City of Mercer Island

Section B

Budget Message

Dear Mercer Island City Council and Island Residents:

"Houston, we have a problem." This oft-quoted line from Apollo 13 succinctly captures the City's projected financial status in the 2017-2018 biennium, which is: beginning in 2017, significant deficits are projected in the General Fund and Youth & Family Services (YFS) Fund, which account for most of the City's services (excluding utilities). What is driving these projected deficits? Simply put, annual revenue growth is not keeping pace with annual expenditure growth. The high level of development activity on the Island in 2014-2016, which is responsible for the record setting spikes in construction-related sales tax and development fees, is projected to decline in 2017-2019. These spikes have masked the underlying structural imbalance. Nevertheless, the projected deficits are not a surprise. They were originally projected back in 2014 when the 2015-2016 Budget was developed, with staff updating the General Fund and YFS Fund forecasts and exploring various budget balancing options at the Council's January and June Planning Sessions in 2015 and 2016. In addition to the projected deficits, there are three other significant operating funding needs as well as capital project funding challenges related to streets, pedestrian/bicycle facilities, parks, and a public building.

The Budget Message is organized as follows: <u>Pages</u>

Following the Budget Message is an Executive Summary of the 2017-2018 Budget.

General Fund Deficits

The General Fund is the City's largest operating fund, accounting for police, fire, emergency medical, municipal court, parks and recreation, street maintenance, planning and community development, and administrative services.

General Fund Forecast

A summary level General Fund forecast for 2016-2023 is presented below (numbers are in millions).

General Fund Forecast	2016	2017	2018	2019	2020	2021	2022	2023
Beginning fund balance	$ 1.43	$ 0.69	$ 0.41	$ -	$ -	$ -	$ -	$ -
Plus total revenues	28.78	28.85	29.11	29.34	30.07	30.83	31.62	32.43
Less total expenditures	(28.99)	(29.44)	(29.92)	(31.07)	(32.64)	(34.29)	(36.03)	(37.87)
Less reserved revenues*	(0.12)	(0.11)	(0.11)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
Surplus (deficit)	**$ 1.10**	**$ 0.00**	**$ (0.51)**	**$ (1.84)**	**$ (2.67)**	**$ (3.56)**	**$ (4.52)**	**$ (5.54)**

* Reserved revenues include the following:

1) $83,000 in property tax is annually reserved for LEOFF I retiree long-term care costs;
2) A portion of investment interest is annually reserved for LEOFF I retiree long-term care costs; and
3) Any unspent DSG technology fees are annually reserved for future information technology costs.

The 2017 and 2018 fiscal years represent the 2017-2018 Adopted Budget. The 2016 projected surplus is $1.10 million, which is being generated by the high level of development activity on the Island (see development-related revenues below under "Primary Drivers"). Of this amount, $694,560 was budgeted as beginning fund balance in 2017 to balance the General Fund and YFS Fund, which have projected deficits of $501,729 and $192,831 respectively ($192,831 will be transferred from the General Fund to the YFS Fund in 2017). The remaining $408,719 was budgeted as beginning fund balance in 2018 to reduce the 2018 projected deficit from $913,914 to $505,195. The disposition of the 2016 projected surplus is summarized in the table below.

2016 General Fund Surplus	Amount
Used to eliminate 2017 General Fund projected deficit	$501,729
Used to eliminate 2017 YFS Fund projected deficit	192,831
Used to reduce 2018 General Fund projected deficit	408,719
Total	**$1,103,279**

In 2018, the $505,195 projected deficit equates to 1.7% of total budgeted expenditures. **The 2018 budget was balanced assuming that an equivalent amount of expenditure reductions would have to be made unless actual revenues are significantly better than projected and/or a new revenue source is identified.**

Total revenues and total expenditures are broken down into their major components in the following two tables (numbers are in millions).

Major Revenues	2016	2017	2018	2019	2020	2021	2022	2023	2017-2018 % of Total
Property tax	$ 11.52	$ 11.87	$ 12.16	$ 12.40	$ 12.65	$ 12.90	$ 13.16	$ 13.43	41.5%
Sales tax	4.60	4.52	4.58	4.55	4.77	5.01	5.26	5.53	15.7%
Utility tax	4.12	4.16	4.22	4.26	4.30	4.34	4.39	4.43	14.5%
License, permit & zoning fees	3.62	3.49	3.26	3.14	3.26	3.39	3.53	3.67	11.6%
Recreation/rental fees	1.64	1.63	1.67	1.70	1.74	1.77	1.81	1.84	5.7%
All other revenues	3.28	3.17	3.23	3.29	3.35	3.41	3.47	3.53	11.0%
Total revenues	**$ 28.78**	**$ 28.85**	**$ 29.11**	**$ 29.34**	**$ 30.07**	**$ 30.83**	**$ 31.62**	**$ 32.43**	**100.0%**

Property, sales, and utility taxes comprise 72% of total revenues in 2017-2018.

Major Expenditures	2016	2017	2018	2019	2020	2021	2022	2023	2017-2018 % of Total
Salaries & wages	$ 15.30	$ 15.19	$ 15.74	$ 16.36	$ 17.18	$ 18.03	$ 18.94	$ 19.88	52.1%
Benefits	5.39	5.58	5.87	6.21	6.64	7.10	7.60	8.13	19.3%
Contractual services	2.26	2.39	2.01	2.06	2.11	2.16	2.21	2.27	7.4%
Fleet & IT charges (internal)	1.40	1.41	1.43	1.50	1.58	1.66	1.74	1.83	4.8%
Interfund transfers	1.37	1.24	1.11	1.01	1.02	1.03	1.04	1.05	4.0%
All other expenditures	3.27	3.61	3.77	3.94	4.12	4.30	4.50	4.71	12.4%
Total expenditures	**$ 28.99**	**$ 29.44**	**$ 29.92**	**$ 31.07**	**$ 32.64**	**$ 34.29**	**$ 36.03**	**$ 37.87**	**100.0%**

Personnel costs (salaries, wages, and benefits) make up 71% of total expenditures in 2017-2018. **Note that personnel costs are approximately the same as property, sales, and utility taxes in 2017-2018. To maintain current service levels on an ongoing basis, property, sales, and utility taxes need to grow at least as much as personnel costs do each year.**

To help identify the primary drivers of the projected deficits, the major revenues and major expenditures are presented in percentage change terms for 2017-2023 in the following table.

