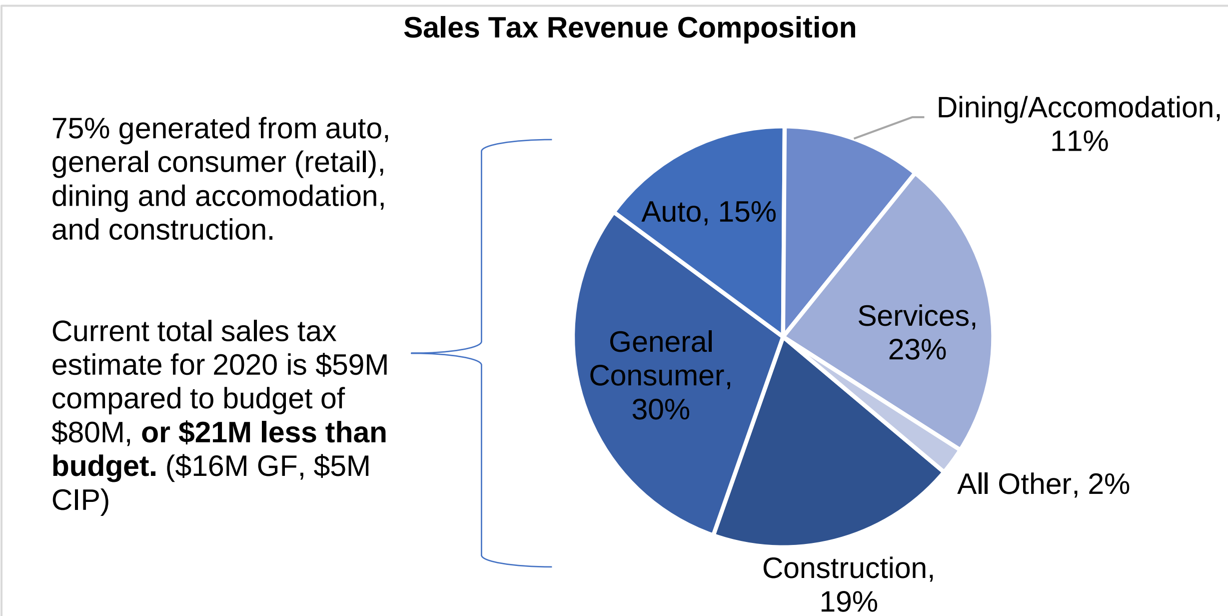
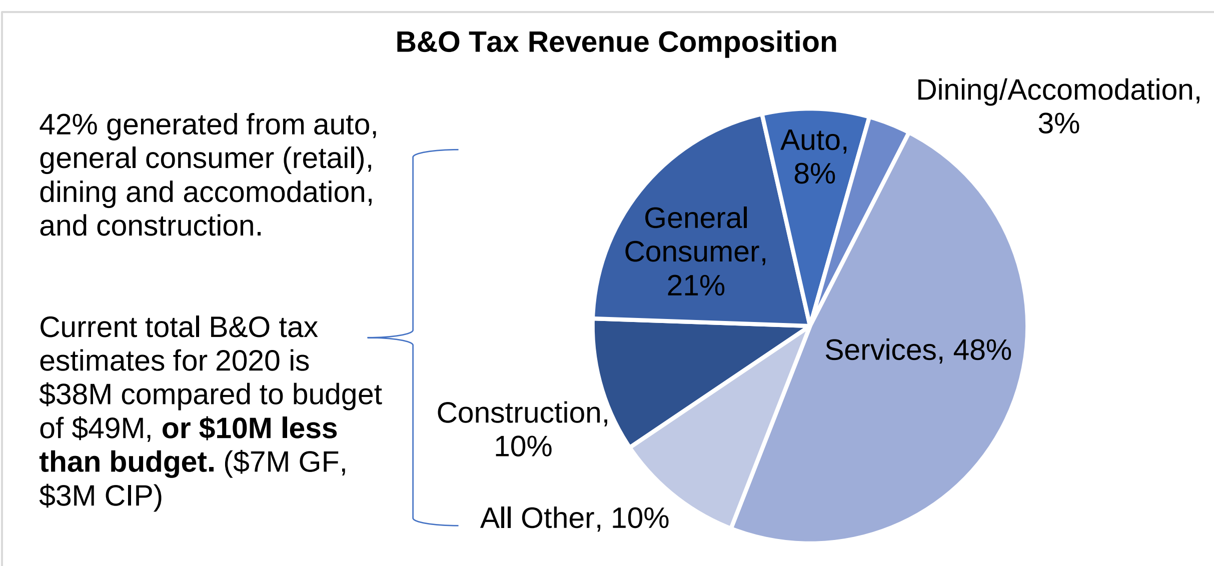


