

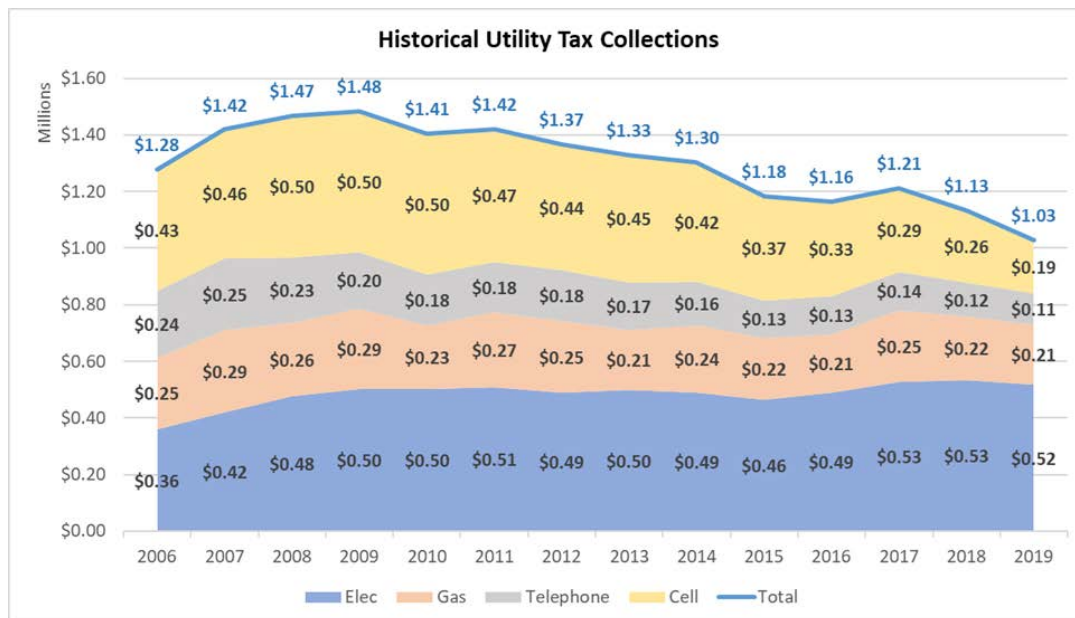


City Council Business Agenda Item
City of Kenmore, WA

<p>Subject/Topic: Financial Sustainability Plan</p> <p>Proposed Council Action/Motion: Adopt Resolution 20-357 Establishing a Financial Sustainability Plan</p>	<p>For Council Meeting Agenda of: October 26, 2020</p> <p>Department: City Manager's Office</p> <p style="text-align: right;"><u>Initial & Date</u></p> <p>Approved by Department Head: <u> RGK </u> Approved by City Attorney: <u> DR via email </u> Approved by Finance Director: <u> JG </u> Approved by City Manager: <u> RGK </u></p> <p>Attached: Attachment 1: Resolution 20-357 & Final Plan Attachment 2: Summary of Fiscal Sustainability Budget Strategies Identified by Management Partners</p>
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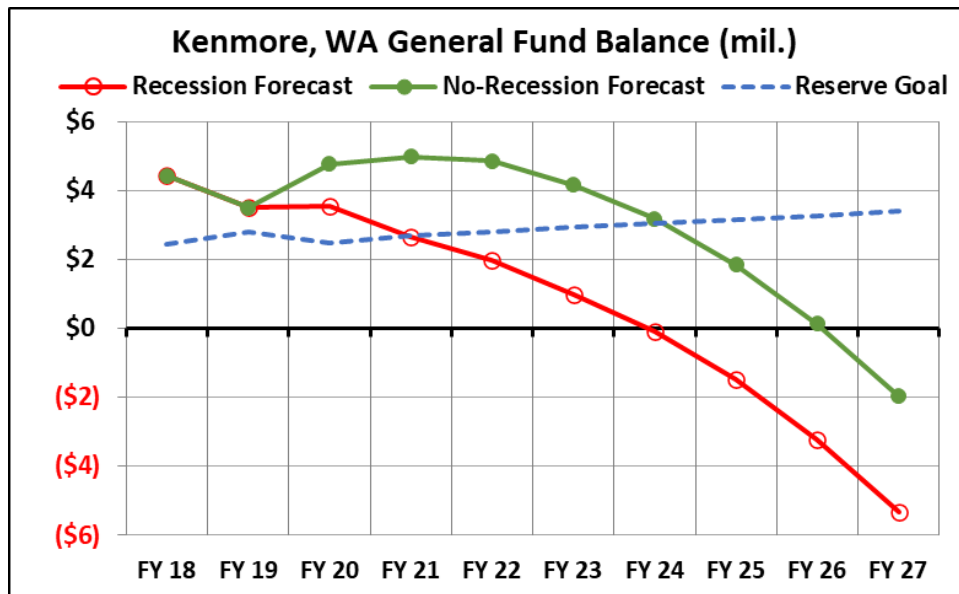
BACKGROUND:

Historically, the City of Kenmore has adopted balanced budgets and maintained healthy fund balances over the years. However, the City's financial forecasts have shown that operating expenditures are likely to exceed operating revenues in future years. A contributor to this phenomenon is the state-imposed restriction on property tax growth. Kenmore is a residential bedroom community with property tax as its largest source of operating revenue, and state law restricts property tax growth to one percent per year plus property tax from new construction. Other contributors include new unfunded mandates from the state and flat or little growth in other sources, including utility taxes, as shown in the following chart:

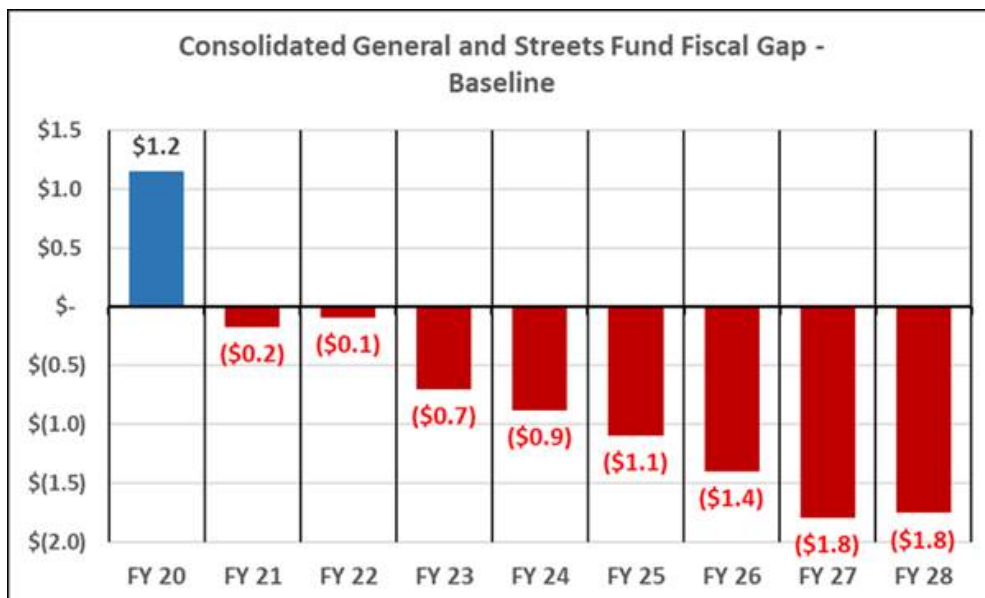


Last year, the financial forecast once again demonstrated that the City is experiencing a structural revenue problem whereby the City’s operating revenue growth is not keeping pace with the cost of providing City services and that the City’s operating expenses would exceed operating revenues as early as 2022.