General Fund Forecast: % Change	2017	2018	2019	2020	2021	2022	2023
Property tax	3.1%	2.4%	2.0%	2.0%	2.0%	2.0%	2.0%
Sales tax	-1.7%	1.3%	-0.7%	5.0%	5.0%	5.0%	5.0%
Utility tax	1.0%	1.3%	1.0%	1.0%	1.0%	1.0%	1.0%
License, permit & zoning fees	-3.6%	-6.7%	-3.7%	4.0%	4.0%	4.0%	4.0%
Recreation/rental fees	-0.5%	2.4%	2.0%	2.0%	2.0%	2.0%	2.0%
All other revenues	-3.3%	1.8%	1.7%	1.8%	1.8%	1.8%	1.8%
Total revenues	**0.2%**	**0.9%**	**0.8%**	**2.5%**	**2.5%**	**2.5%**	**2.6%**
Salaries & wages	-0.7%	3.6%	3.9%	5.0%	5.0%	5.0%	5.0%
Benefits	3.7%	5.1%	5.7%	7.0%	7.0%	7.0%	7.0%
Contractual services	5.8%	-16.2%	2.5%	2.5%	2.5%	2.5%	2.5%
Fleet & IT charges (internal)	0.8%	1.3%	5.0%	5.0%	5.0%	5.0%	5.0%
Interfund transfers	-9.6%	-10.8%	-8.6%	0.8%	0.8%	0.8%	0.9%
All other expenditures	10.5%	4.4%	4.5%	4.5%	4.6%	4.6%	4.6%
Total expenditures	**1.5%**	**1.6%**	**3.9%**	**5.0%**	**5.1%**	**5.1%**	**5.1%**
Net expenditure growth differential each year	**1.3%**	**0.7%**	**3.1%**	**2.5%**	**2.5%**	**2.5%**	**2.5%**

Primary Drivers

The primary drivers of the projected deficits are as follows:

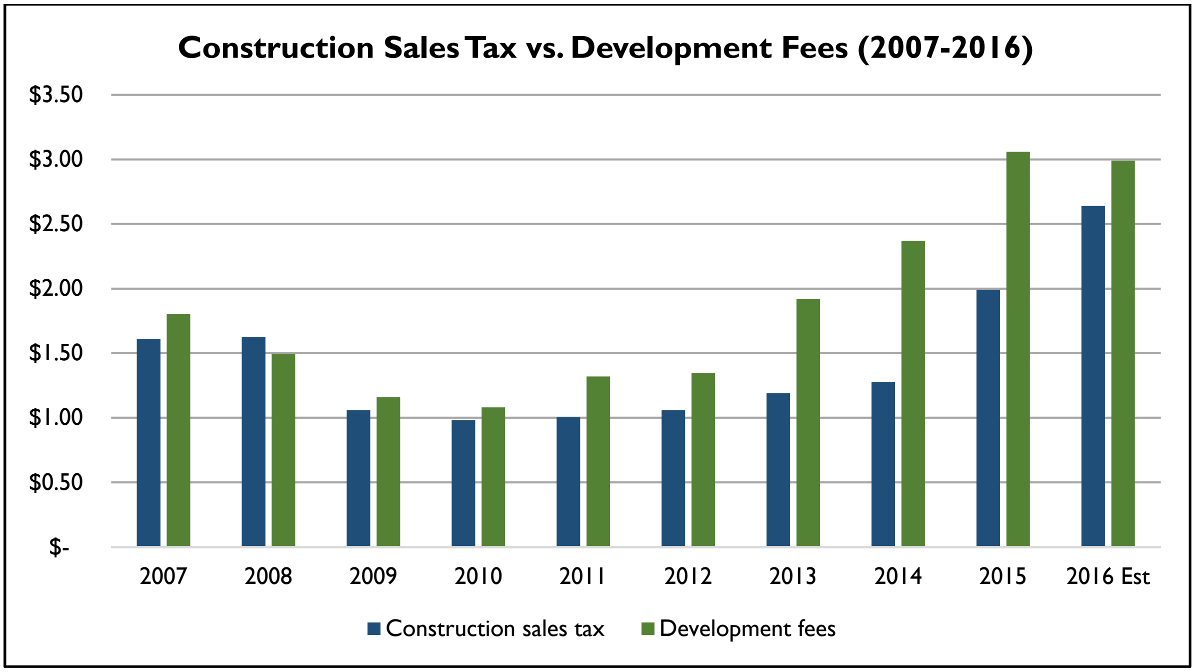
- **Annual revenue growth vs. annual expenditure growth:** As noted in the percentage change table above, total annual revenue growth is not keeping pace with total annual expenditure growth. Excluding the use of the 2016 projected surplus to eliminate the 2017 projected deficit of $501,729 and to reduce the 2018 projected deficit from $913,914 to $505,195, the average net expenditure growth differential in 2018-2023 is approximately $840,000 per year. In other words, total expenditures are projected to grow $840,000 more per year, on average, than total revenues in 2018-2023.

- **Property tax:** At the root of the revenue growth problem is property tax, which makes up 41% of the General Fund's total revenues in 2017-2018. By comparison, property tax makes up only 19-23% of total revenues in the cities of Bellevue, Issaquah, Kirkland, and Redmond, which all have significant retail sales tax bases. Per state law, the Council can increase the regular levy by only 1% per year, excluding the use of "banked capacity," which the City no longer has. In addition, the City is provided an allowance for "new construction," which entitles the City to the property tax revenue generated by newly constructed and improved properties. On average, new construction generates another 1% per year in property tax revenue. Taken together, the effective cap on property tax growth is 2% per year for Mercer Island. This growth limitation on the General

Fund's largest revenue source puts an unrealistic burden for growth on the City's other major revenues: sales tax (16% of total); utility tax (14% of total); license, permit & zoning fees (12% of total); and recreation/rental fees (6% of total).

In 2017 and 2018, property tax is projected to increase 3.1% and 2.4% respectively due to significant "new construction" in 2015-2017. It can take 1-2 years before "new construction" results in property tax revenue for the City. In 2019-2023, "new construction" is projected to generate 1% annually, which represents the City's long-term, historical average.

- **Development-related revenues:** After experiencing a $900,000 construction-related sales tax spike (factoring out inflation) and a $700,000 development fee spike (factoring out fee increases) in 2015-2016 relative to 2013-2014, development activity is expected to slow down in 2017-2019 based on what is currently known about future development on the Island. The spikes in these two revenue sources are evident in the graph below, which encompasses 2007-2016 (numbers are in millions).



The impact of the Great Recession on development activity is evident in 2009-2012. Construction-related sales tax and development fees are projected to decline $1.20 million collectively in 2017-2019, representing 75% of the $1.60 million combined revenue spike, as noted in the table below.

Projected Revenue Reductions	2017	2018	2019	Total
Construction-related sales tax	($150,000)	($200,000)	($250,000)	**($600,000)**
Development fees	(130,000)	(230,000)	(240,000)	**(600,000)**
Total	**($280,000)**	**($430,000)**	**($490,000)**	**($1,200,000)**

Forecasting the development activity level beyond 2017 is very challenging. While it is possible that the decline in these revenues might be slower than projected, one thing is for certain. It would be unwise to bank on the high level of development activity in 2015-2016 continuing into 2017-2018 given the cyclical nature of the economy, the recent changes to building height restrictions in the

Town Center (making redevelopment less financially viable, except in the north end), and the scarcity of available land.

