

CITY COUNCIL STUDY SESSION

Budget 2021-2022 General Fund and 2021-2027 Capital Investment Program (CIP) Workshop

Toni Call, Director, 452-7863

Keyi Lu, Assistant Director, 452-4190

Finance and Asset Management Department

DIRECTION NEEDED FROM COUNCIL**DIRECTION**

Staff will review and seek feedback from Council regarding the budget process and the current financial information that informs the development of the 2021-2022 general fund budget and the 2021-2027 Capital Investment Program (CIP) plan.

RECOMMENDATION

N/A

BACKGROUND & ANALYSIS

Due to the drastic impacts of COVID related events on the City's major tax streams, the budget workshop will focus on the general fund and the CIP. Other fund forecasts such as Utilities and Development Services will be scheduled as needed.

Background

On May 18, staff presented the estimated fiscal and economic impact of the COVID-19 related events. As noted, the City is in uncharted 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 of control of the virus, which is highly uncertain. Early estimates for the 2021-2022 general fund budget indicate a \$12+ million negative impact, which will require a reduction in expenditures or an increase in revenues. (See Attachment A: Impact of COVID Related Events on City Finances - Reprint from May 18 Study Session Council Agenda Memo)

Acknowledging the challenging fiscal conditions that face the general fund and the CIP for the upcoming budget process, staff is seeking any early feedback the Council may wish to provide as the City Manager prepares his preliminary budget. The City Manager's preliminary budget is expected to be delivered to Council in October. Specifically, the purpose of tonight is to:

- Provide information and seek feedback regarding the process and timelines,
- Provide scenarios regarding the impact of COVID related events in the near term (2021-2022) and over the general fund forecast six-year period (2021-2026) and seven-year (2021-2027) CIP, and
- Seek feedback on principles and actions to assist the City Manager in developing his preliminary budget, in light of the forecast reduction in revenues and need to reduce expenditures as a result.

As a reference, a written summary of the performance and budget survey results is included as Attachment B. It is provided for information only.

Regarding the 2021-2022 budget, the materials presented tonight comprise building blocks for the Preliminary Budget and include whitepapers and/or reference materials to help inform the development of the budget. These materials reflect the budget process to date and should be considered a work-in-progress that will be revised over the upcoming months.

Budget Process, Milestones, and Public Engagement

Discussion Objective: Staff will provide Council with the process and timelines for the 2021-2022 Budget and seeks feedback. Staff seeks confirmation with regard to a proposal to revise the outcome areas of the budget to match the Strategic Target Areas in the Council Vision.

See Attachment C: Budget Process and Calendars, and Attachment D: Budget One Public Engagement.

Budget Process Background & Changes

Building on prior budgets, the City will use a similar process, historically titled "Budget One", to develop the 2021-2022 Biennial Budget. The process:

- 1) Identifies the community's priorities;
- 2) Prioritizes services to meet those priorities; and
- 3) Funds those services with available monies.

The Budget One process puts the emphasis on community priorities, not departments. All current programs, services and activities must be submitted as "proposals" in order to be funded and all proposals must align with one of the priorities.

The 2021-2022 budget process continues to engage the public through multiple communication channels, including the February neighborhood leadership gathering, surveys, public hearings, open public comment at regular council meetings, boards and commissions, and direct emails to the City.

Changes for the 2021-2022 Process

Historically, the budget process framed the budget around six "Outcomes" to categorize the priorities for the community. The six "Outcomes" were Economic Growth and Competitiveness, Healthy and Sustainable Environment, Improved Mobility and Connectivity, Quality Neighborhoods/Innovative Vibrant and Caring Community, Responsive Government and Safe Community. These outcomes predate the Council Vision.

