



**BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND, WA**

**AB 5445
June 19, 2018
Regular Business**

CITY'S FINANCIAL CHALLENGES: REVIEW CITY MANAGER'S RECOMMENDATION	Action: Discuss the City Manager's recommendation to address the City's projected budget deficits	<input checked="" type="checkbox"/> Discussion Only <input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
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DEPARTMENT OF	City Manager (Julie Underwood)
COUNCIL LIAISON	n/a
EXHIBITS	n/a
2018-2019 CITY COUNCIL GOAL	2. Maintain QofL/Essential Services
APPROVED BY CITY MANAGER	

AMOUNT OF EXPENDITURE	\$	n/a
AMOUNT BUDGETED	\$	n/a
APPROPRIATION REQUIRED	\$	n/a

SUMMARY

BACKGROUND

In November 2001, Washington State voters passed Initiative No. 747. This limited cities' ability to increase their levies by more than one percent without voter approval. Even though this ballot measure was found to be unconstitutional, the State Legislature met in a special session and reinstated the one percent limitation. Interestingly, Mercer Island voters did not support initiative No. 747 and 55% voted no.

There is an exception to this state law, referred to as a "levy lid lift," which allows cities to ask the voters in their community if they would like to "lift the lid" on this 1% property tax limit.

Tonight's presentation is a continuation of the City's financial challenges discussion and the City Manager's recommendation for addressing Council Goal 2 – Maintain Quality of Life and Essential Services and Infrastructure by Addressing the City's Financial Challenges.

The City began educating the community about the City's financial challenges starting a year ago in June 2017. The City utilized a diverse range of communications and engagement efforts which are described in [AB 5422](#) (May 15, 2018) and [AB 5440](#) (June 5, 2018).

The Council continued to be briefed and updated at the January 2018 Planning Session, and again, at the June 2018 Mini-Planning Session. In addition, Councilmembers attended many of the Community Advisory Group meetings regularly as observers.

The City develops and maintains a six-year financial forecast that estimates resources and expenditures. This forecast and future-oriented lens provides the City’s decision-makers with insight into whether the current mix and level of resources are likely to continue to be sufficient to cover the cost of maintaining current service levels. The City’s current General Fund and Youth & Family Services Fund financial forecasts project budget gaps, where costs to maintain existing services will exceed revenue resources with a cumulative estimated total of \$7.89 million over the coming six-year period 2019-2024.

The recently completed community survey notes that residents have high levels of satisfaction with their quality of life in the City. Listed below are a few examples:

- 95% of residents are very satisfied/satisfied with Mercer Island as a place to live,
- 95% of residents are very satisfied/satisfied with their overall feeling of safety,
- 94% of residents are very satisfied/satisfied with Mercer Island as a place to raise children (66% stating they are very satisfied), and
- 92% of residents are very satisfied/satisfied with the overall quality of life in the City.

Residents are not the only ones who believe that Mercer Island is a great place to live. In January of this year, *Money* magazine named Mercer Island the best place to live in Washington State.¹ *Money* noted the following reasons for this distinction:

Just over five miles long and two miles wide, the Mercer Island community is known for its affluent residential areas, preserved parks and nature, and miles of scenic shoreline. Located between Seattle and Bellevue on the southern portion of Lake Washington—and connected to the mainland on either side by floating bridges carrying Interstate 90—the island has a commercial hub and popular gathering spot in its town center, where islanders can enjoy events like the Mercer Island Farmers Market or Summer Celebration.

Maintaining Mercer Island’s exceptional quality of life is a priority for the Council and staff who serve this community; however, sustaining this continues to be a challenge when faced with a significant financial structural imbalance.

CITY MANAGER’S RECOMMENDATION

Since 2014, staff has projected operating deficits beginning in 2017 driven by annual revenue growth not keeping up with inflation. As a result, staff has communicated that there is a need for a levy lid lift to maintain existing levels of service. Otherwise, service level cuts will be required.