- **Utility tax:** This local tax is applied to electric/gas, telephone (land line and cellular), cable, garbage, water, sewer, and storm water utility bills. It makes up 14% of the General Fund's total revenues in 2017-2018. Annual growth is projected to be 1.0% in 2017, 1.3% in 2018, and 1.0% in 2019-2023. This very modest growth rate is directly related to electric/gas utility tax, cable TV utility tax, and cellular utility tax, which account for 65% of the City's total utility tax revenues. In 2014-2015, electric/gas utility tax and cellular utility tax declined each year. In 2016, cable TV utility tax was flat, electric/gas utility tax was up only 0.7%, and cellular utility tax was down 11.4%. The electric/gas utility tax decreases are directly related to an unusually mild winter in 2014-2015 and a double digit natural gas rate decrease. The decline in cellular utility tax began in 2009 and is directly related to the following: 1) a highly competitive business environment, which has resulted in less expensive monthly phone plans; 2) the popularity of texting over talking, which has reduced the use of voice minutes; and 3) the exclusion of data plans from utility taxes. Finally, the leveling off of cable TV utility tax growth is due to cable TV alternatives, namely online streaming services.

- **Personnel costs:** As noted previously, personnel costs make up 71% of total expenditures in 2017-2018. They grow faster than inflation. Unlike the private sector, the City cannot spread personnel cost increases across the number of "widgets" sold or the number of clients served, with the exception of DSG and Parks & Recreation.

  Salaries and wages are projected to decrease 0.7% in 2017 and to increase 3.6% 2018, 3.9% in 2019, and 5.0% annually in 2020-2023. The anomalous decrease in 2017 is primarily due to salary savings from six retirements in 2015 (with new employees starting at the lower end of their respective salary scales) and from the elimination of the Eastside Narcotics Task Force (ENTF) Detective position following the dissolution of the ENTF in 2016. Cost of living adjustments (COLAs), which are based on the First Half CPI-W for the Seattle metro area (this is a semi-annual average), are generally the biggest cost driver. The 2017 COLA and the 2018-2023 projected COLAs, which vary by bargaining unit, are summarized in the table below.

Bargaining Unit	2017	2018	2019	2020	2021	2022	2023
AFSCME (90% of CPI-W)	2.10%	2.25%	2.70%	2.70%	2.70%	2.70%	2.70%
Fire (100% of CPI-W)	2.33%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%
Police (100% of CPI-W)	2.33%	2.50%	3.00%	3.00%	3.00%	3.00%	3.00%
Unrepresented (90% of CPI-W)	2.10%	2.25%	2.70%	2.70%	2.70%	2.70%	2.70%

  Note that a return to the long-term, average rate of inflation of 3.00% is forecast beginning in 2019. The remaining cost drivers include step increases for represented employees, pay for performance for unrepresented employees, and periodic market adjustments, which are intended to keep the City's workforce at the 50th percentile of the market (which primarily consists of cities in King County and south Snohomish County).

  Benefits are projected to increase 3.7% in 2017, 5.1% in 2018, 5.7% in 2019, and 7.0% annually in 2020-2023. The unusually low benefit increase in 2017 is directly related to the salary savings noted above. Benefits include medical, dental, and vision insurance; worker's compensation costs; long-term disability insurance; life insurance; and state retirement plans. It should be noted that the City's medical, dental, and vision insurance costs, in terms of the total monthly premium cost and the employer's share of that cost for an employee only and for a family of four, have been one of the lowest among King County cities (with a population of at least 20,000) for many years.

Two Questions Answered

The projected General Fund deficits beginning in 2017 and the primary drivers noted above beg the following two questions, one looking backward and one looking forward:

1) **Given the underlying structural imbalance between revenue growth and expenditure growth, how did the City balance the General Fund budget in 2013-2016?**

    - As noted previously, the high level of development activity on the Island in 2014-2016 generated significant spikes in construction-related sales tax and development fees, which masked the structural imbalance.

    - The Council increased development fees based on a desired cost recovery target level of 95% for Building Services, 60% for Planning Services, and 60% for Engineering Services effective January 1, 2014.

    - Significant expenditure reductions, including reduced annual financial support to the YFS Fund, were made to balance the 2013-2014 Budget.

    - A new utility tax (3.9%) was instituted on the City's water, sewer, and storm water utilities beginning in 2013, increasing to 5.3% in 2014.

    - The Council approved a 1.0% annual increase in the property tax levy in 2013-2016.

    - One-time funding of $307,641 and $440,675 was required to balance the biennial budgets in 2013-2014 and 2015-2016 respectively.

    - Low inflation kept the growth of salaries and wages low in 2013-2016.

    - Modest medical insurance premium increases kept the growth of employee benefit costs low in 2013-2016.

2) **How can the City's General Fund go from a $1.10 million projected surplus in 2016 to a $913,914 projected deficit in 2018 (excluding one-time funding used to reduce the projected deficit to $505,195), which represents a $2.02 million negative swing over 2 years?**

    - From the 2016 projected General Fund surplus, one-time funding of $501,729 was used to balance the 2017 budget, and one-time funding of $408,719 was used to reduce the 2018 projected deficit from $913,914 to $505,195.

    - Construction-related sales tax and development fees are projected to decline $350,000 and $360,000 respectively in 2017-2018 (totaling $710,000) relative to the development activity spike in 2015-2016.

    - The balance of the $2.02 million negative swing primarily relates to property tax and utility tax growth lagging behind personnel cost growth in 2017-2018.

Youth & Family Services Fund Deficits

The YFS Fund accounts for the City's social services, including Thrift Shop operations, school counseling, family counseling, Communities That Care program, senior outreach, Volunteer Outreach in Communities Everywhere (VOICE) and Summer Volunteer (SVP) programs, JobLink, and emergency assistance.

Youth & Family Services Fund Forecast

A summary level YFS Fund forecast for 2016-2023 is presented in the following table (numbers are in millions).

YFS Fund Forecast	2016	2017	2018	2019	2020	2021	2022	2023
Beginning fund balance	$ 0.28	$ 0.11	$ -	$ -	$ -	$ -	$ -	$ -
Plus total revenues	2.40	2.68	2.46	2.53	2.59	2.66	2.73	2.80
Less total expenditures	(2.57)	(2.75)	(2.79)	(2.90)	(3.02)	(3.15)	(3.28)	(3.43)
Less reserved revenues*	-	(0.04)	(0.02)	(0.02)	-	-	-	-
Surplus (deficit)	**$ 0.11**	**$ 0.00**	**$ (0.34)**	**$ (0.40)**	**$ (0.43)**	**$ (0.49)**	**$ (0.56)**	**$ (0.63)**

* The YFS Fund's working capital balance, which is mostly depleted, needs to be built back up to $75,000.

The 2017 and 2018 fiscal years represent the 2017-2018 Adopted Budget. The 2016 projected surplus of $107,804 is wholly due to a $120,184 transfer from the General Fund in 2015 to keep the fund solvent through 2016. In 2017, $192,831 of the 2016 projected General Fund surplus was needed to balance the YFS Fund. This amount is in addition to the $400,000 in annual General Fund support provided since 2015. In 2018, the projected deficit is $343,886, which equates to 12.3% of total budgeted expenditures. **The 2018 budget was balanced assuming that an equivalent amount of expenditure reductions would have to be made unless actual revenues are significantly better than projected and/or a new revenue source is identified.**

Total revenues and total expenditures are broken down into their major components in the following two tables (numbers are in millions).