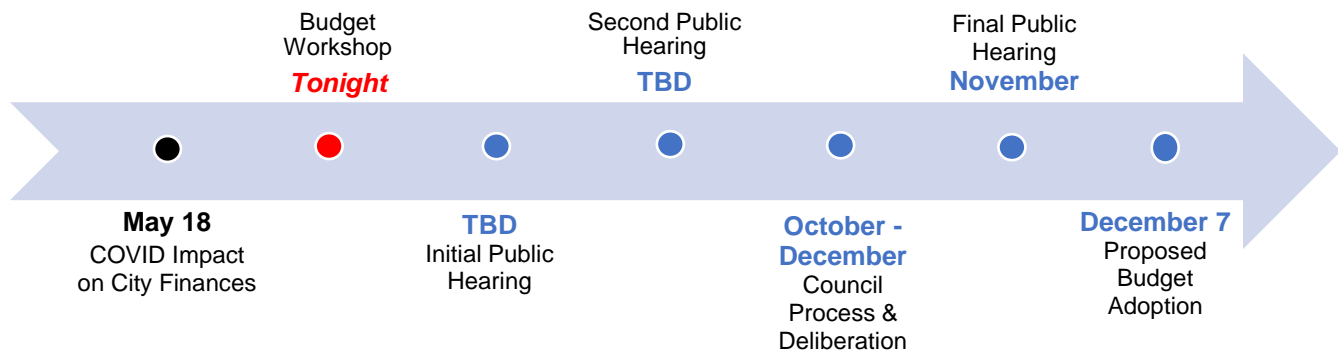
Keeping the foundational purpose of Budget One in mind, and in order to better align budget development with Council's vision, staff recommends that the 2021-2022 budget be framed around the Council Vision and the connecting seven "Strategic Target Areas". Strategic Target Areas include Economic Development, Transportation and Mobility, High Quality Built and Natural Environment, Bellevue: Great Places Where You Want to Be, Regional Leadership and Influence, Achieving Human Potential, and High Performance Government.

Adjusting the frame for the budget to create a clearer alignment to the Council's Vision statement was one of the recommendations from the Budget Book Evaluation project conducted through the Livable

City Year partnership with the University of Washington in 2019. Recent budgets have been displayed three ways, by “outcome”, by department, and by “Strategic Target Area”. By implementing this change, it will alleviate confusion between “outcomes” and “Strategic Target Areas”, create a clearer connection to the Council vision statement, and create clarity in the budget by only providing two displays instead of three.

Budget Milestones

The anticipated milestones for the budget process are noted in the graphic below. In addition, as needed, staff will return to Council throughout the budget process to seek feedback as the City Manager prepares his preliminary budget. The City, by practice, holds three public hearings during the budget process. With the impact of COVID, the first and second public hearing dates are currently being determined, yet are anticipated to occur prior to the City Manager presenting his Preliminary Budget to Council in October.



General Fund Near Term Forecast and General Capital Investment Plan Early Look 2021-2027

Discussion Objective: Provide scenarios regarding the impact of COVID related events in the near term (2021-2022) and over the general fund forecast six-year period (2021-2026) and seven-year (2021-2027) CIP. Seek feedback on principles and actions to assist the City Manager in developing his preliminary budget, in light of the forecast reduction in revenues.

