

Under Washington Law, the City Manager presents a balanced annual or biennial budget for the City's upcoming fiscal period for consideration and adoption by the City Council.

Mercer Island's biennial budget serves a number of essential functions. The budget is more than a "checkbook" posting of proposed revenues and expenditures. It is a financial plan that looks out over two-year (operating budget) and six-year (Capital Improvement Program) horizons, balancing planned income and expenses in a fiscally responsible manner. It is a policy plan, guiding and assuring the City's long-term financial health. And, most importantly, it is a detailed description of the goods and services for which the City and its elected officials will be held accountable. It documents the "social contract" between the citizens and their government.

The budget also serves in a broader policy context. It draws upon many City Council decisions and discussions that precede it, and it will leave a legacy of policy influence for future budgets—helping to give the City's finances long-term stability and continuity.

How the Budget is Organized

The Reader's Guide (Section A) at the beginning of the budget document provides a brief overview of how the City's budget is organized.

The budget covers two operating years for all City departments and functions. However, in order to assess revenue and expenditure trends, most budget sections also show actual data for 2007 and forecast data for 2008.

Service Packages

Reflecting the City Council's desire to focus on significant changes in the proposed budget for the coming biennium, City staff has prepared departmental "service packages" for 2009-2010, which represent new (or renewed) requests for temporary or ongoing positions, contracted services, and/or equipment costing at least \$10,000. This budgeting approach recognizes that most of the services provided by a city extend from one year to the next, especially in a city that isn't growing very much. Consequently, the scope of the budget review process is narrowed to notable increases and decreases in each department's operating budget. In addition, the City Council will review the changes to each department's "base" (i.e. ongoing) budget. These changes are broken down into two major components: 1) general inflationary increases, and 2) other significant changes. Within the latter component, "prior year one-time costs" are called out collectively as a decrease, because they will not be re-budgeted in 2009-2010 within each department's "base" budget. If such a cost needs to be budgeted again in 2009-2010 and it is \$10,000 or more, it will be proposed as a service package.

Service package request detail sheets are provided in Section K. Examples of notable proposed initiatives include the following:

- **Parks & Recreation:** CCMV Staffing; CCMV Drop-in Child Care Program; Boating Program; and Community Art Programs.
- **Development Services:** Maintain Plan Review & Inspection Levels of Service; Digital Plan Review Option; Transportation Plan; Building Code Update; and Comprehensive Plan Update.
- **Maintenance:** Tree Planting Program (Sustainability); Puget Sound Energy Conservation Program (Sustainability); and Town Center Improvements.
- **Municipal Court:** Conversion of Temporary Court Clerk to Regular Status.

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- **Information & Geographic Services:** Computer Support Technician.
- **City Manager's Office:** Production of 4 Episodes of MI View.

Priorities of Government

Over the past two biennia, the City has shown how it spends its resources against the City Council's stated or implied priorities. The Council has sought this information so that it can better understand and consider tradeoff decisions among and across services and cost centers.

In 2004, using a process loosely based on the State of Washington's "Priorities of Government," the City Council adopted six City priorities to serve as a filter through which significant changes to City services and programs could be evaluated:

1. **The community will be safe.**
2. **The community will support effective, efficient and legal delivery of public services.**
3. **The community will support reliable public infrastructure and protect its considerable public investments (e.g. water, sewer, storm water utilities, streets, parks, and buildings).**
4. **The community will support attractive, high quality neighborhood and business environments.**
5. **The community will support a broad range of recreational, cultural, health and educational opportunities.**
6. **The community will support open and informed public involvement processes within the structure of representative, democratic decision making.**

A complete listing of the priorities and their sub-priorities can be found in Appendix A at the end of the Budget Message.

The proposed 2009-2010 Budget confirms what was discovered back in 2004 with the development of the 2004-2005 Budget, namely that:

- The City spends most of its resources on its highest priority services and projects.
- The City provides the highest tax support for its highest priority services – police; fire; infrastructure maintenance (streets and parks); and administrative services that ensure the legal and efficient running of the City like Finance, Human Resources, City Attorney's Office, and City Manager's Office.
- The services that are least tax-supported are those for which the City can "sell" the service through user fees and utility rates (recreation, youth and family counseling, development permits, and utility services).
- The services for which the City has some of its most accurate data on individuals served are those services most associated with user fees. Those services are also often associated with active and supportive constituencies (recreation programs, leagues, seniors, and schools-related groups).
- The City spends comparatively less in services aimed at public information and public involvement.

Performance Measures

This biennial budget will continue to identify key performance measures that can be tracked through the budget period. Performance measures are linked to the City's budgetary resources (inputs) and to the City Council's values (outputs and outcomes) as expressed in the City Priorities. By tracking performance measures over time, the City hopes to create an ongoing link between its stated goals and priorities and how resources are applied. Periodic reporting of performance objectives and results will be presented to the City Council and community via the "MI Dashboard Report" compiled by the Finance Department.

Financial Status

Financial Forecast

Due to a long history of constraining expenditure growth, conservatively estimating revenues, and maintaining a sizeable debt capacity, the City's financial condition is still solid. However, the City's finances have become increasingly sensitive to fluctuations in the local and regional economy that are beyond its control. The current economic downturn coupled with the effects of taxpayer initiatives have had notable impacts on some City revenue streams – most notably sales tax, real estate excise tax, and property tax receipts. Meanwhile, labor cost increases continue to significantly outpace both the CPI for the Seattle metro area and the 1% ceiling on annual property tax increases. These expenditure and revenue trends are discussed below.

Expenditure Trends

- **Public Safety Costs** – A continuing challenge facing the City Council—now and in the future—is constant growth in the cost of providing Public Safety services. During the coming biennium, the Council will face significant increases in wages and health care benefits for our existing police and fire personnel, increases in health care costs for our police and fire retirees, and start-up and ongoing operation costs for transitioning to NORCOM for police and fire dispatching services. In addition, the Police Department continues to grapple with the broader regional issue of housing misdemeanor prisoners at affordable rates. If the City is unable to reduce its current daily bed commitment to Yakima County from 4 beds to 1 bed, the Police Department's jail costs will increase \$71,000 in 2009. In subsequent biennia, the City will face replacement of aging 800 MHz radio (local and regional) technology and an aging South Fire Station.
- **Labor and Fuel Costs** – National and regional inflation rates have continued to climb over the past year. For the Seattle metro area, the June 2008 CPI-W was 6.2% and the First Half 2008 CPI-W was 4.9%. Back in 2006, when the 2007-2008 biennial budget was developed, the corresponding inflation rates were 4.6% and 3.5% respectively. Employee cost of living increases are tied to one of these two inflation indexes in the City's various labor contracts. In addition, rising costs for fuel have resulted in significant increases in fleet operating costs. In 2008, the City will absorb an estimated \$95,000 over the budgeted amount for gas and diesel fuels (i.e. \$145,200).
- **Development Staffing** – Development activity locally and regionally has slowed measurably from the record pace experienced over the past four years. More specifically, residential development, which is down 33% as of mid-2008 (as measured by the number of building permits issued), is not expected to pick up significantly until 2010, with one notable exception. Shorewood Heights is planning to build 124 apartment or condominium units in 2009. As for the Town Center,

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Development Services staff predicts that development activity will continue to slow in 2009 and 2010.