Major Revenues	2016	2017	2018	2019	2020	2021	2022	2023	2017-2018 % of Total
Thrift Shop sales	$ 1.41	$ 1.50	$ 1.57	$ 1.64	$ 1.70	$ 1.77	$ 1.84	$ 1.91	59.8%
General Fund support	0.40	0.59	0.40	0.40	0.40	0.40	0.40	0.40	19.3%
MIYFS Foundation support	0.17	0.20	0.20	0.20	0.20	0.20	0.20	0.20	7.9%
Program fees & donations	0.19	0.19	0.19	0.19	0.19	0.19	0.19	0.19	7.4%
CTC grant funding	0.13	0.09	-	-	-	-	-	-	1.8%
All other revenues	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	3.8%
Total revenues	**$ 2.40**	**$ 2.68**	**$ 2.46**	**$ 2.53**	**$ 2.59**	**$ 2.66**	**$ 2.73**	**$ 2.80**	**100.0%**

Thrift Shop sales and General Fund support comprise 79% of total revenues in 2017-2018. The Communities That Care (CTC) federal grant, which was for five years, will end on September 30, 2017.

Major Expenditures	2016	2017	2018	2019	2020	2021	2022	2023	2017-2018 % of Total
Salaries & wages	$ 1.50	$ 1.60	$ 1.63	$ 1.69	$ 1.75	$ 1.81	$ 1.87	$ 1.94	58.3%
Benefits	0.62	0.67	0.70	0.75	0.80	0.86	0.92	0.98	24.8%
Contractual services	0.12	0.13	0.11	0.12	0.12	0.12	0.12	0.13	4.4%
Fleet & IT charges (internal)	0.11	0.11	0.12	0.12	0.12	0.13	0.13	0.13	4.1%
Other services & charges	0.10	0.11	0.10	0.10	0.10	0.11	0.11	0.11	3.8%
All other expenditures	0.13	0.12	0.13	0.13	0.13	0.13	0.13	0.14	4.6%
Total expenditures	**$ 2.57**	**$ 2.75**	**$ 2.79**	**$ 2.90**	**$ 3.02**	**$ 3.15**	**$ 3.28**	**$ 3.43**	**100.0%**

Personnel costs make up 83% of total expenditures in 2017-2018.

The major revenues and major expenditures are presented in percentage change terms for 2017-2023 in the following table.

YFS Fund Forecast: % Change	2017	2018	2019	2020	2021	2022	2023
Thrift Shop sales	6.0%	5.0%	4.0%	4.0%	4.0%	4.0%	4.0%
General Fund support	48.2%	-32.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Program fees & donations	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
MIYFS Foundation support	15.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
CTC grant funding	-25.0%	-100.0%	N/A	N/A	N/A	N/A	N/A
All other revenues	2.1%	0.0%	-2.0%	0.0%	0.0%	0.0%	0.0%
Total revenues	**11.5%**	**-7.9%**	**2.5%**	**2.6%**	**2.6%**	**2.7%**	**2.7%**
Salaries & wages	6.5%	1.9%	3.5%	3.5%	3.5%	3.5%	3.5%
Benefits	9.1%	3.8%	7.0%	7.0%	7.0%	7.0%	7.0%
Contractual services	11.4%	-12.1%	2.5%	2.5%	2.5%	2.5%	2.5%
Fleet & IT charges (internal)	2.9%	1.9%	5.0%	0.0%	5.0%	0.0%	5.0%
Other services & charges	7.8%	-9.3%	2.5%	2.5%	2.5%	2.5%	2.5%
All other expenditures	-3.1%	6.3%	-1.8%	1.8%	1.8%	1.8%	1.9%
Total expenditures	**6.8%**	**1.4%**	**4.1%**	**4.1%**	**4.3%**	**4.2%**	**4.4%**
Net expenditure growth differential each year	**-4.7%**	**9.3%**	**1.6%**	**1.5%**	**1.7%**	**1.5%**	**1.7%**

Primary Drivers

The primary drivers of the projected deficits are as follows:

- **School District support:** The District reduced its financial support for mental health counselors from 42% of the total cost to a fixed sum of $60,000 beginning in 2010 due to its own financial challenges during the Great Recession. In 2017, the total cost of the mental health school counseling program, which encompasses 7.5 FTEs, is $627,388, of which the City is funding $567,388, or 90%.

- **General Fund support:** The YFS Fund received $465,000 annually from the General Fund through 2009. However, due to the Great Recession's impact on General Fund revenues, this amount was reduced significantly in 2010-2014 (ultimately down to $200,000 in 2014). Beginning in 2015, annual General Fund support was increased to $400,000, which was funded by the spike in construction-related sales tax and a portion of the City's remaining "banked" property tax capacity.

- **Thrift Shop sales:** After 5 years of strong annual growth in 2008-2012, Thrift Shop sales, which made up 59% of the YFS Fund's total revenues in 2016, plateaued in 2013-2015. However, Thrift Shop sales are projected to increase significantly in 2016 following the conversion of work study hours to three part-time positions and the conversion of one of these part-time positions to a full-time position for a one-year trial period (this latter conversion is being funded by the MIYFS Foundation). This revenue bump has been factored into the 2017-2023 Thrift Shop sales forecast.

- **New school counselor:** In the 2015-2016 Budget, the Council added a new mental health counselor position, which is funded 100% by the City, to serve the new elementary school, which opened in September 2016.

Other Operating Funding Needs

In addition to the projected deficits in the General Fund and the Youth & Family Services Fund, the City has three other operating funding needs:

- Fire apparatus replacement;
- Communications Specialist (0.5 FTE); and
- Youth Development Coordinator (0.5 FTE).

Fire Apparatus Replacement

The fire apparatus sinking fund, which was established in 2007, is dedicated to replacing four maxi pumper fire trucks, two midi pumper fire trucks, and one fire rescue truck. The original funding model relied on a 1.65% property tax levy and investment earnings on the City's cash balances, excluding the Utility Funds. However, the investment market has been abysmal since September 2009, with annual returns below 1%. As a result, the City's annual funding contributions have consistently fallen short of the annual target amount. Excess proceeds from the Fire Station and Fire Rescue Truck levy lid lift (i.e., over and above the amount needed to cover annual debt service) have been and will continue to be deposited in the fire apparatus sinking fund in 2014-2021, keeping the sinking fund solvent through 2026. An additional $55,000 in annual funding (plus 1% growth per year) beginning in 2018 would keep the sinking fund solvent through 2036. However, given the projected deficits in the General Fund, the only way to address this funding need is through a new revenue source (e.g., voter approved levy lid lift), which was not assumed in the 2017-2018 Budget.

Communications Specialist

In 2014-2016, the City experienced a marked increase in major community issues, such as the Mercer Island Library remodel; siting of the Mercer Island Center for the Arts; Town Center development code update; Coval subdivision; residential code update; and I-90 loss of mobility negotiations with Sound Transit, the Washington State Department of Transportation, and the Federal Highway Administration. Every one of these issues has generated significant community interest and public comment. The burden placed on the City Manager's Office to keep the public informed has become unsustainable, with recent City Council requests for additional public outreach avenues or more labor-intensive engagement strategies exceeding the capacity of the Communications/Sustainability Manager and the Assistant City Manager.