Since the national, regional, and local economy are currently in a “boom” period, it would appear counterintuitive that the City would need additional resources. As a residential community, the City’s most significant resource is property taxes, accounting for 41% of the General Fund budget. With property values increasing 10-12% on average, it would seem logical that the City’s property tax collection would see substantial growth. However, in Washington State, a city’s property tax levy is not tied to property value changes. Rather, the current year’s levy amount is capped by state law at a 1% increase of the prior year’s levy amount, plus an allowance for “new construction.” So, as property values increase, the City’s levy rate correspondingly decreases to ensure that the levy amount collected in the current year does not exceed 1% of the prior year’s levy.

Since the adoption of I-747, the Seattle-Tacoma-Bremerton Consumer Price Index-W (CPI-W) rate has been as follows:

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
3.6%	1.8%	1.5%	1.6%	3.0%	3.7%	3.8%	4.5%	0.4%	0.8%	3.2%	2.5%	1.2%	1.9%	0.9%	2.3%	3.3%

¹ Klebnikov, Sergei and Renzulli, Kerri Anne. “Best Places to Live in the U.S.” *Money*, Jan. 2018: <http://time.com/money/5108196/best-places-to-live-every-state-us/>

Additionally, as the economy grows costs rise. For example, the City held the open space vegetation management contracts budget constant at 2010 dollars; however, when seeking bids for the 2017 contract, bids came in over budget. When faced with escalating costs and less funds, the City is forced to scale back its level of service.

Another example of increasing costs is with Washington’s minimum wage, which is currently \$11.50 per hour and is expected to grow to \$12 in 2019 and to \$13.50 in 2020 (Seattle’s current minimum wage is \$15). Starting in 2021, minimum wage increases will be tied to the rate of inflation (CPI-W). Increases in minimum wage typically result in higher wages for all entry level jobs, and eventually push all wages higher in the region.

Boom-bust cycles last for varying lengths of time and vary in severity. It is hard to predict when a bust period or an economic downturn will come. Nevertheless, a recession in the coming six-year period is likely given the history of economic recessions. Accordingly, staff believes it would be prudent to be financially prepared for an eventual economic downturn, as well as a potential natural catastrophe or other one-time extraordinary expenditures (e.g., I-90 tolling, Sound Transit litigation, e-coli water emergency, etc.).

To continue to meet the high expectations of the Mercer Island community, sustain the Island’s quality of life, remain fiscally responsible, reduce the potential need for borrowing or service reductions during economic downturns, and manage unforeseen, extraordinary financial demands, the City Manager recommends the following:

- **6-Year Levy Lid Lift**

The City Manager recommends that the Council ask voters to consider a 6-year levy lid lift by placing a ballot measure on the November 2018 General Election to lift the City property tax levy lid and to reset the current property tax rate of \$1.00 per \$1,000 of assessed valuation to \$1.22 per \$1,000 of assessed valuation in 2019. Additionally, the measure would set the annual maximum increase for property tax levies for 2020 through 2024 at the Seattle Consumer Price Index (CPI-W) and would use the 2024 levy as the base for future year levies. It is worth noting that the City’s maximum statutory levy rate is \$3.46. The current levy rate is 29% of the maximum statutory limit. The recommendation is an 8.5% increase bringing the levy rate to 35% of the maximum statutory limit.

Provided below are two 6-Year Levy Lid Lift options for Council’s consideration. Figures are based on forecasts done in June 2018.

Option 1: 6 Levy Lid Lift (Actual Annual Funding Need + Inflation @3%)

Funding Need	2019	2020	2021	2022	2023	2024	6-Year Annual Avg
General Fund deficit	\$376,088	\$1,379,106	\$2,677,263	\$3,351,553	\$4,206,575	\$5,101,826	\$2,848,735
Youth & Family Services Fund deficit	209,553	258,233	293,291	315,702	357,962	405,799	306,757
Total Funding Need	\$585,641	\$1,637,339	\$2,970,554	\$3,667,255	\$4,564,537	\$5,507,625	\$3,155,492
\$ Increase Over Prior Year	\$585,641	\$1,051,698	\$1,333,215	\$696,701	\$897,282	\$943,088	\$917,938
Levy lid lift rate per \$1,000 AV	\$0.044	\$0.123	\$0.223	\$0.276	\$0.343	\$0.414	\$0.237
Annual cost (\$1.20M AV home)	\$53	\$148	\$269	\$332	\$414	\$499	\$286