During the 2005-2006 biennium, the City increased its temporary development staff to handle the increased permit activity. Still, permit activity increased to levels where permit revenues substantially exceeded the 65% cost recovery policy set by the City Council. In the 2007-2008 biennium, some temporary positions were converted to regular, ongoing positions, other temporary staff contracts were extended, and 2.5 more temporary staff were added to service the permit load. These actions brought the City back to its 65% cost recovery policy and reset the permit processing level of service to match expectations of the City's development customers. For the coming biennium, 3.0 contract FTE's won't be renewed. By Spring 2009, the administration will re-evaluate staffing versus permit activity to ensure the proper balance of permit activity, cost recovery, and service levels.

Revenue Trends

- **Citizen Initiatives** – With the Legislature's 2000 enactment of Initiative 695, the City experienced a loss of approximately \$1.1 million per year in annual Motor Vehicle Excise Taxes (via sales tax equalization) – approximately 9% of General Fund revenues. The City continues to adjust to this loss of General Fund revenue through a mixture of constrained expenditures and growth in more volatile revenues such as sales taxes and permit fees.
- **Property Taxes** – Further constraining revenues, the City's single largest source, property taxes, saw relatively low growth during the early part of the decade. Since passage of Initiative 747 in 2001, the City has been limited to annual property tax increases of 1%. Throughout the past ten years the cost of basic services has increased an average of 5.0% per year. In three of the past seven years, the City Council increased the property tax 1% but refunded 1% back to taxpayers from year-end revenue surplus in the General Fund. In 2007, the City Council approved a slight increase in property taxes above the 1% threshold using "banked capacity" to generate a long-term funding stream for fire apparatus replacement. Fortunately, new construction during the past five years has helped to re-index the Island's total assessed value and has generated new property taxes in the range of 1% to 2% per year.
- **Sales Taxes** – Counteracting the effects of these revenue reductions, sales tax receipts have been strong during the past two biennia; however, this trend is expected to change in the coming biennium. Compared to 2008, Finance staff is estimating a cumulative reduction of \$1.1 million in construction-related sales tax in 2009-2010. The projected decline can be primarily attributed to the mid-2009 completion of two major projects in the Town Center and a significant decline in residential construction. On a positive note, the Legislature enacted the Streamlined Sales Tax measure during the 2007 session. Destination-based sales tax revenues will begin flowing to the City in September 2008. While it is too early to accurately predict annual receipts from this new source, Finance staff is only budgeting an additional \$200,000 in sales tax revenue for 2009 and \$350,000 for 2010 relative to 2008 given the current and projected state of the economy. This represents a \$400,000 reduction in 2009 and a \$300,000 reduction in 2010 from the streamlined sales tax forecast by the Washington State Department of Revenue.

The table below displays actual and projected total sales tax revenues as well as construction-related sales tax revenues for 2003-2010.

Year	Sales Tax Revenue	
	Total	Construction
2003	\$2,685,252	\$917,966
2004	\$2,565,501	\$912,572
2005	\$2,643,672	\$1,303,825
2006	\$2,627,512	\$1,244,519
2007	\$3,949,552	\$1,607,679
2008	\$3,675,000	\$1,600,000
2009	\$3,340,000	\$1,250,000
2010	\$3,460,000	\$850,000

- **Development Fees** – Relative to 2008, permit fees are expected to decrease by \$446,000 in 2009 and by \$466,000 in 2010. Over the 2009-2010 biennium, this represents a cumulative projected reduction of \$912,000. Of course, this revenue is cyclical and directly tied to the level of construction in the community. As development activity subsides permit revenues fall, and as development activity picks up so do the permit fees along with the staff costs required to process the increased permit load. However, there is a timing delay between revenue collection and staff work. Permit fees are collected up front before a project breaks ground, but the related staff work can extend for a year or more depending on the size of the development project.

Budget Summary

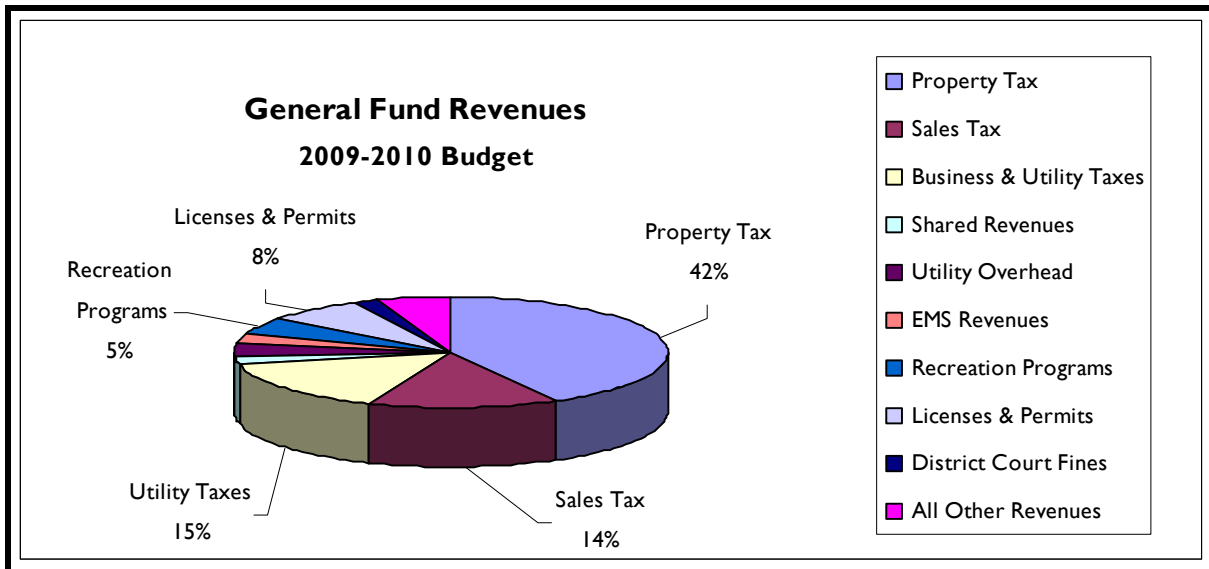
At its highest level of generalization, this budget can best be summarized in the following ways. The 2009-2010 Budget:

- Maintains existing service levels without unexpected tax increases.
- Provides for Council-sought initiatives in Sustainability, Pedestrian/Bicycle Facilities, Shoulder-widening, and Town Center Improvements.
- Provides needed investments in basic infrastructure for Streets, Water, Sewer, and Storm Water facilities with associated utility rate increases.
- Provides for addition of necessary staff in basic services: CIP project management, Municipal Court, facilities maintenance/project management, and information technology support.