In theory, the City's Communications/Sustainability Manager is split 60/40 between communications and sustainability. However, considerably more time is spent handling both routine weekly oversight of the

City's various outreach channels and interactions with the Leadership Team, the City Council, and the media. In addition, the Communications/Sustainability Manager and the City Clerk jointly oversee all website content, adding information to the site regularly, building new sections of the site based on current issues, and making approximately 85% of all updates to the site. As a result, there is effectively no time for proactive engagement that could serve to inform the public about controversial issues. Instead, the City usually finds itself forced into a reactive mode. Increasingly, outside consultants must be contracted at short notice and at great cost to supplement the efforts of staff.

Much of the basic information dispersal activities and routine newsletter publishing duties currently provided by the Communications/Sustainability Manager could be handled by a Communications Specialist, freeing up valuable time for much-needed strategic communications planning and proactive outreach, both of which are certain to be necessary before and during light rail construction on I-90. While a full-time position is currently needed, only a half-time Communications Specialist was requested as a service package in 2017-2018, assuming that the unusual number of major community issues would subside after 2018. However, given the projected deficits in the General Fund, this new position is contingent on a new revenue source (e.g., voter approved levy lid lift), which was not assumed in the 2017-2018 Budget.

Youth Development Coordinator

The Youth Development Coordinator position has been a part of the Youth & Family Services Department for almost 25 years. This position coordinates the VOICE and SVP programs for high school and middle school aged youth respectively. The goal of these programs is to develop leadership skills through experiential learning and diverse experiences that enhance the social and emotional development of adolescents. The "service learning" model develops esteem, resiliency, confidence, communication skills, and social responsibility.

As a result of the Great Recession, this position was reduced from full-time to half-time in 2011, with a commensurate loss in structured volunteer opportunities for youth during the school year (i.e. VOICE and SVP became strictly summer programs). To maximize department resources at that time, and in part due to a significant reduction by the School District to its share of the school counseling program, the half-time Youth Coordinator position was combined with the half-time Substance Abuse Prevention Specialist at Islander Middle School.

Restoring the Youth Development Coordinator position to full-time status was requested as a service package in 2017-2018. In addition, a change in the position's title (to Youth Development/Healthy Youth Initiative Coordinator) and responsibilities is recommended, encompassing community-wide substance abuse prevention coordination under the Communities That Care/Healthy Youth Initiative project, which is currently focused on youth wellness. However, given the projected deficits in the YFS Fund, this staffing increase is contingent on a new revenue source (e.g., voter approved levy lid lift), which was not assumed in the 2017-2018 Budget.

Additional Information

The two half-time staffing needs noted above are different than what was shown to the Council at its June 2016 Mini-Planning Session, when a new Information Technology (IT) position (1.0 FTE) was identified as the City's greatest staffing need by the Leadership Team. In the 2017-2018 Budget, the Council approved the addition of a new IT position, beginning in 2018, using the cost savings from the ENTF Detective position, which is being formally eliminated in 2017. Adding a half-time Communications Specialist and restoring the Youth Development Coordinator to full-time status represent the next highest staffing needs in the organization.

Capital Project Funding Challenges

As part of the 2017-2018 Budget, the Council adopted a six-year Capital Improvement Program (CIP) for 2017-2022, with the first two years representing budgeted (i.e., appropriated) projects and the remaining four years representing planned projects. Looking out over this six-year period, capital project funding challenges exist in the Street Fund, which accounts for all street and pedestrian/bicycle facilities capital projects, and the Capital Improvement Fund, which accounts for all parks, open space, and public building capital projects. Following are the projected ending funding balances for each fund, a summary of the primary drivers of the projected deficits, and a listing of partially funded and unfunded capital projects. It should be noted that modest (i.e., <$150,000), temporary deficits are not a concern because the Street Fund and the Capital Improvement Fund have working capital and/or reserves that can cover the shortfalls.

Street Fund

Based on the revenue projections, which primarily consist of real estate excise tax, motor vehicle fuel tax, and vehicle license fees, and the funded capital projects in the 2017-2022 CIP, the projected ending fund balances in the Street Fund are noted in the table below.

Street Fund	2017	2018	2019	2020	2021	2022
Ending Fund Balance	$1,992,520	$1,066,683	$637,646	$152,225	$92,607	($396,359)
Less Working Capital	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)
Available Ending Fund Balance	**$1,792,520**	**$866,683**	**$437,646**	**($47,775)**	**($107,393)**	**($596,359)**

The primary drivers of the projected deficits in 2020-2022 are the following projects:

- **SE 40th Street at 86th Avenue SE (West and East Legs)**, which is budgeted in 2017-2018 for $1.26 million and which was not on the City's radar until 2014 when the 2015-2020 CIP was developed;

- **Gallagher Hill Road Sidewalk Improvement**, which is budgeted in 2022 for $465,000 and which represents new, additional infrastructure; and

- **East Mercer Way Roadside Shoulders (Phase 11)**, which is budgeted in 2022 for $465,000 and which represents new, additional infrastructure.

In addition, there are three unfunded pedestrian/bicycle facilities projects in the 2017-2022 CIP, which are listed in the table below.

Unfunded Pedestrian/Bicycle Facilities Projects	Year	Unfunded Amount
Safe Routes to School—Madrona Crest Sidewalk Phase 2	2019	$340,000
Safe Routes to School—92nd Ave SE	2019	200,000
North Mercer Way Re-channelization at 77th Ave SE	2019	90,000
Total	**2019**	**$630,000**

Capital Improvement Fund

Based on the revenue projections, which primarily consist of real estate excise tax, grants, and the 2008 Parks levy lid lift (property tax), and the funded capital projects in the 2017-2022 CIP, the projected ending fund balances in the Capital Improvement Fund are noted in the table below.

Capital Improvement Fund	2017	2018	2019	2020	2021	2022
Ending Fund Balance	$1,322,117	$845,406	$758,567	$673,765	$890,291	$1,232,511
Less Working Capital & Reserves	(1,167,305)	(605,305)	(778,566)	(701,878)	(893,957)	(1,089,877)
Available Ending Fund Balance	**$154,812**	**$240,101**	**($19,999)**	**($28,114)**	**($3,666)**	**$142,633**

The negative ending fund balances in 2019-2021 are not concerning, since they are significantly under $150,000 and the 2022 ending fund balance is positive ($142,633). However, it should be noted that there are 11 partially funded and unfunded parks and public building projects in the 2017-2022 CIP, which are listed in the following table in chronological order.