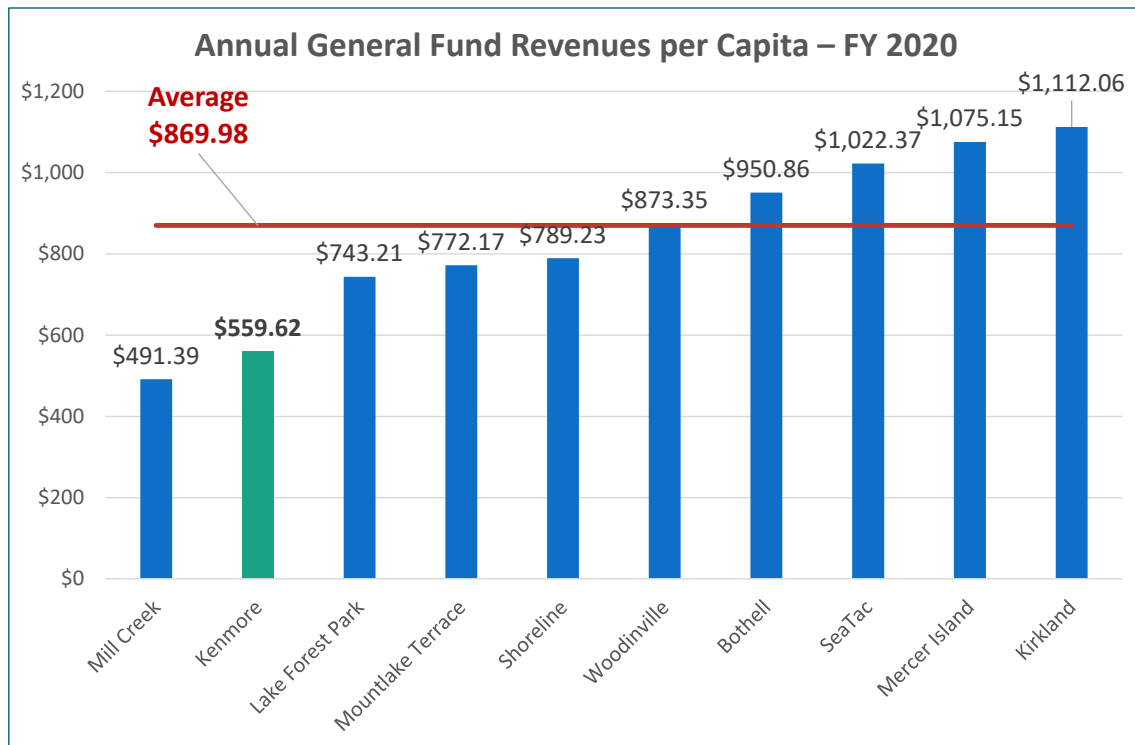
In early 2019, the City Council established “Create and implement a financial sustainability plan” as one of its top five goals for 2019 and 2020. Later that year (2019), the City retained the firm Management Partners to serve as an independent consultant to review the City’s financial condition and provide assistance in working toward a balanced financial forecast. Management Partners confirmed that operating expenses and revenues would be out of balance by 2022 and perhaps even sooner with the pandemic recession. Amidst last spring and summer’s economic uncertainty stemming from the pandemic, Management Partners forecasted potential declines in General Fund reserves as follows:



Since then, the revenue picture has improved; for example, sales tax revenue has declined, but not as much as predicted last spring. Even so, Management Partners’ updated forecast for the combined General and Street Funds still shows a fiscal gap (the difference between revenues and expenditures) as follows:



Management Partners also looked at Kenmore’s fiscal capacity and concluded that compared to other cities in the area, Kenmore’s General Fund revenues per capita are relatively low, as shown in the following chart on the next page (revenues were normalized for cities that provide fire services):

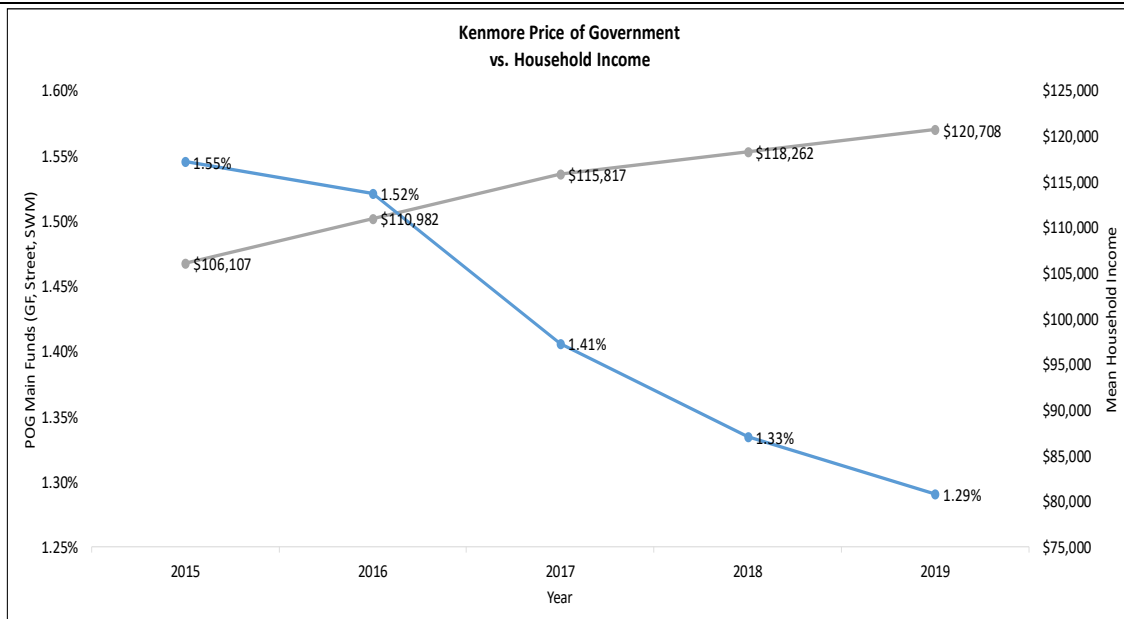


In keeping with its adopted priority to create and implement a Financial Sustainability Plan, on October 7, 2019, the City Council approved a process to create a financial sustainability plan. This process authorized the creation of a City Financial Sustainability Plan Task Force to advise the City Manager on ways to resolve the City’s upcoming structural deficit. On November 12, 2019, the Council approved the Task Force’s charter, and the City Manager appointed Task Force members soon thereafter.