General Fund – Revenue Sources

Reflecting the recent trends mentioned above, the General Fund continues to receive nearly all of its operating revenues from the same tax sources in approximately the same proportions as previous years. A breakdown of the budgeted major revenue sources for 2009-2010 is provided on the following page.

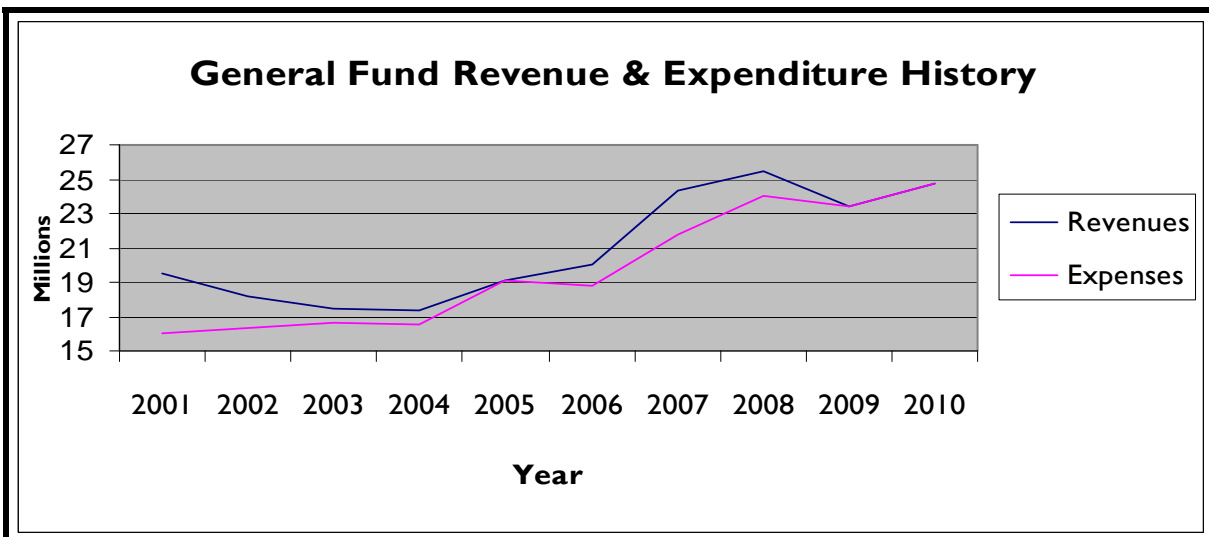
Budget Message



Total budgeted General Fund resources for 2009 and 2010 are \$23,208,210 and \$24,459,585 respectively. The ten year history of General Fund revenues and expenditures is displayed in the table and graph below.

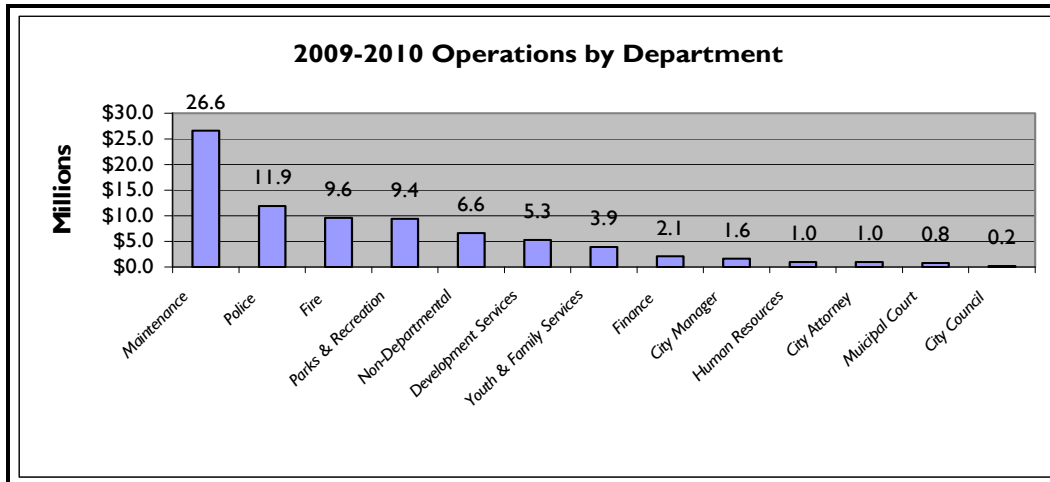
	Actual 2001	Actual 2002	Actual 2003	Actual 2004	Actual 2005	Actual 2006	Actual 2007	Actual Forecast 2008	Budget 2009	Budget 2010
Revenues	\$19.53	\$18.18	\$17.51	\$17.66	\$19.11	\$20.07	\$22.98	\$25.55	\$23.21	\$24.50
	10.2%	-6.9%	-3.7%	0.9%	8.2%	5.0%	14.5%	11.2%	-9.2%	5.6%
Expenses	\$16.00	\$16.34	\$16.61	\$17.58	\$19.11	\$18.79	\$21.74	\$23.98	\$23.21	\$24.50
	3.9%	2.1%	1.7%	5.8%	8.7%	-1.7%	15.7%	10.3%	-3.2%	5.6%
Reserves	\$3.53	\$1.84	\$0.90	\$0.08	\$0.00	\$1.28	\$1.24	\$1.57	\$0.00	\$0.00

Average annual expenditure increase (2001-2010) = 5.0%



Department Operating Budgets

The City continues to dedicate the largest portions of its resources to Public Safety (police, fire, and medical aid) and Maintenance. As shown below, the combined operating budgets for these areas account for \$48.10 million, or 60%, of total operating expenditures for the 2009-2010 biennium.



Staffing

Reflecting only the organization's most pressing staffing needs given the current economic environment, a **0.5 employee net decrease** is proposed for 2009-2010, which is broken down as follows:

Proposed Changes in Regular Employees:

- Convert 1.0 FTE DARE Police Officer to 1.0 FTE Patrol Officer.
- Eliminate 1.0 FTE Right of Way Maintenance Team Member.
- Add 1.0 FTE Computer Support Technician (funded by elimination of ROW Maintenance Team Member and overtime savings from DARE Officer conversion).
- Add 1.0 FTE Municipal Court Clerk (funded by court revenues).