Option 2: 6 Year Levy Lid Lift (Smoothed Annual Funding Need + Inflation @3%)

Funding Need	2019	2020	2021	2022	2023	2024	6-Year Annual Avg
General Fund deficit	\$2,643,000	\$2,722,290	\$2,803,959	\$2,888,077	\$2,974,720	\$3,063,961	\$2,849,335
YFS Fund deficit	285,000	293,550	302,357	311,427	320,770	330,393	307,249
Total Funding Need	\$2,928,000	\$3,015,840	\$3,106,315	\$3,199,505	\$3,295,490	\$3,394,354	\$3,156,584
\$ Increase Over Prior Year	\$2,928,000	\$87,840	\$90,475	\$93,189	\$95,985	\$98,865	\$565,726
Levy lid lift rate per \$1,000 AV	\$0.220	\$0.227	\$0.234	\$0.241	\$0.248	\$0.255	\$0.237
Annual cost (\$1.20M AV home)	\$265	\$273	\$281	\$290	\$299	\$308	\$286

- **Additional Revenue Enhancements**

Unfortunately, the 6-year levy lid lift still does not bridge the gap fully. Therefore, the City Manager recommends adopting additional revenue enhancements including: 1) increasing the Business & Occupancy (B&O) tax from 0.10% to 0.15%; 2) maintaining the utility tax rate at 8.0%; 3) consolidating the Beautification Fund into the General Fund; and 4) eliminating the 1.7% water utility tax transfer to the Water Fund (these were reviewed at the [Council's June 5 Mini-Planning Session](#)). Moreover, the City Manager recommends continuing to conduct regular fee studies and to develop and adopt a master fee schedule. While there is considerable property levy rate capacity, spreading the tax burden among a mix of taxpayers provides a balanced approach.

- **Organizational Effectiveness Review**

The City must continue to strive to be judicious stewards of limited tax dollars, efficient in delivering services, and constantly looking at cost saving/control measures. The City Manager recommends the implementation of an organizational effectiveness review, which would include detailed review and evaluation of City programs and services, including examining staffing and service delivery models as well as costs and value. It is a best practice to continually review and set priorities, discontinue outdated/under-performing programs, and rely more on technology to achieve efficiencies and boost productivity. Examples of services to be evaluated are development services, fire and emergency medical response, community-based counseling services, and municipal court services.

Due to limited bandwidth and the need for outside objective expertise, the recommendation is to contract with outside consultants and analysts to assist with implementing the review. The City Manager will return to Council during the 2019-2020 Biennium Budget process to discuss the costs and resources involved in this recommendation.

- **Comprehensive Financial Management Policies**

While the City has good general policies in place, this recommendation is designed to create a work plan item devoted to having thorough and thoughtful discussions with the Council regarding formal financial management policies and their implications. The Government Finance Officers Association (GFOA) states that financial policies are central to a strategic, long-term approach to financial management and highlights the following reasons for adopting formal, written comprehensive financial management policies:

1. Institutionalize good financial management practices. Formal policies usually outlive their creators, and, thus, promote stability and continuity. They also prevent the need to re-invent responses to recurring issues.

2. Clarify and crystallize strategic intent for financial management. Financial policies define a shared understanding of how the organization will develop its financial practices and manage its resources to provide the best value to the community.
3. Define boundaries. Financial policies define limits on the actions staff may take. The policy framework provides the boundaries within which staff can innovate in order to realize the organization's strategic intent.
4. Support good bond ratings and thereby reduce the cost of borrowing.
5. Promote long-term and strategic thinking. The strategic intent articulated by many financial policies necessarily demands a long-term perspective from the organization.
6. Manage risks to financial condition. A key component of governance accountability is not to incur excessive risk in the pursuit of public goals. Financial policies identify important risks to financial condition.
7. Comply with established public management best practices. The Government Finance Officers Association (GFOA), through its officially adopted Best Practices endorsement of National Advisory Council on State and Local Budgeting (NACSLB) budget practices and the GFOA Distinguished Budget Presentation Award Program, has recognized financial policies as an essential part of public financial management.