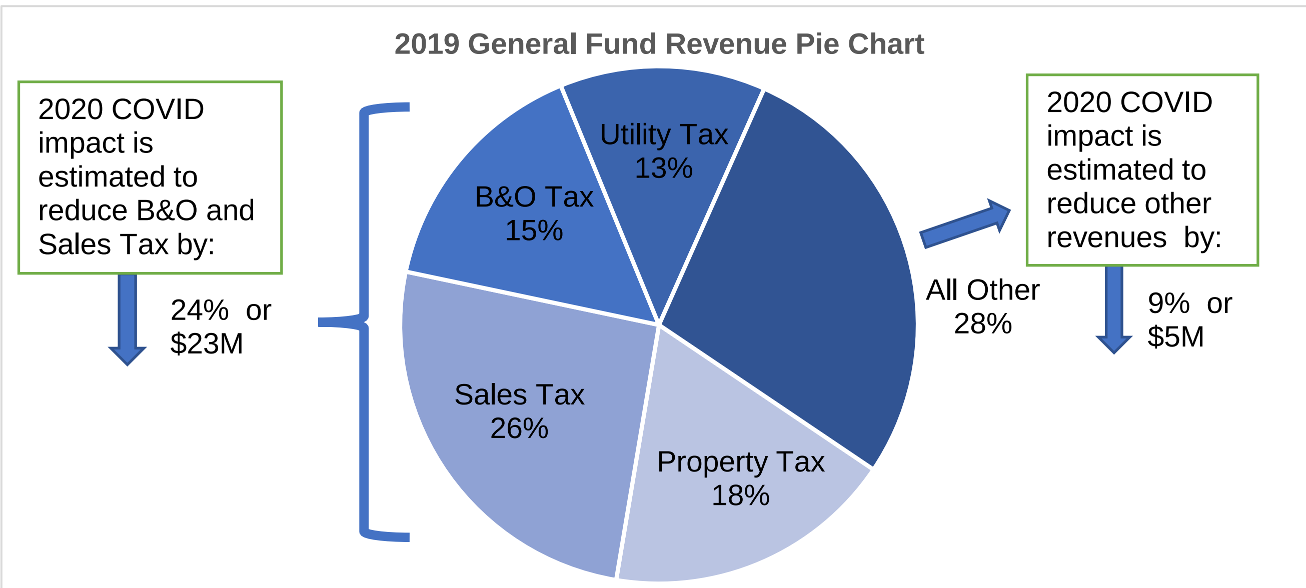
Chart 2



Impact to 2020 General Fund Budget

Today, analysis shows that the city's general fund will face a loss of revenues of up to $28 million (13 percent of the total general fund) in 2020. The city's general fund supports most of the direct services to the community including police, fire, parks, community development, transportation, and most administrative services such as legal, city management, finance, customer service, and others. The city's mix of general fund revenue consists of property tax, sales tax, business and occupation (B&O) tax, utility tax, and all other revenues such as state-shared, grants, interlocal, parks fees, and others. See Chart 3 below for the makeup of total general fund revenues and a summary of how the revenues are impacted in the current economic situation.

Chart 3



- Sales tax and B&O tax: Combined, comprise an average of 41 percent of total general fund revenue. Best estimates today are that the general fund portion of Sales and B&O is projected to drop up to 24 percent, or $23 million in 2020. Total combined is $31 million as noted in the previous section, the remainder is in the CIP.
- Other Revenues: There are several areas where the stay home orders have a negative impact. One example is the city will face a reduction in parks and recreation fees due to closure of recreation sites. Overall, other revenues, in total, are estimated to drop up to 9 percent, or $5 million in 2020.
- Property tax and Utility tax: The impact on those revenues streams is projected to be minimal outside of the normal course of business due to the relatively stable demand on utility services and the way property tax is charged and collected. If the stay home orders, and therefore the economic shutdown lasts longer, many of the temporary job losses could become permanent and property tax and utility tax assumptions would need to be revised.