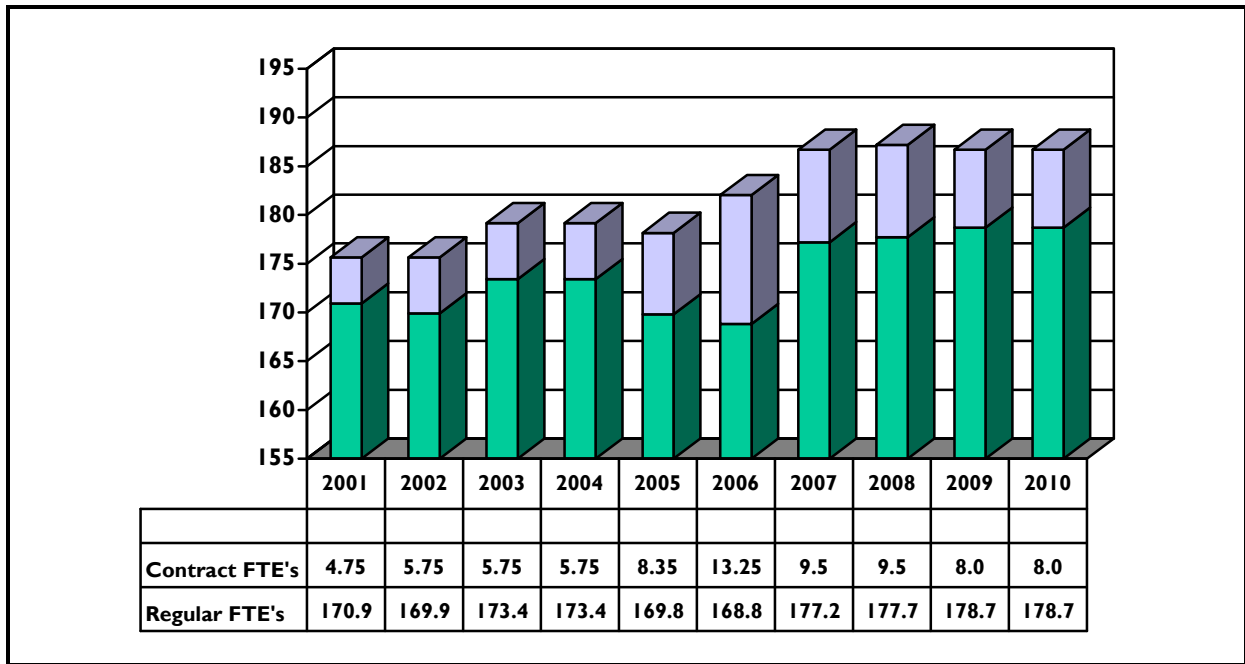
Proposed Changes in Contract Employees:

- Eliminate 3.0 contract FTE's in DSG (part of temporary development staffing approved for 2007-2008 Budget).
- Add 1.5 contract FTE's for CIP project management and support (1.0 FTE Facilities Project Manager and 0.5 FTE Administration Clerk, which would be wholly funded by CIP revenues).

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The total number of regular (i.e. ongoing) and contract employees approved for 2001-2008 and proposed for 2009-2010 is displayed below.

**10 Year Staffing (FTE's) History
2001-2010**



Outstanding Debt

The City continues to carry a low level of outstanding debt. The general-purpose debt capacity, according to state statute, is \$221,955,901 for voted and non-voted debt. The debt capacity for Parks and Open Space is an additional \$221,955,901. Mercer Island's bonded and lease obligation as of 12/31/2007 is \$5,502,008 representing only 1.2% of that allowed under state law.

Biennial Budget Issues & Initiatives

Listed below are the major issues, initiatives, and changes in the proposed biennium. The proposed General Fund increases and decreases are explained in greater detail below and in Section C (Budget Policies).

Sustainability

Since the early 1990's, the City has been a regional leader in resource conservation. The City has experienced significant success in recycling and solid waste stream diversion, water conservation, storm water quality improvements, building energy efficiencies, and invasive species removal.

In the coming biennium, the City will step up its activities in the following areas:

- **Fleet Operations** – Achieve platinum status in the Evergreen Fleets Initiative.

- **Healthy Neighborhoods** – Bicycle and pedestrian emphasis, Citizens’ Climate Action Task Force, carbon emission challenge with Bainbridge Island.
- **Water Quality** – Stage 2 NPDES storm water discharge permits, Sewer Lake Line project, and Luther Burbank demonstration area projects.
- **Energy & Resource Conservation** – Continued recycling goals, water conservation, “tree bank” and tree planting pilot program, partnership with Puget Sound Energy and the School District for energy conservation in City and School buildings.

The costs for most of these activities will be covered by savings generated from higher resource efficiencies and one-time funding, as needed. See Sustainability policy in Section C (Budget Policies) for more details.



Look for this logo throughout the budget document for sustainable activities.

Public Safety

The Police Chief has conducted a thorough review of departmental needs in light of the resources that are available. He has concluded that by restructuring how the Department undertakes drug and alcohol education in the schools (DARE) the City can maintain the most effective aspects of DARE while addressing staffing concerns in routine police patrol. Simply stated, the proposal involves shifting drug and alcohol education to the Middle School level, using school instructional staff, Police School Resource Officer, and YFS staff for curriculum instruction, and re-converting the DARE Officer back to a patrol officer position from which it originally came. This proposal would result in a net savings of almost \$58,000 to the City due mostly to a reduction in expected Police Patrol overtime. Finally, it has the understanding and support of the School District and YFS staff.

NORCOM is expected to “go live” in July 2009. At that time, police and fire 911 calls will be received and dispatched from the NORCOM Regional Communication Center in Bellevue. As a consolidation of public safety communications for the entire Eastside, NORCOM has significant start-up and transition costs. In 2009-2010, Mercer Island’s share of start-up, technology, and transition costs is budgeted at \$346,000; however, this amount will be reduced to \$232,000 provided that the recommended \$1.5 million federal Homeland Security grant to NORCOM receives final approval. This would result in one-time technology costs being significantly below what was projected when the Council approved the NORCOM interlocal agreement. Annual operating costs for Mercer Island will be \$475,000 in 2009 and \$605,000 in 2010, representing an increase of \$383,000 over the 2007-2008 biennium.

In addition to communication costs, the Police Department continues to see increasing jail costs driven by King County’s notification to displace all city misdemeanor prisoners by 2012. Jail contracts with King County, Yakima County, and Issaquah will cost the City \$169,000 in 2009 and \$174,000 in 2010. Efforts are underway to reduce the City’s daily jail bed commitment with Yakima County from 4 beds to 1 bed, thereby reducing jail costs.

See Police & Fire Dispatching and Jail Services policies in Section C (Budget Policies) for more details.