- **Balanced Budget with Level of Service (LOS) Reductions**

The City Council is required to adopt a balanced budget. Without additional revenues, the City Manager recommends level of service reductions. Moreover, it would be her priority to provide quality service programs; and therefore, service elimination is preferable to poor or marginal quality programs. Staff would engage the Council and community regarding the proposed LOS reductions and program eliminations as well as the potential implications and impacts. Initial changes to LOS may include the following:

- Reduce parks maintenance, which would impact mowing, irrigation, trash collection, restroom maintenance, etc.
- Eliminate or reduce financial support to Mary Wayte Pool, Sister City Association, Mountains to Sounds Greenway, ARCH, and the Mercer Island Chamber of Commerce.
- Eliminate lifeguards at beaches.
- Eliminate Summer Celebration and other special events (e.g., Tree Lighting & Firehouse Munch, Spring Egg Hunt, Parents Night Out, Community Camp out, Movies in the Park, Leap for Green)
- Eliminate any subsidy tied to logistical support for City and regional special events (e.g., Seafair, Rotary Half Marathon, Farmer's Market)
- Reduce the Senior Social Program (care is currently provided three days per week)
- Reduce operating hours at the Mercer Island Community and Event Center
- Reduce right-of-way trail and tree maintenance, median and roadside vegetation maintenance
- Eliminate/reduce Town Center beautification (e.g., hanging baskets, planted medians, etc.)
- Reduce elementary school counselors, clinical supervisor support, and geriatric specialist services, youth development coordinator, high school drug/alcohol intervention specialist
- Reduce investigations/detective services and patrol services
- Reduce support staff commensurate with other reductions (e.g., IT, Finance, City Manager)

Property Tax Exemptions

Property tax exemptions or deferrals are available to seniors (60 or older) or disabled persons with primary residence in Washington. Households earning a combined income of \$45,000 or less may qualify for a deferral based on the level of equity in the home. More details are available at the following link:

<https://dor.wa.gov/find-taxes-rates/property-tax/property-tax-exemptions-and-deferrals>. Additional

information on tax relief programs and how to access them is also available at the following link:
<https://www.kingcounty.gov/depts/assessor/TaxpayerAssistance/TaxRelief.aspx>.

Resource/Fiscal Impact

Staff estimates election costs associated with placing a levy lid lift measure on the General Election ballot in November to be between \$35,000 and \$55,000 for election expenses and voters' pamphlet expenses, depending on how many jurisdictions in King County have ballot measures or candidates on the ballot.

Recently, the King County Council appropriated funds to King County Elections for prepaid postage for all ballots, which may help to improve voter participation. Maple Valley and Shoreline were test cities for the February 2017 special election and according to King County, voter turnout increased in comparison to previous special elections by three (3) percent in Maple Valley and 10 percent in Shoreline.

Ballot Measure and Voter Pamphlet Requirements

If the City Council decides to place a levy lid lift on the November 2018 ballot, a ballot measure's title and voter pamphlet are required to adhere to the following requirements:

Ballot Title

The ballot title for the levy lid lift consists of three elements:

1. An identification of the enacting legislative body and a statement of the subject matter;
2. A concise description of the measure; and
3. A question.

The ballot title must conform to these requirements and be displayed substantially as provided under state law (RCW 29A.72.050), except that the concise description must not exceed 75 words. The ballot title must also be approved by the City Attorney.

Any person who is dissatisfied with the ballot title may, at any time within 10 days from the time of the filing of the ballot title with King County Elections, appeal to King County Superior Court.

Voters' Pamphlet

For the primary and general election, King County publishes a voters' pamphlet. The City must provide an explanatory statement of the ballot title for the voter's pamphlet. The statement describes the effect of the measure if it is passed into law and cannot intentionally be an argument likely to create prejudice either for or against the measure. The explanatory statement is limited to 250 words, must be signed by the City Attorney, and submitted to King County elections by August 7, 2018.