Actions Underway

Considering the current revenue estimates, the city must take responsible fiscal actions now to actively plan and prepare for the future. The city has built the reserve fund in recent years, reaching 22 percent of general fund revenues as of the end of 2019; the general fund council policy is for reserves to be at 15 percent of general fund revenues. With the current level at 22 percent, that allows 7 percent (approximately $15 million) to be used in 2020 to assist with offsetting the COVID-related fiscal impact. In addition, the city is actively reducing spending through a variety of measures including eliminating non-necessary travel/training, holding vacancies open, and generally, reviewing all costs before spending. The city is working to limit workforce impacts, such as furloughs, yet, with the rate of revenue loss, that may not be attainable. Staff commits to returning to Council for updates as new information becomes available.

2021-2022 General Fund Budget Impact

Not only does economic shutdown and social distancing measures during the reopening impact 2020 revenues, the loss of consumer confidence due to uncertainties in personal finance, employment status and economic outlook also impact the 2021-2022 budget. Different from the prior recessions, the restoration in consumer confidence may not be due to an improving economy, but when consumers become convinced the spread of COVID-19 has been effectively contained. Residual fears of exposure to some virus may still limit people’s willingness to be in crowds at shopping malls, restaurants, sport stadiums, theaters, airplanes, hotels, cruises, or social events. From there, as the employment data and overall economy starts to improve, people’s spending behaviors start to recover. While most of these changes in behaviors will not be permanent, they will certainly persist over the next few years throughout the 2021-2022 budget.

Forecasting recessions is challenging in any circumstance. With the catalyst of the anticipated recession being a pandemic, the degree of uncertainty is increased due to a lack of comparable events in recent history. The city is currently working on a range of impacts and varying scenarios of recessions. Some economists suggest the recession or revenue loss and recovery would resemble a “V” shape, or go down quickly and then rise quickly back, though the longer the economic shutdown continues, the less confidence remains in a “V” shaped recession. Another recession option is more shaped like a “U” where revenue drops quickly, then flattens for a while, then rebounds. The greatest fear at this time is if we enter a recession shaped like a “W” or that bounces back and then drops again.

Based on current national and local economic data, the planning scenario today assumes a recession that would recover back to pre-COVID or 2019 levels within the 2021-2022 budget cycle. This planning assumption is a cross between a “V” and a “U”, and is modeled after the Dot-Com recession in the early 2000’s.

Under these planning assumptions, based on cost of service today, the general fund will need to make a course correction of current spending of $12+ million in 2021-2022 budget to address the reduced revenues in sales and B&O tax streams in order to balance the budget. Expenditures will need to be reduced or revenues increased. Staff acknowledges that this is the best estimate today and that as the economy begins to open and rebuild, and additional data and information is gathered, the planning scenario will change. Staff will continue to refine and bring additional information regarding the 2021-2022 budget to Council through a budget workshop.