General Fund Near Term Forecast

Background

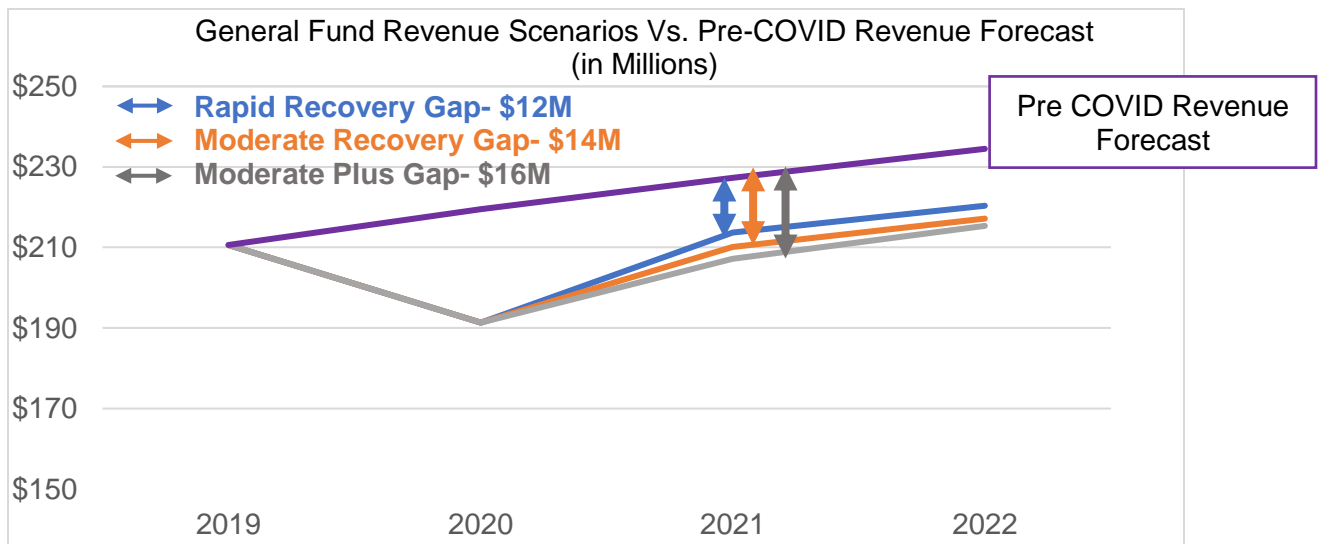
As discussed on May 18, not only do economic shutdown and social distancing measures impact 2020 revenues, the loss of consumer confidence due to uncertainties in personal finance, employment status and economic outlook will also impact the future. Forecasting recessions is challenging in any circumstance. With the catalyst of the anticipated recession being a pandemic, the degree of uncertainty is increased due to a lack of comparable events in modern history. Under the planning assumptions at the May 18 meeting, we noted a need to reduce spending in the general fund by \$12+ million in 2021-2022 budget, to address the reduced revenues in sales and B&O tax streams in order to balance the budget. In response, Council requested a series of scenarios to better understand a reasonable range of levels of impact that COVID may have on City finances.

2021-2022 Forecasting Scenarios

Staff prepared three scenarios to provide a range of reasonable levels of impact for the near term. Staff acknowledges that the number of scenarios available is infinite; the three provided are within reasonable likelihood of occurring. The scenarios are based on recent fiscal information for the City as well as data from the City's forecasting service, IHS Markit. Staff acknowledges that these are the best estimates today and that as the economy begins to open and rebuild additional data and information will be gathered to inform the budget process. As with all forecasts, these scenarios serve as a planning tool to make fiscal decisions. See Attachment E: General Fund Financial Forecast for details.

The three scenarios are described here and follow with a chart depiction:

- **Rapid Recovery:** assumes revenue collections return to pre-COVID level by the end of 2021. The revenue impact due to the loss of growth in 2020 and 2021 will be ongoing and requires an ongoing \$12 million expenditure reduction in the 2021-2022 budget.
- **Moderate Recovery:** assumes revenue collections return to pre-COVID level by the end of 2022 (a year later than the rapid recovery scenario) as consumers become more confident. Due to a longer recovery path, the loss of revenue growth extends through 2022 for a total of three years, requiring an ongoing \$14 million expenditure reduction in the 2021-2022 budget.
- **Moderate Plus Recovery:** assumes the same three year period to pre-COVID levels and includes additional impacts to utility taxes and property taxes due to longer term job losses in the community. Under this scenario, the impact is an ongoing \$16 million expenditure cut in the 2021-2022 budget.



Under these planning assumptions, based on the cost of service today, the general fund will need to cut expenses by \$12 million (~6 percent) to \$16 million (~8 percent) in the 2021-2022 budget to address the reduced revenues in order to balance the budget. Either expenditures will need to be reduced or revenues increased. This is the best information available today, and the City must plan accordingly.