The City is also responsible for appointing committees to prepare statements in favor of and in opposition to the ballot measure. There is a limit for three members per committee. The committee appointments must be filed with King County Elections by August 10, 2018. If the Council directs the City Manager to move forward on a levy lid lift, staff will need to advertise to recruit committee members of the "Pro and Con" committees and schedule appointments for the July 17 Council meeting.

The statements in favor of or in opposition to the ballot measure must be submitted by the Pro and Con committees to King County Elections no later than August 14, 2018. These statements are limited to 200 words. Rebuttal statements by each of the respective committees must be submitted to the County no later than August 16, 2018. Rebuttal statements are limited to 75 words.

COUNCIL INFORMATION REQUESTS

Council requested additional information regarding the proposed B&O tax increase. Provided below are the gross receipts by business sector; number of businesses who are operating on the island (physical location on the Island) versus off the island; number of businesses by gross receipt range; three B&O tax increase scenarios; and an example of what a business with \$500,000 in gross receipts would pay with the increase.

Gross Receipts by Business Sector 3/1/17 - 2/28/18

Business Sector	Gross Receipts*	% of Total
Construction	280,540,324	29.7%
Retail/Wholesale Trade	266,222,281	28.2%
Finance, Insurance & Real Estate	149,680,468	15.8%
Professional, Scientific & Technical Services	64,615,502	6.8%
Administration & Support Services	33,534,478	3.5%
Food Services	25,920,861	2.7%
All Other Sectors	124,381,491	13.2%
Total	944,895,405	100.0%

*Gross receipts reported by business before deductions and \$150K annual exemption.

On-Island vs. Off-Island Businesses

Physical Location	# of Businesses	% of Total
On-Island	1,220	30.0%
Off-Island	2,851	70.0%
Total	4,071	100.0%

Number of Businesses by Gross Receipts Range

Business Gross Receipts Range	# of Businesses	% of Total
\$0 - \$150,000	3,375	82.9%
\$150,001 - \$200,000	97	2.4%
\$200,001 - \$250,000	82	2.0%
\$250,001 - \$500,000	208	5.1%
\$500,001 - \$1,000,000	142	3.5%
\$1,000,001 - \$5,000,000	143	3.5%
\$5,000,001+	24	0.6%
Total	4,071	100.0%

3 B&O Tax Change Scenarios

Scenario	B&O Tax Rate	Annual Exemption	2019 New Revenue
CAG recommendation	Increase to 0.15%	\$150,000	\$325,000
Requested by Council	Increase to 0.15%	\$200,000	\$156,000
Requested by Council	Increase to 0.15%	\$250,000	\$124,000

CAG Recommendation Example: \$500,000 gross receipts

	0.10% Tax Rate	0.15% Tax Rate
Gross receipts	\$500,000	\$500,000
Annual exemption	(150,000)	(150,000)
Subject to B&O tax	350,000	350,000
B&O tax rate	0.001	0.0015
Annual B&O tax	\$350	\$525

NEXT STEPS

The last time the Council sought voter approval for a levy lid lift was in 2012 for a new fire station (FS 92) and fire apparatus. If the majority of Council directs the City Manager to move forward with the recommendation. The staff would prepare an ordinance for first reading at the July 10, 2018 special meeting. In addition, state law requires the City to conduct a public hearing, which would need to be scheduled for that same meeting. The second reading and adoption of the ordinance would occur on July 17, 2018 in order to meet the August 7, 2018 filing deadline.

For residents who would like to review the 6-year forecast and make adjustments to revenue options, change scenarios, and evaluate projected deficits, please visit this Google Docs spreadsheet model at the following link: <https://docs.google.com/spreadsheets/d/1W7zYQu9A3AwQqiECupfy32xIEe11Ea-BMphs-J30VCo/edit?usp=sharing>

RECOMMENDATION

City Manager

Receive recommendation, discuss, and provide staff direction.