Partially Funded & Unfunded Parks & Public Building Projects	Year	Unfunded Amount
Aubrey Davis Park Regional Multi-Use Corridor Plan	2017	$200,000
Island Crest Park South Field Improvements	2017	150,000
Maintenance Building Renovation/Expansion	2018	3,900,000
Island Crest Park Improvements (Adventure Play)	2018	64,000
Luther Burbank South Shoreline Restoration	2019	820,000
Luther Burbank Boiler House Remediation	2019	135,000
Pioneer Park Path Lighting	2020	100,000
Island Crest Park North Outfield Improvements	2021	1,550,000
Luther Burbank Swim Beach Restoration	2021	500,000
Clarke Beach Shoreline Restoration	2022	2,000,000
Aubrey Davis Park Area B Sports Field	2022	413,000
Total	**2017-2022**	**$9,832,000**

The greatest unfunded capital project need is the renovation/expansion of the Maintenance Building, which houses all Public Works and Parks Maintenance employees, comprising 44.5 regular employees and 17 seasonal employees. During the Great Recession, the City had to push out a number of public building renovation projects due to the downturn in real estate excise tax revenue. The replacement of Fire Station 92 was the number one priority, which was accomplished in 2015. The Maintenance Building, which is 15,347 square feet, including a 1,025 square foot warehouse and a 1,000 square foot shop, is next in line. What is envisioned is the removal of the lawn roof above the warehouse and the construction of a second story. To free up needed space at City Hall, the IGS Department staff would be moved to the expanded Maintenance Building. The total estimated cost is $3.9 million, which is a very preliminary estimate. The design phase of the project, which is budgeted in 2017, will provide a much better cost estimate.

In addition to the partially funded and unfunded pedestrian/bicycle facilities, parks, and public building projects noted above, which are included in the 2017-2022 CIP, there are a number of unfunded projects, which are not included in the 2017-2022 CIP due to a lack of funding. Many of these partially funded and unfunded projects would be good candidates for a capital levy lid lift, which is discussed below.

Operating Funding & Capital Funding Options

Two options for addressing the 2018-2023 projected deficits in the General Fund and YFS Fund and the three other operating funding needs will be explored first. Then, three options for addressing the capital project funding challenges in the Street Fund and Capital Improvement Fund will be identified.

Addressing the Operating Funding Needs: 2 Options

The City's five operating funding needs in 2018-2023 are summarized in the following table.

2018-2023 Operating Funding Needs

Funding Need	2018	2019	2020	2021	2022	2023	Annual Average
General Fund Deficit[1]	$505,195	$1,836,002	$2,665,737	$3,557,475	$4,515,255	$5,543,380	$3,103,841
Youth & Family Services Fund Deficit[2]	343,886	397,696	431,501	494,670	555,341	626,156	474,875
Communications Specialist (0.5 FTE)[3]	54,828	57,569	60,448	63,470	66,644	69,976	62,156
Youth Development Coord. (0.5 FTE)[4]	49,541	52,018	54,619	57,350	60,217	63,228	56,162
Fire Apparatus Replacement[5]	55,000	55,550	56,106	56,667	57,233	57,806	56,393
Total Funding Need	**$1,008,450**	**$2,398,835**	**$3,268,410**	**$4,229,632**	**$5,254,690**	**$6,360,546**	**$3,753,427**
$ Increase Over Prior Year	**$1,008,450**	**$1,390,385**	**$869,575**	**$961,221**	**$1,025,059**	**$1,105,855**	**$1,060,091**

Notes

[1] **General Fund:** Based on updated forecast per 2017-2018 Final Budget.

[2] **YFS Fund:** Based on updated forecast per 2017-2018 Final Budget.

[3] **Communications Specialist:** This 0.5 FTE request is tied to a significant increase in demand for public communication in 2014-2016. Currently, the Communications/Sustainability Manager is split 60/40 between communications and sustainability.

[4] **Youth Development Coordinator:** This position was cut to half-time beginning in 2011 due to the Great Recession. It coordinates the Volunteer Outreach in Communities Everywhere (VOICE) and Summer Volunteer (SVP) programs for high school and middle school youth. This 0.5 FTE request would restore the position to full-time status.

[5] **Fire apparatus replacement:** $55,000 per year + 1% annual growth would fund through 2036 (currently funded only through 2026).

As a reminder, the 2016 projected General Fund surplus of $1.10 million was used to balance the General Fund ($501,729) and Youth & Family Services Fund ($192,831) in 2017 and to reduce the 2018 projected deficit in the General Fund by $408,719 (leaving a deficit of $505,195).

Option 1: Expenditure Cuts

Under this option, the ongoing expenditure cuts needed each year to eliminate the projected deficits are identified in dollar, percentage, and FTE terms in the table below.

Expenditure Cuts	2018	2019	2020	2021	2022	2023
Expenditure cuts each year ($)	$1,008,450	$1,390,385	$869,575	$961,221	$1,025,059	$1,105,855
Expenditure cuts each year (%)	3.1%	4.1%	2.4%	2.6%	2.6%	2.7%
FTE cuts each year	10.0	13.0	7.0	8.0	8.0	9.0

The annual expenditure cuts are relative to the total projected expenditures in the General Fund and YFS Fund. **To balance 2018-2023, 55 FTEs, or 27% of the City's total workforce, would have to be cut under this option.** In 2017, the City has almost 207 authorized FTEs, including 12.25 contract staff.

Given how leanly staffed the City is, this budget balancing option would have very significant service level impacts. For a full service city, which typically includes police; fire & emergency medical; parks & recreation; development regulation; street/right-of-way maintenance; and water, sewer, and storm water utility services, Mercer Island has one of the lowest total number of employees per 1,000 population in King County, excluding Youth & Family Services, which no other city has except for Seattle. The 2016 FTEs per 1,000 population for each full service city on the Eastside, with and without social services, are noted in the following table.

Full Service Eastside City	2016 FTEs per 1,000 population		Note
	Total	Excluding Social Services	
Redmond	10.81	10.81	
Bellevue	9.32	9.28	No Municipal Court
Mercer Island	**8.18**	**7.49**	
Issaquah	7.21	7.18	No Fire Department
Kirkland	6.78	6.77	Major annexation in 2011

Compared to Mercer Island, Issaquah has a lower staffing ratio, because it does not have a Fire Department, and Kirkland has a lower staffing ratio due to its annexation of Juanita, Finn Hill, and Kingsgate in June 2011, which added over 31,000 residents. Because the annexation occurred during the Great Recession, Kirkland was constrained in adding new staff. Prior to the annexation, Mercer Island had the lowest staffing ratio among this group of full service cities, including and excluding social services. Over time it is expected that Kirkland's staffing ratio will exceed that of Mercer Island again.

The following table, which is organized by department, provides relevant information about the challenges of cutting staff.

Department	Challenges of Cutting Staff
Police	No cost savings would be achieved by eliminating positions due to contractual minimum staffing requirements, which would have to be maintained using overtime. The exception is the ENTF Detective position, which is being formally eliminated in 2017.
Fire	Same challenges as Police.
DSG	DSG's staffing level is tied to development activity, and their costs are mostly funded by development fees, not taxes. In 2016, the Council added a planning position to address long-range planning issues. Development cost recovery targets were adjusted beginning on August 1, 2016 to free up tax revenues, which are currently dedicated to DSG, to cover the cost of this position.
Public Works	Most of Public Works is budgeted in the Water, Sewer, and Storm Water Funds. The services budgeted in the General Fund relate to right-of way work (roadway maintenance, vegetation maintenance, planter bed maintenance), neighborhood traffic control, and administrative support. During the Great Recession, 2.5 FTEs were cut from the Right-of-Way Team, which have not been restored.