Community Center

The Community Center at Mercer View (CCMV) continues to experience expanding usage and demand for increased hours of operation. Over the past biennium, the CCMV increased its holiday and weekend operations. Weekday operations continue to run from 7:30am to 9:00pm. It should be noted that CCMV staff has managed to stay within the authorized General Fund subsidy for the 2007-2008

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biennium, but this won't be possible in the coming biennium at current levels of service. Accordingly, to properly staff and maintain the CCMV within current operating hours, hourly ("casual") staff and custodial budgets need to be increased by a combined total of \$120,000 in 2009 and \$123,000 in 2010. These expenditures can be partially offset by improved room rental revenue from increased marketing efforts. However, even after bumping up room rental revenue by almost \$57,000 in 2009 and \$69,000 in 2010, Parks & Recreation and Finance staff are still projecting a funding shortfall of \$63,000 in 2009 and \$65,000 in 2010, assuming no change in the current budget policy regarding General Fund support. It is recommended that the General Fund subsidy be increased to cover this difference and that this issue be re-visited at the mid-biennial budget review in November 2009. This will give CCMV staff 10 months to see how much room rental revenue can be realistically generated from increased marketing efforts.

See Parks & Recreation Financing policy in Section C (Budget Policies) for more details.

Development Services – Permit Processing

Since 1999, the City has seen a significant increase in single-family home development/remodeling and commercial construction. In 2000, the Development Services Group (DSG) processed a record 2,973 land use, single family, commercial, and over-the-counter permits. That pace increased to 3,205 permits in 2005. During the same time period (2000-2005), building valuations for permits increased from \$48.1 million to \$80.1 million. This was largely driven by home remodels and the redevelopment of the Town Center. To provide some additional context, key development statistics for 2003-2007 are presented below.

Development Statistic	2003	2004	2005	2006	2007
Single Family Residential Permits Issued	246	377	396	374	293
Commercial/Multi-Family Permits Issued	63	89	58	80	56
Over the Counter Permits Issued	1,896	2,465	2,656	2,589	2,572
Total Building Valuation	\$26.83M	\$93.53M	\$80.13M	\$95.91M	\$86.26M
Total Development Fees	\$1.26M	\$1.42M	\$2.10M	\$2.03M	\$2.25M

With permit activity having hit a "plateau" at significantly higher levels than in the 1990's, the 2007-2008 budget included a number of staffing changes to reset the "core staff" complement. Staff changes included conversion of an Associate Planner, Permit Technician, and Utility Site Inspector from "contract" to "regular" status. In addition, resources to fund temporary contracts for a Plans Examiner, a Building Inspector, and a Permit Coordinator were approved. Each of these "contingent" positions was approved for a two year period as long as the permit workload could justify the position.

In the proposed 2009-2010 Budget, the DSG "contingent staff" has been reduced by 3.0 FTE's, leaving 2.0 contract FTE's. Should development activity slow further than projected, additional reductions will be enacted in order to maintain the overall cost recovery policy of 65% from permit fees.

See Development Review Fees policy in Section C (Budget Policies) for more details.

Revenues

Property Taxes – 1% Increase

Mercer Island continues to be highly dependent upon the property tax for funding its basic services (40% of total revenues in 2009-2010). As primarily a residential community, Mercer Island's commercial/retail tax base yields revenues that fall below the statewide average for similar sized communities. Generally, Mercer Island and other "bedroom communities" have lower reliance on sales tax receipts and, consequently, a higher reliance on local property taxes. In contrast to past trends, the development boom over the past four years has generated significant increases in construction-related sales taxes and new construction property taxes. However, as previously mentioned, construction-related sales taxes are projected to decline beginning in 2009, and if the redevelopment of the old Safeway site and phase II of The Mercer don't move forward in 2009, this revenue decline will become much steeper. Given the uncertainty around construction-related sales tax and the current rate of inflation as measured by the Seattle metro area CPI-W (6.2% in June 2008 and 6.2% in August 2008), the proposed 2009-2010 Budget assumes a 1% Council-approved property tax increase in 2009 and 2010.

See Property Tax policy in Section C (Budget Policies) for more details.

Utility Rates

The 2009-2010 utility rates discussed below are preliminary estimates. Any significant changes in water consumption (from budget planning assumptions) or new project cost information will be factored into the rate recommendation, which will be presented to the City Council on November 17th.

- **Water Rates** – In 2003, the City Council approved a new 60 year water supply agreement with Seattle Public Utilities. As expected with Seattle's new rate structure, wholesale rates rose in 2005, 2006, 2007, and 2008. Wholesale water rates will also increase by 10% in 2009. In order to meet revenue requirements for these expenses and for planned capital improvement needs, the Utility Board and City Manager recommend an overall increase (across all customer classes) of 10.5% in 2009. For a single family residential customer, the 2009 rate increase is estimated to be 9.5%, which translates into a \$4.25 increase in the bi-monthly bill, assuming normal water usage.
- **Sanitary Sewer Rates** – Since 2004, the City Council has approved significant annual increases in the "sewer line maintenance" rate in order to fund the repair and replacement of the lake line along the northwest shore of Mercer Island. This covers the City's portion of operating and maintaining the sanitary sewer system and equals about 50% of the total bi-monthly sewer bill paid by the average single family residential customer. For 2009, the City Manager recommends a rate increase of 12.0% to fund lake line construction, which is expected to begin early in 2009. This represents a \$6.40 increase to the average single family residential customer's bi-monthly bill. [The Utility Board recommended a higher rate increase of 18.0% for 2009 in order to cover project bids that come in higher than expected.]
- **Sewage Treatment Rates** – Sewage Treatment rates from King County METRO, which represent a "pass through" charge, will increase in 2009 by 14.13%, which represents a \$7.90 increase to the bi-monthly bill for an average single family residential customer.
- **Storm Water Rates** – To give utility customers a break in 2008 (in light of the approved 18.1% increase in sewer line maintenance rates that year), storm water rates were held at the adopted 2007 levels. In order to maintain the capital improvement program expectation of the Utility Board (one major basin project per year) as well as ongoing small neighborhood projects each year, a rate

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increase of 5.5% is recommended for 2009. In dollar terms, this translates into a \$1.43 increase in the bi-monthly bill of a single family residential customer.

- Emergency Medical Service (EMS) Rates** – Emergency Medical Service rates are adjusted annually for inflation based on the Seattle metro area’s CPI-W. A rate increase of 4.94% is recommended for 2009, which corresponds to the First Half 2008 CPI-W. This represents a \$0.19 increase to the average single family residential customer’s bi-monthly bill.

Taken together, the total (i.e. water, sewer, storm water, and EMS) bi-monthly utility bill for the average single family residential customer is preliminarily budgeted to go up by 11.0% in 2009 and 6.9% in 2010, which equates to a \$20.17 increase and a \$14.09 increase respectively, as noted in the table below.

Description	2008	2009	2010
Bi-Monthly Bill	\$183.85	\$204.02	\$218.11
Rate Increase over Prior Year	6.9%	11.0%	6.9%
Dollar Increase over Prior Year	\$11.88	\$20.17	\$14.09

See Section F (Utility Funds Summary) for more details.