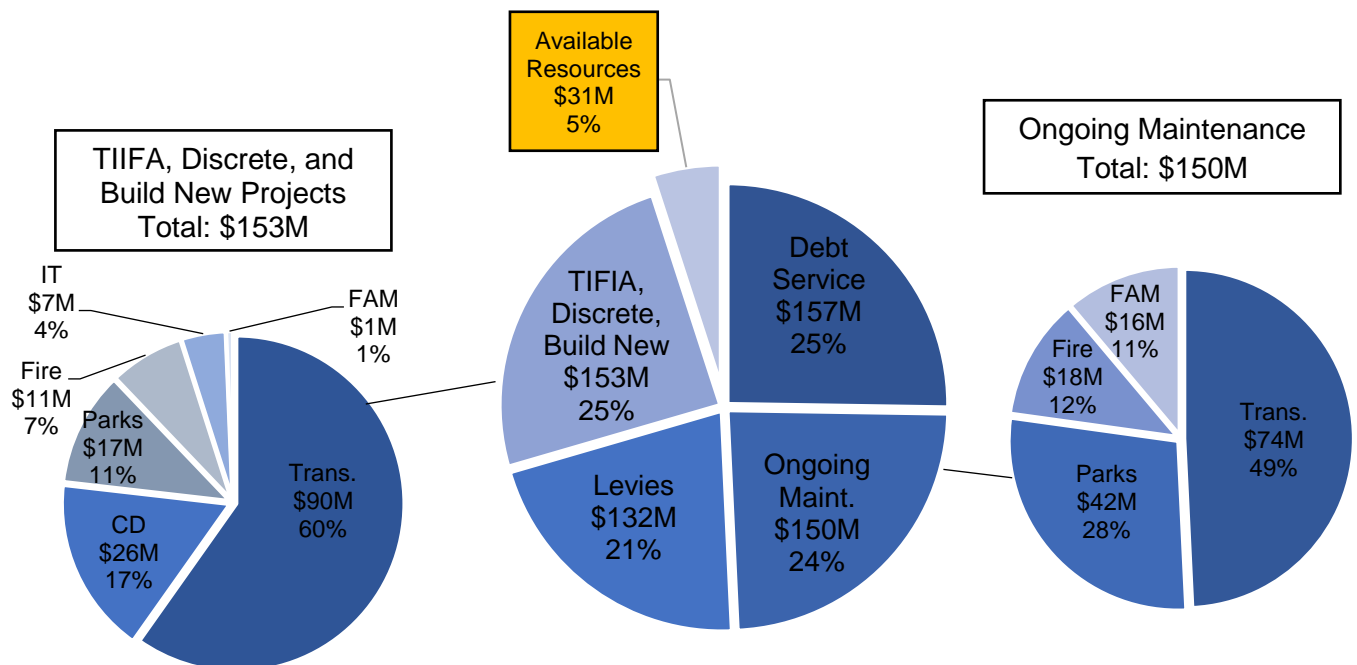
General Capital Investment Program (CIP) Plan

Like previous CIP plans, the 2021-2027 CIP will be resource constrained; continuing projects that are currently underway and adding years 2026 and 2027. In accordance with Council policy and historical practice, the first draw on new resources is to fund debt service which is contractually committed, together with ongoing projects that maintain the City's existing infrastructure before building new projects, and continuing projects underway. Based on best estimates today, the remaining new resources to pay for recosting of existing projects, scope changes for unforeseen developments, and new projects is projected to be approximately \$31M in total across the two years being added to the CIP. This is less than historical funding amounts due to the reduction of revenue estimates from COVID related impacts. This estimate is based on the modest recovery option noted in the general fund forecast section, and as the forecasts are updated, the amount available will adjust. Further, it is anticipated that the amount of recosting and the new projects submitted to the 2021-2027 will greatly exceed the available funding.

With the near term COVID impacts, the projects in the early years of the CIP may need to be adjusted in timing to avoid a cash flow issue in the early years of the next CIP. As the forecasts continue to be developed, staff will review the timing of projects in detail and make any needed recommendations. See Attachment F: Capital Investment Plan Early Look for additional detail.

2021-2027 CIP Resource Allocation

Total: \$623M



Council Discussion

The work before the City is daunting. The expenditure reductions to bring the general fund budget into balance will be difficult and deep, we recommend for planning purposes that we assume a \$16 million reduction in spending (an 8% reduction) as based on best information today and it does provide us with a reasonable planning path. Both the hard choices ahead, and the uncertainty as to how the economy will recover, challenge us to ensure we are taking a balanced approach to reductions. An overly conservative approach may have us cutting too deep and too quickly, while an overly optimistic approach could leave the City with the need to make further reductions in the middle of a budget year.