Department	Challenges of Cutting Staff
Parks & Recreation	Parks & Recreation has a total cost recovery policy of 50-55% from recreation, ballfield, and room rental fees. Any cuts to Recreation would result in reduced recreation fees, partially negating the cost savings achieved. Nevertheless, recreation programs are a discretionary service. Parks Maintenance is funded primarily by taxes and is a discretionary service as well.
Youth & Family Services	In 2017, YFS is primarily funded by $1.50 million in Thrift Shop sales, $400,000 in General Fund support, $202,000 in MIYFS Foundation support, and $190,500 in program fees and donations. Cutting Thrift Shop staff would negatively impact Thrift Shop sales. The School Mental Health Counseling program, which is provided by YFS staff and partially funded by the School District ($60,000 per year), is a discretionary service.
Municipal Court	Court fines cover almost all of the cost of operating a court, which is staffed by a part-time (0.7 FTE) judge and 2.75 staff. In terms of efficiency, the Court processes significantly more cases per FTE than other municipal courts in King County. This is not a discretionary service.
City Manager's Office, City Attorney's Office, Finance, Human Resources, and Information & Geographic Services	Compared to other full service cities, these administrative departments are extremely lean. For example, even with the new IT position approved in the 2017-2018 Budget, which is funded by the elimination of the ENTF Detective position, the City's IT staffing ratio is only 2.4% vs. 3-5% recommended by Gartner, the leading IT industry research organization.

Option 2: Operating Levy Lid Lift

This option focuses on a new revenue source: a property tax levy lid lift, which must be approved by the voters. A smoothed funding structure with a 5% annual inflator is presented below based on a six-year (2018-2023) operating lid lift, including and excluding the two half-time positions.

Smoothed Funding Need + 5% Annual Growth

Funding Need	2018	2019	2020	2021	2022	2023	Annual Average
General Fund Deficit	$2,738,000	$2,874,900	$3,018,645	$3,169,577	$3,328,056	$3,494,459	$3,103,940
YFS Fund Deficit	419,000	439,950	461,948	485,045	509,297	534,762	475,000
Communications Specialist (0.5 FTE)	54,828	57,569	60,448	63,470	66,644	69,976	62,156
Youth Development Coord. (0.5 FTE)	49,541	52,018	54,619	57,350	60,217	63,228	56,162
Fire Apparatus Replacement	50,000	52,500	55,125	57,881	60,775	63,814	56,683
Total Funding Need	**$3,311,369**	**$3,476,937**	**$3,650,784**	**$3,833,324**	**$4,024,990**	**$4,226,239**	**$3,753,941**
$ Increase Over Prior Year	**$3,311,369**	**$165,568**	**$173,847**	**$182,539**	**$191,666**	**$201,249**	**$704,373**
Including 2 half-time positions:							
Levy lid lift rate per $1,000 AV	$0.274	$0.288	$0.302	$0.317	$0.333	$0.350	$0.311
Annual cost ($1.0M AV home)	**$274**	**$288**	**$302**	**$317**	**$333**	**$350**	**$311**
Excluding 2 half-time positions:							
Levy lid lift rate per $1,000 AV	$0.265	$0.279	$0.293	$0.307	$0.323	$0.339	$0.301
Annual cost ($1.0M AV home)	**$265**	**$279**	**$293**	**$307**	**$323**	**$339**	**$301**

For a Mercer Island resident with a home assessed value of $1.0 million, the average annual cost would be $311 (including the two half-time positions) or $301 (excluding the two half-time positions). For 2018, the annual cost would be $274 (including the two half-time positions) or $265 (excluding the two half-time positions). Because the total funding needs in 2018-2023 have been smoothed over the six year period, a significant portion of the annual levy proceeds collected in the first three years (2018-2020) would need to be reserved for the last three years (2021-2023).

Addressing the Capital Funding Needs: 3 Options

Looking at the Street Fund and the Capital Improvement Fund together, there are 3 funding options:

1. Make more project cuts;
2. Increase vehicle license fee; or
3. Put a capital levy lid lift on the ballot.

Option 1: Make More Project Cuts

Based on the City's adopted CIP budget policy, capital reinvestment projects (which address existing assets) take priority over capital facilities projects (which represent new assets). Accordingly, $447,000 of the $2.01 million in planned pedestrian/bicycle facilities projects in the Street Fund would have to be cut to keep the projected deficit in 2022 under $150,000. No project cuts would be necessary in the Capital Improvement Fund, since the projected deficits are under $150,000 and the 2022 ending fund balance is positive.

Option 2: Increase Vehicle License Fee

Increasing the vehicle license fee from $20 to $30 per vehicle beginning in 2019 would generate $175,000 in new annual revenue and would fully address the projected Street Fund deficits in 2020-2022. However, it would not help the Capital Improvement Fund. To accomplish that, the vehicle license fee would have to be increased from $20 to $40 per vehicle beginning in 2019. This would generate $350,000 in new annual revenue, thereby enabling the Council to re-direct $175,000 in annual real estate excise tax from the Street Fund to the Capital Improvement Fund to fully address the projected deficits in 2019-2021 and to provide a modest amount of funding for unfunded parks and public building projects.

Option 3: Put a Capital Levy Lid Lift on the Ballot

This option, if approved by the voters, would enable the Council to fund the Maintenance Building renovation/expansion project and many of the partially funded and unfunded pedestrian/bicycle facilities and parks projects, which were noted above. When bonds are issued, a capital levy lid lift is limited to 9 years, with the annual levy proceeds used to pay the annual debt service on the bonds. Three funding scenarios are summarized in the table below, showing the estimated annual property tax impact on a Mercer Island home with a $1.0 million assessed value, assuming a 3.0% effective interest rate (note that the effective interest rate in January 2017 is 2.0%).

Total Funding Amount (3 Scenarios)	Levy Lid Lift Rate Per $1,000 AV	Annual Property Tax Impact ($1.0M Home)
$9.5 million in capital projects	$0.10000	$100 per year for 9 years
$11.8 million in capital projects	$0.12500	$125 per year for 9 years
$14.2 million in capital projects	$0.15000	$150 per year for 9 years

The primary concern with this option relates to the operating levy lid lift funding option discussed above. If the Council ultimately decides to put both an operating levy lid lift and a capital levy lid lift on the same ballot, this would invite significantly greater voter approval risk than if the Council put just the operating levy lid lift on the ballot.

Recommended Path Forward

The recommendations below, which are organized around the City's operating funding needs and capital funding needs:

1. Recognize that Island residents expect good value for the taxes they pay to the City;
2. Assume that Island residents want to maintain current service levels, based on the results of the March 2016 and prior biennial citizen surveys; and
3. Reflect a perceived desire in the community to accelerate the planned pace of pedestrian/bicycle facilities and parks capital improvements on the Island.