Capital Improvement Program

The 2009-2010 Capital Budget is part of the broader six-year Capital Improvement Program (CIP). The policy basis for the CIP is explained in detail in Section C (Budget Policies). Actual project details and financing strategies are also detailed in Section H (Capital Improvement Program). Listed below are the key issues and initiatives associated with the proposed CIP.

Financing Strategies

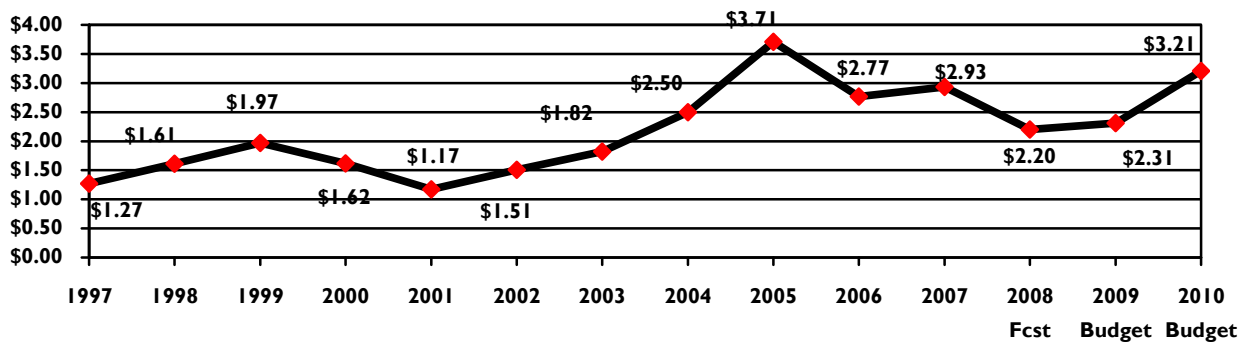
The CIP continues to be largely a pay-as-you-go program. Utility rates cover all capital expenditures for water, sewer, and storm water facilities. Public building, streets, trails, and parks capital maintenance are supported in whole or in part by real estate excise tax receipts. Major technology system and public safety equipment costs are funded by General Fund revenues. Finally, fleet and computer replacements are funded by annual contributions to their respective sinking funds. In addition to REET revenues, the City Street Fund receives revenues from local portions of the fuel tax.

Real Estate Excise Taxes

The Real Estate Excise Tax (REET) is the main revenue source to the Street Fund and the CIP Fund. REET revenues have been volatile over the last 10 years. During 1998-2000, the City received unprecedented levels of REET revenue, owing to a strong housing market and rapidly increasing housing prices. During the 2001-2002 biennium, actual REET revenue dropped below the \$1,600,000 level budgeted for the biennium, as the economy slowed down. During 2003-2007, we again experienced unprecedented levels of REET revenue due to a boost in the number of home sales amidst a very low interest rate environment. In 2005, the City received about \$1.0 million in extraordinary REET revenue from two major commercial property sales—Shorewood Apartments and Farmer’s New World Life. The exceptional REET revenue receipts from 1998-2000, and again in 2003-2007, allowed the City to build up fund balances in the Street Fund and CIP Fund. In the case of the CIP Fund, most of this fund balance (approximately \$3,000,000) was contributed to the construction of the Community Center, reducing the amount of debt financing needed for the project.

In 2008, the nation and region experienced a major contraction in the housing market. As a result, the number of annual home sales on Mercer Island is projected to drop by 46% in 2008, and REET revenue in 2008 is projected to fall to \$2.2 million. A modest rebound in REET revenue is forecast for 2009 (\$2.67 million) and 2010 (\$3.21 million). Actual and forecasted REET revenues for the period of 1997-2010 are shown in the chart below.

Real Estate Excise Tax Revenues



Project Management

A financing policy approved by the City Council in 2007 states, “whenever possible, capital projects will be scheduled and completed in the same year [for which funding is approved]”. In addition, City staff has made it a consistent practice to show how all CIP projects will account for their project management expenses in their project budgets. Project management staffing will come from staff or otherwise be outsourced at skill levels and quantities to design and construct CIP projects in the timeframes approved by the City Council. In order to implement these Council policies and management practices for the projects slated for 2009 and 2010, the City will need to increase its project management and support staff by 1.5 FTE’s. Each of these positions will be “contracted labor” for the biennium.

Parks and Open Spaces

Major park improvement projects in the biennium will be focused on Open Space Vegetation Management and local trail connections to the regional I-90 trail system. Should the Parks Bond and Levy ballot measures pass in November 2008, significant new investments will be made in Luther Burbank Park, Island athletic fields, and open space management.

Streets, Pedestrian and Bicycle Facilities

The proposed 2009-2010 Transportation Improvement Program includes over \$5.5 million in roads, streets, and pedestrian/bicycle improvements. Among them are the following major projects:

- Arterial Streets:** The City will reconstruct 72nd Avenue SE encompassing both water mains and street/pedestrian facilities. In addition, a decision on Island Crest Way and Merrimount intersection improvements will be determined after a public involvement effort has been conducted. Town Center street overlays will be designed in 2010 while traffic signals on SE 27th Street will be installed in 2009.

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- **Residential Streets:** Residential street overlays will be completed depending on street condition evaluations made early in 2009. The entire biennial allotment of \$1.1 million will be programmed for expenditure in 2010.
- **Roadside Shoulders:** Improvements along East Mercer Way all the way to the south tip of the Island will be constructed to create safe areas for pedestrians and bicycle pull outs. This combines Phases 6 and 7 of the planned East Mercer Way shoulder work and will total \$2.2 million.
- **Pedestrian and Bicycle Facilities:** Along with street improvements, pedestrian and bicycle improvements will be designed and constructed along 72nd Avenue SE. The “Gap Completion Program” will be continued, connecting safe walk routes for Island schools.

Utilities

- **Sewer:** The major project involving the Island’s utilities continues to be the replacement of the Sewer Lake Line at the north end of the Island. The project involves replacement of one reach of the sewer lake line system. This reach stretches along the northwest corner of the island and includes some of the oldest piping in the system, originally constructed from 1956 to 1961. Construction costs of \$25.3 million are budgeted for 2009-2010.
- **Storm Water:** In 2009-2010, the City will design and construct improvements for Phase II of Basin 26 (this drainage basin is located between Island Crest Way and West Mercer Way at approximately the 4600 block of the Island). The estimated cost to construct the second phase of this basin is \$1.3 million. Neighborhood drainage and small-to-medium drainage system improvements will also be undertaken in the biennium.
- **Water:** The City will continue with its annual water main, pressure reducing valve, and hydrant replacement programs. The 72nd Avenue SE water main work will be coordinated with street and pedestrian/bicycle improvements. In addition, construction will commence on the Emergency Well Project in 2009.