The CIP, has its own struggles, with only \$31 million in years 2026 and 2027 to meet the investment needs of the community. There are many projects in the queue for the future, and with a resource constrained CIP, the choices will be difficult. The potential projects include:

- Infrastructure to support growth, like 120th Stage 4, Bellevue Way HOV, 150th Ave. SE corridor and others,
- Quality of Life investments, such as an aquatics center and additional phases of Meydenbauer Park, and
- Critical City Facilities such as replacing aging enterprise technologies and aging or deficient facilities.

To guide the work, we expect to use guiding principles from prior budgets:

Budget One Guiding Principles

Foremost is the Council's long-term policy that quality service programs will be offered by the City of Bellevue. Other guiding principles include:

- a focus on services that deliver outcomes important to the community and that are responsive and accessible to all;
- position Bellevue to realize opportunities;
- an examination of the entire budget, not just incremental changes from the last budget;
- a commitment to innovation, efficiency, and sound business practice;
- a focus on Citywide, not Department, priorities;
- a long-range strategic approach to an affordable and sustainable budget; and
- if expenditure reductions are necessary, service elimination is preferable to poor or marginal quality programs.

Discussion 1: General Fund Approach to Budget Decisions

First and foremost, we anticipate that the required expenditure reductions to achieve a balanced budget will mean that levels of service in at least some areas will not be where they have been in the past, nor where we may have thought, as recently as February this year, that we would be. Early this year, we were anticipating continued revenue growth into this biennium, and were looking at areas to increase expenditures in order to meet high demand – such as in areas anticipated to be impacted by our jobs growth downtown.

- Building on the guiding principles above, the other tools for assistance in the budget work are the City's financial policies, City Code, Ordinances, and the Council vision. Data set 1: Budget

proposals include metrics to show how the City is delivering on the desired outcome across all the Strategic Target Areas. In this process, staff will be reviewing proposals in light of their performance and how closely they are related to the Council vision. The current budget and performance surveys will inform this work as well. This work may provide insight into areas where a reduced level of service may be an acceptable trade-off in order to ensure program continuity in another area.

- Data set 2: In previous budget processes, ranked lists of proposals were developed in alignment with how important they were to the delivery of the outcomes. Staff will use these historical rankings as areas to help identify those services where reduction in investment may lead to lower, yet still acceptable level of service impacts, and where elimination of a service altogether is warranted due to budget constraints and looser connection to the highest priority outcomes.
- Data set 3: The organization is currently undertaking the development of what an 8 percent across the board reduction would look like, which services are impacted, and where. This information is a third set of data to assist in identifying where the most appropriate reductions would be.

Staff seeks feedback on these processes or other processes that will best inform Council in making decisions about the budget moving forward.

Discussion 2: Options for Revenue Flexibility

Attachment G has an overview of the major taxes and their current allocations. In a review of the financial policies and Ordinances, there is revenue policy adopted by the Council that direct a specific revenue split between funds. Because this split is adopted at the local level, a change in this policy would allow more flexibility to use revenue where the need is greatest. The policies and ordinances are:

Sales Tax (2021 Forecast: \$73 million splits General Fund \$54 million and CIP \$19 million)

Financial Policy XI.H “Non-Utility CIP Maintenance and Operating (M&O) Costs: Proposals for CIP project funding shall include the estimated future M&O cost, to provide full cost disclosure. Such M&O costs anticipated to be incurred in the upcoming biennium should be included in operating budget proposals for funding consideration. As of 2011, funding for existing CIP M&O is provided by a distribution of the City’s Sales Tax revenue, split between 75 percent General Fund and 25 percent CIP. The dollar amount for CIP M&O is adjusted upward each year by the anticipated Consumer Price Index for all Urban Consumers (CPI-U) after first making any necessary adjustments (e.g., partial vs full-year costs) and eliminating any one-time items. The distribution amounts should be reviewed periodically by the Council for reasonableness and potential adjustment.”

In implementing this policy, in 2011 the general fund received 75% of the sales tax and the CIP received 25%. Each year since then, the general fund allotment has been increased by CPI. Under state law, this revenue stream is unrestricted in use, and therefore can be directed based on the local policies.