The Work of the Task Force

The Task Force held nine meetings between January 2020 and August 2020. During the first several meetings, Management Partners reported on its findings of the City’s financial projections, and City staff provided the Task Force with information on city functions, funding sources, and how financial resources are allocated. The Task Force also learned about Priority Based Budgeting and how City programs were prioritized and scored against results established by the City Council.

The concept of “Price of Government” was also discussed with the Task Force, including Kenmore’s revenue trends compared to household income in Kenmore. The Price of Government analysis showed that City revenues as a percentage of household income have been declining over the years, as shown in the following chart:



The left axis and the blue line represent the Price of Government in Kenmore, meaning the City’s operating revenues divided by total household income in Kenmore—in other words, the average tax burden per household, as a percentage of household income. The right axis and the gray line represent the mean household income for Kenmore. While income has increased, the Price of Government has declined. Note that 2020 data (and pandemic effects) is not yet available.

Task Force meetings included opportunities for public comment and other opportunities for public participation, including the Balancing Act financial public engagement tool. In August, Management Partners updated its forecast with recessionary assumptions and provided a list of financial strategies for the Task Force to consider.

The Task Force reviewed the information provided by City staff, Management Partners, and the public and created a proposed financial sustainability plan through 2027 that includes multiple actions phased in over several years. Management Partners’ list of potential budget balancing strategies, including fiscal impact, difficulty of implementation, and percentage of Balancing Act respondents that selected particular strategies, is included as Attachment 2 to this agenda bill.

The Task Force members presented their findings and recommendations for a financial sustainability plan to the City Manager and City Council on September 10, 2020. At that same meeting, the Kenmore City Council provided comments and feedback regarding the Task Force’s recommended financial sustainability plan.

The City Manager agreed to incorporate the City Council’s collective comments and present a financial sustainability plan for City Council approval in October. The attached resolution establishing a financial sustainability plan is a result of the Task Force’s work and the adjustments offered by the City Council.

Public Outreach and Engagement

In August 2020, an online budget simulator tool, known as “Balancing Act,” was provided as an interactive way for the public to consider Kenmore’s budget challenges and offer input on how to balance the City budget. A postcard was sent to all mailboxes in the city to encourage the public to engage the Balancing Act tool and provide comments on the City’s finances. Preliminary results of public input from Balancing Act were provided to the task force at the August 24th, 2020 meeting.

Going back to 2019 and up to the present, other methods of informing the public and seeking public participation included a statistically valid survey, public comment at all task force meetings, an online public open house, FSP articles in several mailed newsletters, e-news articles, and social media posts.

Recommended Strategies

Both the Task Force’s recommended strategies and the proposed final plan include a combination of expenditure reductions and increases in revenue. A summary of operational expenditure and program reductions implemented in 2020 is part of the final plan and will continue in the next biennium. These reductions are shown in the following table:

Expenditure Reductions in the General Fund and Street Fund

Program	2019-2020 Budget	2021-2022 Proposed Budget	Biennium (Two-Year) Savings	Savings Per Year
Economic Development, Communications, Federal Lobbyist, etc.	807,000	286,776	520,224	260,112
Public Safety				
Court	260,000	155,100	104,900	52,450
School Resource Officer	100,000	-	100,000	50,000
Jail	850,000	550,000	300,000	150,000
Subtotal	1,210,000	705,100	504,900	252,450
Public Works				
Arterial Landscape Maintenance	363,400	245,500	117,900	58,950
Transportation Consulting (design)	112,550	10,000	102,550	51,275
Street Banners	50,000	-	50,000	25,000
Materials (including flower baskets)	60,000	36,000	24,000	12,000
Subtotal	585,950	291,500	294,450	147,225
Total	2,602,950	1,283,376	1,319,574	659,787

The list of revenue and expenditure strategies as recommended by the Task Force and the proposed final list of strategies is included as Exhibit A to the attached Resolution 20-357. The following two tables compare the expenditure and revenue strategies of the Task Force to those of the proposed final Financial Sustainability Plan:

Expenditure Strategy	Est. Annual Amount	Year of Implementation	
		Recommended by Task Force	Proposed Final Plan
Discontinue Contribution to School Resource Officer Program	\$50,000	2021	2021
Continue most of the reductions made in 2020	\$659,000	2021	2021
Add HR/Diversity, Equity, Inclusion Position & Program	\$197,000	2021	2021
Increase Mental Health RADAR Program	(\$50,000)	2021	2021
Increase Pavement Preservation Funding	(\$1,000,000)	2022	\$500k in 2022; then \$1m in 2023
Seek Alternative Jail Providers	\$50,000	2024	2024

Revenue Strategy	Est. Annual Amount	Year of Implementation	
		Recommended by Task Force	Proposed Final Plan
Property Tax Banked Capacity	\$400,000	2022, phased in over three years	2023, phased in over four years
Cable TV Utility Tax	\$380,000	Second Half of 2022	Second Half of 2022
Traffic Photo Enforcement	\$1,700,000	Second Half of 2022	Second Half of 2022
User Fee Study	\$50,000	2022	2022
Admissions Tax (5%)	\$200,000	Second Half of 2023	2024
Solid Waste Utility Tax (6%)	\$183,000	2024	--
Surface Water Utility Tax (6%)	\$125,000	--	2023
Transportation Sales Tax (0.1-0.2%, Voter Approved)	\$657,000	--	2027

There are two primary reasons for the differences between the Task Force recommendations and the proposed final plan:

1. Updates to the forecast, including expenditure and revenue assumptions, and
2. City Council policy direction to avoid a solid waste utility tax

1. Updates to the Forecast (and Proposed Voter-Approved Transportation Sales Tax in 2027)

After the Task Force recommendations were presented to the City Council in the first half of September, the preliminary 2021-2022 budget was produced with revised baseline numbers. The forecast for the Street Fund has been updated, including the removal of transportation district revenue, also known as the \$20 vehicle license fee (for the purpose of this discussion, we will call it TBD revenue). Even though the State Supreme Court has struck down Initiative 976 which would have eliminated the City's TBD revenue, the forecast and proposed final plan conservatively assume no TBD revenue beyond 2020. The decision to not include TBD revenue in the forecast comes from political uncertainty, including the possibility that the State Legislature might enact legislation in keeping with I-976 as well as the possibility that another version of I-976 might be proposed to the voters next year.

As a result of these changes in the forecast, the fund balances decline to unacceptable levels by 2027. By no later than 2026, the City Council will need to take action in one or a combination of the following three ways:

- a. Cut more services and programs starting in 2027,
- b. Councilmanically impose more taxes such as B&O or utility taxes starting in 2027, or
- c. Go to the voters for a property tax levy lid lift or transportation sales tax (authorized by the state under transportation benefit district legislation) that would come on line in 2027.

The proposed final plan selects the third option—proposing a measure to the voters, and in particular, a transportation sales tax (0.1% - 0.2%) ballot measure in 2026. The reasoning for a voter-approved transportation sales tax measure comes from the loss of I-976 revenue which was exclusively dedicated for transportation, as well as the corresponding Street Fund balance decline which is causing the structural revenue imbalance in the later years of the plan.

If the uncertainty surrounding the TBD revenue subsides, then the TBD revenue can be re-inserted back into the forecast. If this happens, the need for a voter-approved transportation sales tax measure may be delayed.

2. Utility Tax Discussion

Consistent with the City Council's preference expressed at the September 10th meeting, the proposed final plan does not include the Task Force's recommended solid waste utility tax starting in 2024. Instead, the proposed final plan includes a surface water utility tax starting in 2023.

A six percent solid waste utility tax (not recommended in the final plan), would cost a single family homeowner about \$4.18 per month in today's dollars, assuming a 60-gallon container, a recycling container, and a yard waste container. A Surface Water utility tax at six percent will cost single family residential property owners, at today's rate, \$13.28 per year or \$1.11 per month (note that this tax would be paid annually or semiannually as part of the property tax bill). Surface Water utility tax rates would vary for commercial property owners, based on impervious surface area coverage.