Other Projects

- **Fleet Replacements:** Fleet replacements will continue according to the vehicle replacement schedules in the Equipment Rental Fund. All future vehicle replacements will be made in accordance with Evergreen Fleet Initiative Standards. Mercer Island will achieve the highest possible certification under the standards within this biennium.
- **Public Buildings:** The City will make annual repair and maintenance investments in the following buildings: City Hall, North and South Fire Stations, Maintenance Center, Thrift Shop, Community Center, and Luther Burbank Administration. Consistent with Council direction, planned expenditures are based on specific repair and maintenance projects as identified in their respective CIP project sheets.
- **Technology:** Nearly all new Information Technology projects have been deferred into 2010 or later in order to focus the City’s attention on maintaining existing IT systems, including the City’s Financial System, PC network, server operating system, and database software. Website design improvements and Fire Department scheduling software and EOC Incident Management software projects are scheduled during the biennium.

Acknowledgements

Each budget development cycle represents a major planning, analysis and coordination effort by city staff. The process begins in March and continues through September, concurrently with delivery of all other public services to the City's many customers.

Once again, we recognize the dedication and hard work that all staff put into the budget process. In particular, Finance Director Chip Corder, Deputy Finance Director Francie Lake, and Accounting Manager Lajuan Tuttle have all demonstrated the expertise and professionalism for which Mercer Island has become known.

For all these fine efforts, the City Manager expresses his sincerest thanks.

Postscript

During a series of regular and special meetings held in October, November, and December 2008, the City Council reviewed the Preliminary 2009-2010 Budget proposed by the City Manager. After making some changes to the Preliminary Budget, the City Council adopted the Final 2009-2010 Budget on December 8, 2008. The changes made by the City Council and staff to the Preliminary Budget, along with any follow-up items, are summarized in the following two tables: 1) Operating Budget, and 2) CIP Budget.

Operating Budget

Category	Budget Changes Made by Council & Staff and Follow-Up Items
Revenues	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: Reduced budgeted revenues in the General Fund by \$1.05 million in 2009-2010 consisting of the following: 1) \$350,000 reduction in streamlined sales tax; 2) \$350,000 reduction in construction-related sales tax; and 3) \$350,000 reduction in development fees. ▪ Council changes: <ol style="list-style-type: none"> 1. For 2009, the City will levy only \$772,000 of the recently approved \$900,000 Parks M&O lid lift, backing out the \$128,000 in maintenance and operating costs related to the new parks capital projects that were to be funded by the bond levy that failed. Of the \$772,000, \$630,000 is for parks maintenance and operations (\$370,000 for Luther Burbank Park + \$260,000 for school-related parks and recreation activities). 2. Reduced 2009 rate increase on "sewer line maintenance" portion of utility bill from 12% to 8%, resulting in a \$100,000 reduction in revenue to the sewer utility. Fund balance will be used to make up the difference.
Expenditures:	
City Council	<ul style="list-style-type: none"> ▪ No changes.
City Attorney's Office	<ul style="list-style-type: none"> ▪ Council change: Added \$10,395 for cable franchise negotiations (AB 4362, 10/6/08).

Budget Message

Category	Budget Changes Made by Council & Staff and Follow-Up Items
Expenditures (cont'd):	
City Manager's Office	<ul style="list-style-type: none"> ▪ Council change: Eliminated "Production of 4 Episodes of MI View" service package (\$44,000 one-time costs). ▪ Follow-up item: Council directed staff to negotiate with Comcast to help fund broadcasting/equipment costs as part of cable franchise negotiations.
Human Resources	<ul style="list-style-type: none"> ▪ No changes.
Finance	<ul style="list-style-type: none"> ▪ No changes. ▪ Follow-up items: <ol style="list-style-type: none"> 1. Make sure Contingency Fund is at target before 12/31/09. 2. Discuss Finance Director's proposed "Rainy Day" strategy during 1st quarter of 2009.
Municipal Court	<ul style="list-style-type: none"> ▪ No changes.
Non-Departmental	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: Reduced budgeted personnel costs in the General Fund by \$56,654 in 2009 and \$91,419 in 2010 based on planned position vacancy savings. ▪ Staff change: Increased ARCH administration budget by \$1,982 in 2009 and \$2,676 in 2010.
Youth & Family Services	<ul style="list-style-type: none"> ▪ No changes.
Development Services	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: <ol style="list-style-type: none"> 1. Reduced the "Maintain Plan Review & Inspection LOS" service package by 3.0 contract FTE's (\$538,585 in one-time costs to the General Fund). 2. Reduced the "Transportation Plan" service package by \$40,000 and pushed it to 2010 (impacting the General Fund). ▪ Follow-up item: Re-visit the "Development Review Fees" budget policy (namely, cost recovery goals) and implement approved fee changes in 2009.
Fire	<ul style="list-style-type: none"> ▪ No changes.
Police	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: Withdrew "Ongoing Police Fleet Replacement Funding" and "Police Staff Vehicle" service package requests (\$10,900/yr in ongoing costs to the General Fund + \$30,000 in one-time costs to the Beautification Fund). ▪ Follow-up item: Address patrol officer overtime issue with Public Safety Committee during 1st quarter of 2009.

Category	Budget Changes Made by Council & Staff and Follow-Up Items
Expenditures (cont'd):	
Maintenance	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: <ol style="list-style-type: none"> 1. Reduced budgeted fleet fuel costs in the General Fund by \$67,500 in 2009 and 2010 respectively. 2. Eliminated a new 0.25 contract FTE included in the “Resource Conservation Manager” service package (impacting the General Fund) by allocating 0.25 of an existing contract FTE in the Stormwater Fund to this program in 2009-2010.
Parks & Recreation	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: Reduced the “CCMV Staffing” service package by \$65,000 per year in 2009 and 2010 (impacting the General Fund). As a result, the General Fund subsidy level was increased from \$235,100 in 2008 (\$207,600 approved subsidy + \$27,500 adjustment for utility and landscape maintenance costs accounted for in a different cost center) to \$308,000 in 2009. ▪ Council change: Eliminated “77th Ave SE Floral Enhancements” service package (\$3,500/yr in ongoing costs to the Beautification Fund + \$15,000 in one-time costs to the General Fund). ▪ Staff change: Increased budget by \$241,520 in 2009 and \$232,617 in 2010 per new Parks M&O levy lid lift, which passed on November 4, 2008. Of the \$772,000 to be levied in 2009, \$630,000 is for parks maintenance and operations (\$370,000 for Luther Burbank Park + \$260,000 for school-related parks and recreation activities). Because the Preliminary Budget was based on the November 2003 Luther Burbank Park M&O levy lid lift, an adjustment was required to increase the authorized expenditures up to \$630,000 in 2009 and \$637,720 in 2010.