In addition, Ordinance No. 6209 directed, by budget adoption, \$694,000 of sales tax to be directed to the CIP to cover a portion of the debt service for the 2015 bonds.

As an additional reference and disclosure, the B&O tax is also split as follows: 73 percent (\$34 million) to the General Fund, and 27 percent (\$12 million) to the CIP; of the CIP amount 6 percent is dedicated to transportation capital projects. This split is based on prior Ordinances, budgets, and practices and dates back to 1987.

In the general fund, these tax revenues are unrestricted and provide funding for approximately 40 percent of the total general fund. In the CIP, these funds are the first call for debt service, beyond that they are used to fund projects that would not have other funding sources including the difference between dedicated revenues and the project costs for discrete projects (a specific road or park project) or ongoing projects (maintenance), and other projects with no discrete project funding such as affordable housing, early implementation of the Grand Connection, and others.

The split of revenue between the General Fund and the CIP has served to ensure that the City has resources in the CIP to meet demand, and to have a robust source for infrastructure and facility maintenance. Many other jurisdictions do not dedicate a portion of their sales and businesses taxes to the CIP, relying on property tax and voted measures. While a long-term rethinking of Bellevue's approach is not feasible within the time we have to develop the 2021-22 budget, a short-term modification of the split would allow additional flexibility for ensuring our limited revenues go to our highest needs.

For purposes of developing a balanced preliminary budget, we are seeking Council feedback on a proposal to allow a 2-year minor adjustment of up to \$3 million each year, reducing by up to \$3 million the amount of sales and B&O tax flowing to the CIP, and instead channeling those resources into the General Fund.

We believe this flexibility is warranted and prudent in light of the unpredictability of the economic recovery coming out of the COVID shut-down. While this redirection of revenue does not eliminate the need for reductions in the General Fund, it does help smooth the impact, and allows some more time for us to read the economic landscape and adjust.

This concept is not without impact. Early thinking is that in order to address the \$3 million in both 2021 and 2022 maintenance projects would be delayed, such as the street overlay program and building maintenance. For instance, \$1 million reduction in the overlay would reduce the overlay program by one mile a year for the two years, reducing building maintenance would defer preventive maintenance such as exterior wall repairs and electric panel upgrades for two years. During the Great Recession, the city employed similar deferrals in maintenance programs across the city.

Staff seeks feedback if this is an area of interest for Council. If it is, then staff would return at a later date with a full proposal with specific impacts.

Discussion 3: Approach to CIP Balancing

A team made up of Leadership Team (department directors) members will make a recommendation to the City Manager for the 2021-2027 CIP as has been the case for the past several budget cycles. In addition to the budget guiding principles, they will use the historical CIP criteria and planning policies, see Attachment H: Capital Prioritization Criteria and Planning Policies.

Staff seeks feedback on these criteria or other criteria that Council may wish to provide as the City Manager begins to develop his Preliminary Budget.

Next Steps

Staff will return to Council for additional feedback over the course of budget development as the forecasts are updated, issues arise, and to set priorities.

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. Key areas covered include:

- Preparation and filing of a preliminary budget by the Chief Administrative Officer, i.e., City Manager;
- A "budget message" from the Chief Administrative Officer explaining the content, financial policies and major proposed changes;
- A public hearing on the proposed preliminary budget conducted before adoption of a final budget, which shall be held on or before the first Monday in December;
- Balanced expenditure and revenue estimates for each of the City's funds;
- Council adoption of the budget prior to the beginning of the ensuing fiscal biennium, i.e., January 1, 2021

OPTIONS

N/A

ATTACHMENTS & AVAILABLE DOCUMENTS

- A. Impact of COVID Related Events on City Finances (Reprint from May 18)
- B. Performance and Budget Survey Results
- C. Budget Process and Calendar
- D. Budget One Public Engagement
- E. General Fund Financial Forecast
- F. Capital Investment Program Early Look
- G. Overview of Major Taxes and Current Allocations
- H. Capital Prioritization Criteria and Planning Policies

AVAILABLE IN COUNCIL LIBRARY

N/A