One reason a surface water utility tax is recommended over a solid waste utility tax is the full exemption from surface water management fees for lower income seniors and disabled residents. The primary qualifications for the Senior Citizen/Disabled surface water management fee exemption in 2020 include:

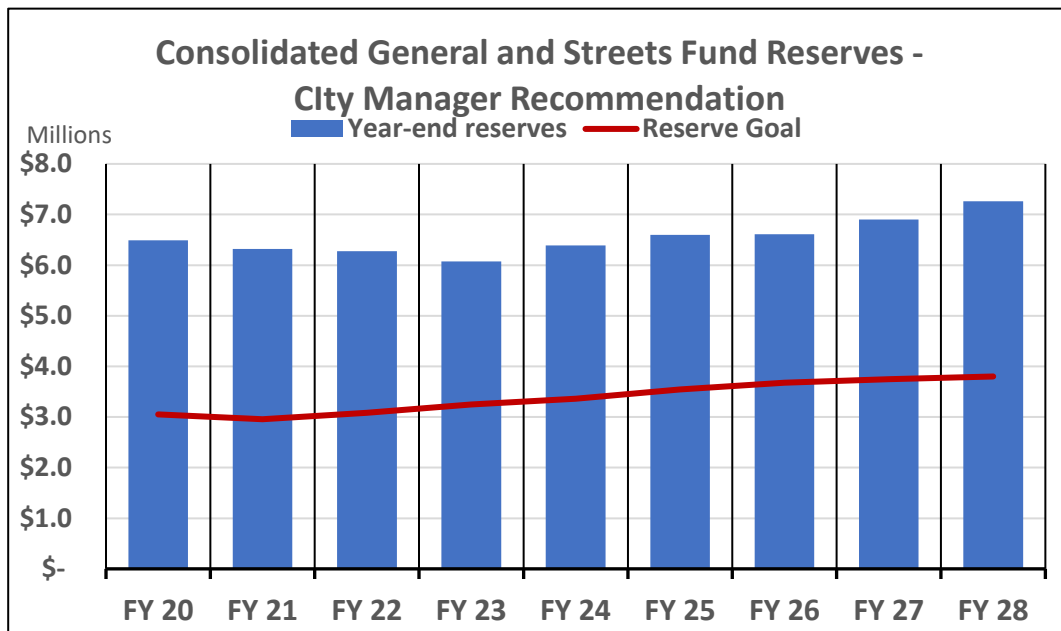
- Annual household income of \$58,423 (65% median King County household income) or less,
- Own and occupy a house, mobile home, condo, or co-op (as of 12/31/2019 and occupy as primary residence 9 months each year), and
- 61 years of age by December 31 of the previous year, or
- Retired because of disability or
- Veteran with a 100% service-connected disability, or
- You are a widow, or widower, or state registered domestic partner at least 57 years of age whose spouse or state registered domestic partner had an exemption at the time of death.

A cable TV utility tax at 6% would cost a cable subscriber approximately \$3.30 per month (based on Xfinity taxable portion of basic cable package). Note that the City does not have the authority to impose a utility tax on internet services.

Kenmore’s total utility taxes collected appear to be low compared to other cities in the area. In Management Partners’ report dated August 5, 2020, average annual utility tax revenue per capita for the comparison cities is \$121.27, and Kenmore collects approximately \$83.28 per capita (see Table 8 in the report included in the September 10 City Council meeting agenda).

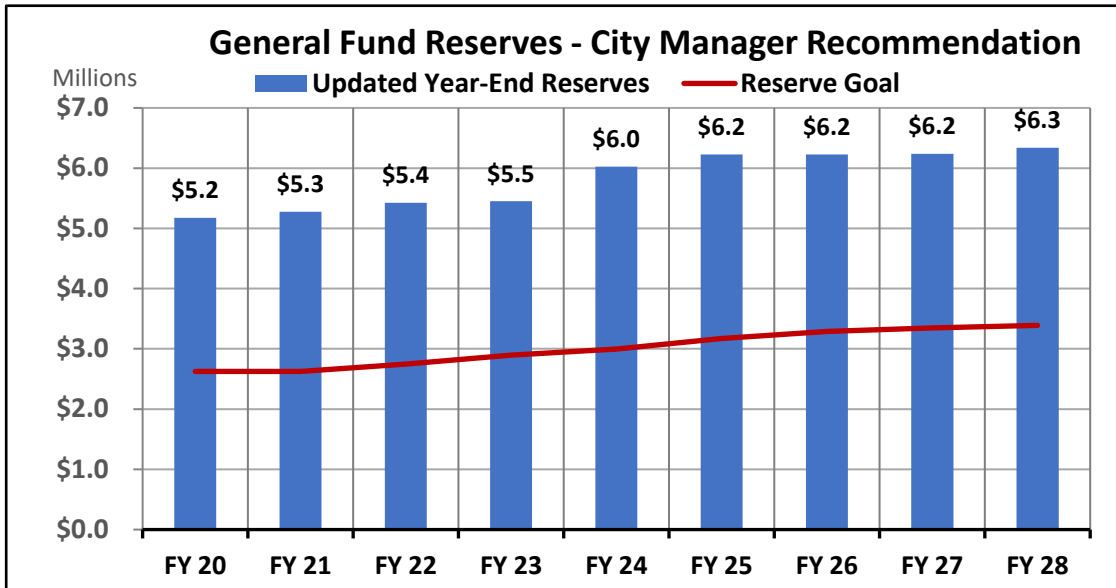
Fund Balance Forecast

If the City Council approves the final plan as proposed in Resolution 20-357, the combined General and Street Funds balance will be maintained above the established target level as shown in the following chart:

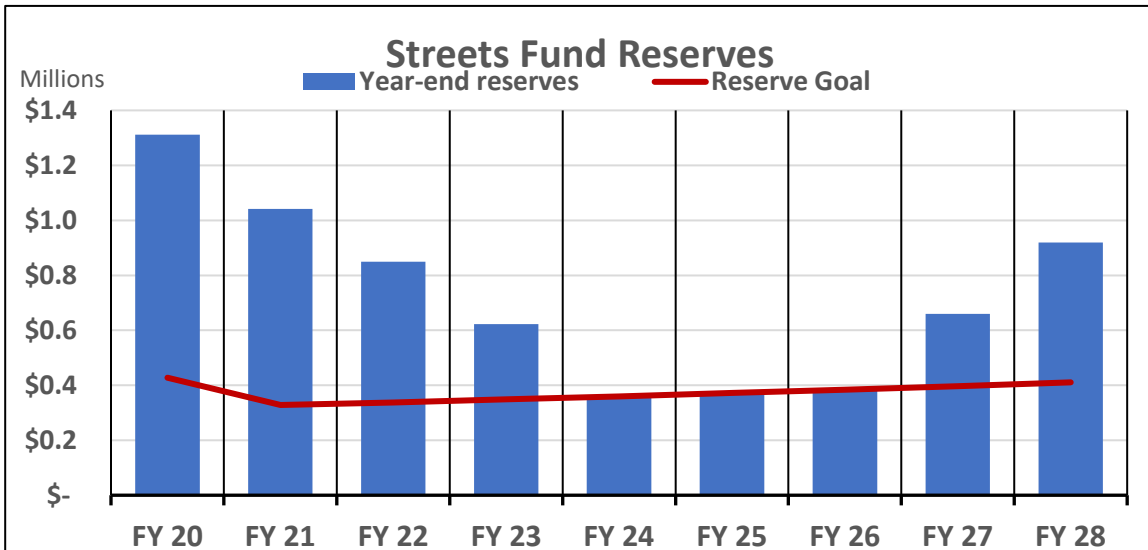


Note that in 2021 through 2023, the combined fund balance will see relatively small reductions then stay steady through 2028. This rise in fund balance is a result of phasing in revenue strategies in later years. The Task Force was willing to tolerate these temporary fund balance reductions in the early years of the plan given the difficult economic times caused by the pandemic.

The General Fund reserves, however, incrementally climb in every year of the plan:



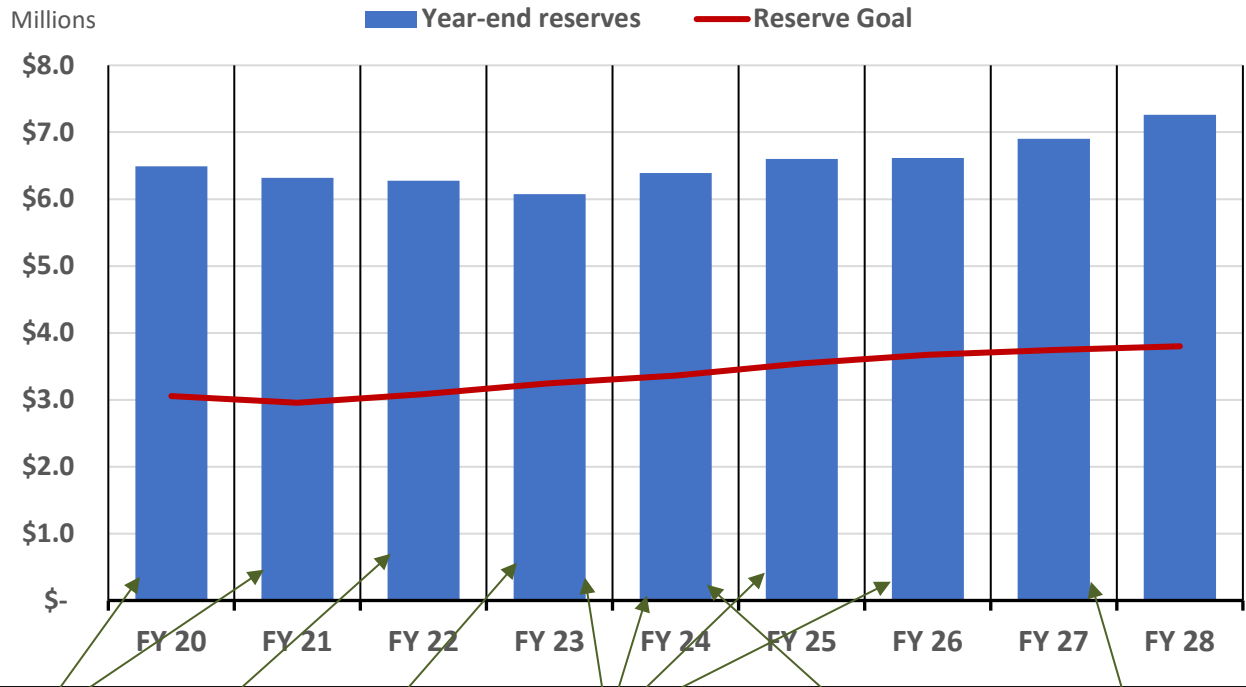
The temporary decline in reserves takes place in the Street Fund, down to the allowable policy target threshold of 20% of its operating budget:



The plan keeps the Street Fund reserves at the reserve goal from 2024 through 2026. The passage of the transportation sales tax increase in 2026 would allow the Street Fund balance (reserves) to grow again in 2027 and 2028. As stated previously, re-insertion of TBD revenue will stem the decline in Street Fund reserves and could delay the need for a voter-approved transportation sales tax.

The following illustration shows the combined Street and General Fund balances and when the more substantial expenditure and revenue strategies are proposed:

Consolidated General and Streets Fund Reserves - City Manager Recommendation



- Expenditure & Program Reductions
- Cable TV Utility Tax & Traffic Photo Enforcement
- Surface Water Utility Tax
- Property Tax Banked Capacity Phased in Over 4 Years
- Admissions Tax
- Transportation Sales Tax (Voter Approved)

Conclusion

The City Manager recommends that the City Council adopt the final Financial Sustainability Plan, as shown in Exhibit A of proposed Resolution 20-357, attached to this agenda bill.

The proposed final plan accomplishes the goal set forth by the City Council this time last year, which is to create a sustainable financial plan for six years, or three biennia through 2026. This plan meets that goal with councilmanic authority. For continued financial sustainability beyond 2026, this plan recommends a voter-approved transportation sales tax increase to go into effect in 2027.

The plan’s strategies identified for 2021 and 2022 are already included in the preliminary 2021-2022 Biennial Budget. Adopting Resolution 20-357 will set a path forward for maintaining strong fund balances at or above the City Council’s established target level through 2028—two years longer than the six-year goal set last year.

The City Manager also recommends that the plan be reviewed regularly and adjusted as needed. Economic conditions that turn out to be worse than the recession-based assumptions in the plan may drive the need to accelerate some of the strategies in the plan; on the other hand, better-than-anticipated financial conditions may delay the need to move forward with certain strategies.

The following timeline summarizes the financial sustainability plan development process:

- | | |
|--------------|---|
| 2019 January | City Council adds Financial Sustainability to its top five priorities. |
| October | City Council approves a process to develop a financial sustainability plan. |
| November | City retains Management Partners to assist with development of a financial sustainability plan. |
| November | City Council approves charter for the Financial Sustainability Plan Task Force. |
| December | City conducts statistically valid survey asking residents about the City's budget and performance. |
| 2020 January | Task Force is appointed and holds its first meeting. |
| April | Task Force work is paused due to the pandemic. |
| August | Task Force resumes work and develops recommended strategies, and holds its last meeting on August 25. |
| August | The Balancing Act budget simulator, open house, and other engagement methods are employed to seek public input. |
| September | Task Force recommendations and Management Partners' analysis and strategies are brought forward for Council review. |
| October | City Manager brings forward Resolution 20-357 containing the final financial sustainability plan for City Council adoption. |
| 2021 January | Begin implementation of the plan. |

Thank you for the opportunity to present Resolution 20-357, Financial Sustainability Plan, for your consideration. We very much appreciate the Task Force for their many hours of service and their most helpful ideas and recommendations. We would also like to thank Steve Toler of Management Partners and his team for providing much-needed analysis and expertise throughout this process.



COUNCIL PRIORITIES ADDRESSED

City Council Goal 5: Create and implement a Financial Stability Plan.