CIP Budget

Category	Budget Changes Made by Council & Staff and Follow-Up Items
Revenues:	<ul style="list-style-type: none"> ▪ Economic downturn reductions by staff: <ol style="list-style-type: none"> 1. Reduced budgeted REET revenue by \$2.3 million in 2009-2010. 2. Re-directed the \$1.15 million that had been originally transferred from the CIP Fund to the Street Fund for the EMW Shoulders project in June 2008 to fund other street projects instead in 2009-2010. 3. Used \$113,808 that had been previously set aside for NORCOM start-up costs to help bridge the \$2.3 million funding gap. In addition, the 2009 interfund transfer from the Criminal Justice to the Technology & Equipment Fund for NORCOM start-up costs was reduced by \$68,118. 4. Used \$291,000 of the Street Fund balance to help bridge the \$2.3 million funding gap. 5. Allocated REET evenly between the Street Fund and the CIP Fund in 2009-2010 to maintain a positive ending fund balance in each fund.

Budget Message

Category	Budget Changes Made by Council & Staff and Follow-Up Items
Revenues (cont'd):	<ul style="list-style-type: none"> ▪ Staff changes: <ol style="list-style-type: none"> 1. Of the \$772,000 from the recently approved Parks M&O lid lift, \$142,000 will be used to fund parks capital projects (\$77,000 for Pioneer Park Forest Management + \$65,000 for Open Space Vegetation Management). In addition, \$110,000 from the 2003 Luther Burbank Park lid lift will be levied in 2009 for small capital projects. 2. Staff learned after the Preliminary Budget was prepared that the City will receive \$194,479 in property tax funding in 2009 from the King County Flood Control District, which can be used to fund stormwater CIP projects. 3. Staff reduced the projected investment interest allocation to the Capital Reserve Fund from \$180,000 in 2009 and 2010 to \$0. ▪ Follow-up items: <ol style="list-style-type: none"> 1. The REET allocation policy in effect for 2009-2010 (i.e. 50/50 split between the Street Fund and the CIP Fund) will be re-visited again during the 2011-2012 Budget process. 2. The City Attorney will prepare an amended “Fee in Lieu of Stormwater Detention” ordinance for the Council’s consideration in January 2009. The current ordinance restricts the use of the fee to the same basin as the development for which the fee was collected. The proposed amendment would expand the use of the fee to any basin on the Island. The 2009-2010 Stormwater CIP was prepared assuming the Council adopts the amended ordinance.
Expenditures:	
Capital Facility Plan	<ul style="list-style-type: none"> ▪ Council changes: <ol style="list-style-type: none"> 1. Remove Shoreline Restoration project (\$150,000), which staff was able to add to the 2008 Luther Burbank Shoreline construction contract due to the favorable bids received. 2. Postpone East Mercer Way Shoulders project (\$2,245,000) for 2 years until 2011.
Capital Reinvestment Plan	<ul style="list-style-type: none"> ▪ No changes.

Because the General Fund is the primary focal point during the budget review process, a summary expenditure reconciliation between the Preliminary and the Final 2009-2010 Budget is provided in the table on the following page.

Budget Message

General Fund Expenditures	2009 Budget	2010 Budget
“Original” Preliminary Budget	\$23,800,210	\$24,901,585
Economic downturn reductions by staff*	- 592,000	- 442,000
“Revised” Preliminary Budget	\$23,208,210	\$24,459,585
Changes by Council:		
Eliminate “Production of 4 Episodes of MI View” service package	- 22,000	- 22,000
Eliminate “77 th Ave SE Floral Enhancements” service package	-15,000	
Changes by Staff:		
Adjust Parks & Recreation budget per Nov 2008 Parks M&O levy lid lift (reflects net increase)	241,520	232,617
Shift 0.25 of existing 1.0 contract FTE from Stormwater Fund to serve as Resource Conservation Manager	20,000	21,200
Add funding for cable franchise negotiations	10,395	
Final Budget	\$23,443,125	\$24,691,402
% Change from Prior Year	2.2% decrease	5.3% increase

* In addition to the \$1,034,000 in expenditure reductions, staff increased CCMV hourly rental revenues by \$8,000 per year. Taken together, the General Fund’s Preliminary 2009-2010 Budget was adjusted by \$1,050,000.

Budget Message

Appendix A Priorities – Mercer Island City Services

I. The community will be safe.

- 1.1 {
 - Make timely and effective responses to crime.
 - Make timely and effective responses to fire.
 - Make timely and effective responses to medical emergencies.
 - Crime is investigated and prosecuted.
- 1.2 {
 - Buildings are safely built.
 - The transportation system is safely built and operated.
 - The City's drinking water will be safe.
- 1.3 {
 - Crime is prevented.
 - Fires are prevented.
 - Mental and physical health problems are prevented.
 - Emergency responses are planned for.

2. The community will support effective, efficient and legal delivery of public services.

- 2.1 {
 - The City Council will have the information and forums necessary for making well-considered and informed decisions.
 - The decisions of the City Council will be implemented.
- 2.2 {
 - The City will comply with and enforce all applicable laws and ordinances.
 - The City will account for its expenditures and revenues and manage its finances according to all applicable laws and ordinances.
 - The City will provide for judicial services.
- 2.3 {
 - The City will continually evaluate and improve upon the effectiveness and efficiency of its services.

3. The community will support reliable public infrastructure and protect its considerable public investments (e.g. water, sewer, storm water utilities, streets, parks, buildings).

- 3.1 {
 - The City will operate and maintain its infrastructure to assure continuous, reliable and safe service.
 - The City will repair and replace its infrastructure before it fails.
- 3.2 {
 - The City will maintain its infrastructure to prevent failure and extend its useful life.

Budget Message

4. The community will support attractive, high quality neighborhood and business environments.

- 4.1 {
 - Public and private physical features such as streams, shorelines, ponds, forests/trees, lakes, parks, open spaces, trails and hillsides will be protected.
 - Land development regulations are applied and enforced.
 - Building design regulations are applied and enforced.
- 4.2 {
 - Parks, trails and open spaces are provided and maintained.
 - Developed public rights of ways will be used and maintained.

5. The community will support a broad range of recreational, cultural, health and educational opportunities.

- 5.1 {
 - The City will assist its least advantaged citizens with the basic necessities of food, shelter and health care.
- 5.2 {
 - The City will support mental and physical health services for all segments of the community.
- 5.3 {
 - The City will support the education of all segments of the community.
- 5.4 {
 - The City will provide recreational, cultural and community service programs for children and teens.
 - The City will provide recreational, cultural and social service programs for senior citizens.
 - The City will provide recreational, cultural and social service programs for adults.

6. Community will support open and informed public involvement processes within the structure of representative, democratic decision making.

- 6.1 {
 - The City Council will make decisions on behalf of the community.
- 6.2 {
 - The City will generate and disseminate public information to the community on the issues that confront the community and about the services and programs it provides.
- 6.3 {
 - The City will receive information and opinions from citizens, businesses and other interested parties during the course of its policy making and delivery of its services.