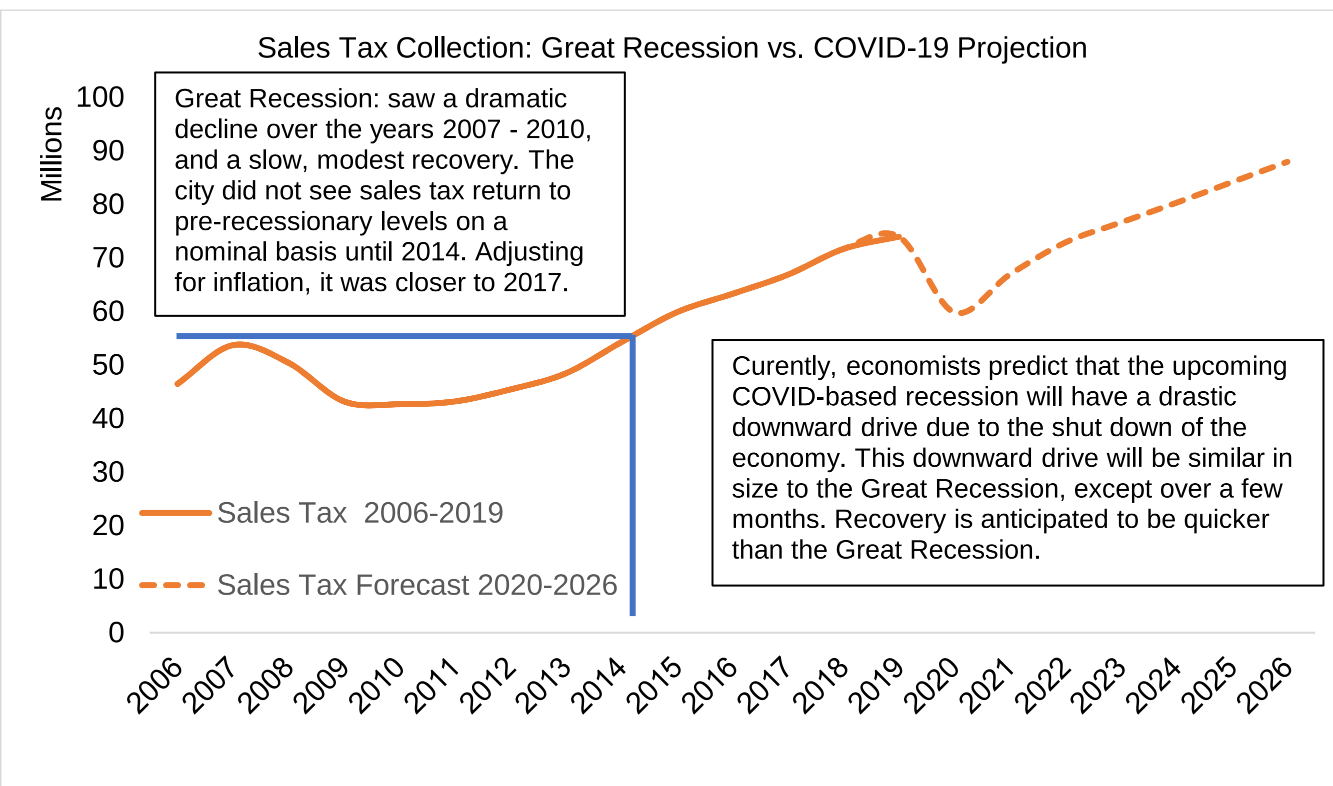
Impact to the General Capital Investment Program (CIP)

The CIP provides for major public facility improvements for items such as park development, transportation roadways, signals, and sidewalks, among others. The CIP is primarily supported by sales and B&O tax, grants, real estate excise tax, transportation impact fees, voted levies, intergovernmental contributions and the Transportation Infrastructure Finance and Innovation Act (TIFIA) loan. Since Sales tax and B&O are split between the general fund and the CIP, the CIP is also experiencing a reduction in revenues. Based on analysis today, that impact is approximately $8 million in 2020. In addition to reduced sales and B&O, staff anticipates that Real Estate Excise Tax will also be impacted in 2020, though the estimate is under development. Staff will return at an upcoming Budget Workshop with additional information regarding the CIP.

Comparison to the Great Recession

Due to the order of magnitude of the impact from COVID-19, there is a reasonable question as to how the current events compare to the impacts of the Great Recession. The following chart uses sales tax as a proxy to explain. The impact to sales tax is anticipated to be as dramatic as the Great Recession, except it took about three years during the Great Recession to reach the lowest sales tax point, in comparison, with the impacts of COVID, the low point is expected within weeks or months.

Chart 4



Comparison with Other Jurisdictions

As the entire country struggles through the impacts of COVID-19, a similar level of revenue impact is being felt by many, if not all jurisdictions. Both King County and Seattle have published information that aligns with the city's findings thus far as to the impact on the fiscal condition of sales and B&O tax. King County's updated revenue forecast released on March 31 projected significant declines in sales tax from the previous forecast released in early March. The revised forecast is 21 percent lower in 2020, 12 percent lower in 2021, and 8 percent in 2022 (Source: King County Office of Economic and Financial Analysis - Fiscal impacts of coronavirus/COVID-19). The City of Seattle revised their general fund revenue forecast down by 13 percent in 2020 and predicted the recovery to last through 2022.The majority of the general fund impact is due to decline is sales tax and B&O tax, property and utility taxes impact are estimated to be relatively small (Source: April 22 Seattle Revenue Forecast to Council).

Next Steps

In light of the impact on the 2020 revenues, the 2021-2022 Budget and the CIP, staff intends to return to Council for a Budget workshop for further discussion and feedback.

POLICY & FISCAL IMPACTS

Policy Impact
RCW 35A.34 – Biennial Budgets:
State law specifies requirements that must be followed in budgeting each of the city's funds including balanced expenditure and revenue estimates for each of the city's funds.

OPTIONS

N/A

ATTACHMENTS & AVAILABLE DOCUMENTS

N/A

AVAILABLE IN COUNCIL LIBRARY

N/A