Operating Funding Needs

The City has a revenue growth problem, not an expenditure growth problem, and many other cities are in the same boat—especially those that have a very modest retail sales tax base and, consequently, are heavily reliant on property taxes, which are limited to 1% annual growth plus "new construction," to fund services.

As a service organization, most of the City's costs are tied to staff, accounting for 71% of the General Fund's 2017-2018 Budget and 83% of the Youth & Family Services Fund's 2017-2018 Budget. Personnel costs grow faster than inflation, even in the private sector. However, the private sector can spread those personnel cost increases across the number of "widgets" sold or the number of clients served. With few exceptions, the City cannot. The only way the City can bend the expenditure growth line downward is to pay its employees less and have them pay more for medical, dental, and vision benefits. Pursuing such a course of action would be a recipe for high employee turnover and reduced productivity given that employee salaries are based on the 50^{th} percentile of the market and medical, dental, and vision insurance benefits are at the bottom of the market (and have been for at least two decades). If the City's employee compensation policy could be likened to a car, it would be a Honda Civic, not a Cadillac.

Consequently, it is recommended that the Council initiate a public engagement process in the second half of 2017 utilizing a diverse community stakeholder group appointed by the City Manager. This group would consist of 25-30 Island residents who would be tasked with reviewing the City's current and projected financial challenges (including the primary drivers), reviewing each of the five operating funding needs and the estimated cost impact on a typical Mercer Island household, and making a recommendation to the Council regarding what should be included in a six-year operating levy lid lift. In addition, a community survey would be conducted to provide the Council with the "pulse" of Island residents before making a final decision on placing a six-year operating levy lid lift on the ballot.

Further, it is recommended that the operating levy lid lift be tied directly to maintaining current service levels in Parks & Recreation and Youth & Family Services, which fall under the City's number five priority of government, which is: "The community will support a broad range of recreational, cultural, health, and educational opportunities." From a legal perspective, the services provided by these two departments are considered "discretionary" rather than "mandatory" or "essential." However, for many Island residents, the services provided by Parks & Recreation and Youth & Family Services are highly valued, because they enhance their quality of life.

Capital Funding Needs

With the exception of the renovation/expansion of the Maintenance Building, many of the partially funded and unfunded projects related to bicycle/pedestrian facilities and parks represent wants more than needs.

Nevertheless, there appears to be significant community interest in many of these projects based on public comments received over the past few budget cycles. Therefore, it is recommended that the community stakeholder group also be tasked with reviewing this list of partially funded and unfunded projects and making a recommendation to the Council in light of the City's operating funding needs. The community survey noted above would be used to assess the willingness of Island residents to fund these projects, thereby helping the Council decide what to place on a future ballot, namely: 1) a nine-year capital levy lid lift, 2) a six-year operating levy lid lift, or 3) both levy lid lifts.

If the Council ultimately decides to put both an operating and a capital levy lid lift on the ballot, it is recommended that the cost impact of the nine-year capital levy lid lift be limited to $100 per year on a $1.0 million home to improve the chances of both ballot measures being approved by voters. That would provide funding for $9.5 million in capital projects. In addition, it is recommended that the cost of the Maintenance Building renovation/expansion project be split 50/50 between a capital levy lid lift and the City's water, sewer, and storm water utility rates. The 50/50 split corresponds to the Public Works Department and Park Maintenance Division's staffing (including seasonal employees) allocation between the General Fund and the Utility Funds. The estimated bi-monthly utility bill impact of funding the annual debt service on $1.95 million (50% of $3.9 million) in bonds is 1.4%, or $4.49, in 2018.

Additional Information

The following information is intended to provide the City Council and Island residents with additional insight into the taxes they pay to the City in 2016.

2016 Property Tax Levy Breakdown by Jurisdiction

The 2016 property tax levy breakdown provided in the table below applies to a Mercer Island home with a $1.0 million assessed value (AV), which is very close to the 2016 median AV ($982,000).

Taxing Jurisdiction	2016 Levy Rate*	2016 Levy Amount	% of Total
Mercer Island School District	$2.47976	$2,480	29.7%
State School Fund	$2.16898	$2,169	26.0%
King County	$1.48027	$1,480	17.7%
City of Mercer Island	**$1.16502**	**$1,165**	**13.9%**
King County Library System	$0.47714	$477	5.7%
King County EMS	$0.28235	$282	3.4%
Port Authority	$0.16954	$170	2.0%
Flood Zone	$0.12980	$130	1.6%
Total	**$8.35286**	**$8,353**	**100.0%**

* The levy rate is per $1,000 AV.

The total property tax bill in 2016 is $8,353, of which 29.7% goes to the Mercer Island School District and 26.0% goes to the State School Fund. In other words, over half (55.7%) of the total property tax bill is dedicated to funding public education. Also of note, Island residents pay more to King County (17.7%) than to the City (13.9%).

2016 Property Tax Levy Rate Comparison

The 2016 property tax rates for all King County cities, with populations greater than 20,000, are listed in the following table from lowest to highest.

King County City	City Levy Rate*	King County City	City Levy Rate*
1. Bellevue	$0.93563	10. Burien	$1.45568
2. Mercer Island	**$1.16502**	11. Kent	$1.51139
3. Federal Way	$1.18504	12. Shoreline	$1.54115
4. Maple Valley	$1.19270	13. Des Moines	$1.65223
5. Issaquah	$1.20379	14. Sammamish	$1.98559
6. Kenmore	$1.25804	15. Auburn	$2.04719
7. Kirkland	$1.40413	16. Renton	$2.70956
8. Redmond	$1.41020	17. Seattle	$2.77302
9. Bothell	$1.43401	18. SeaTac	$2.99542

* The levy rate is per $1,000 AV.

In 2016, Mercer Island had the second lowest city property tax rate, which can be attributed primarily to its high assessed valuation relative to other King County cities. As a result, a Mercer Island resident with a $1.0 million home, in terms of assessed value, paid less property tax to the City than any other King County resident with a $1.0 million home did to his or her respective city, with the exception of Bellevue. It should be noted that Bellevue has the lowest property tax rate because of its substantial retail sales tax base, which made it financially possible for its Council to forego the 1% property tax increase for many years. That streak of no levy increases was broken in 2015. Also, it should be noted that Federal Way, Maple Valley, Issaquah, and Kenmore, which have the third, fourth, fifth, and sixth lowest property tax rates, would have significantly higher rates if they had a Fire Department (these cities are served by Fire Districts, which have their own property tax levies).

2016 Monthly Cost Comparison: City Taxes vs. City Utility Bill vs. 3 Other Utility Bills

How can Island residents determine if they are getting good value for the taxes they pay to the City? The following comparison represents a simple way to make such an assessment for a typical Mercer Island household (i.e., family of four and $1.0 million home assessed value), with the total taxes paid to the City on an average monthly basis compared to that household's average monthly Puget Sound Energy, Comcast, and Verizon bills. In addition, the average monthly City utility bill for water, sewer, storm water, and EMS services is included in the comparison (the City actually bills its utility customers on a bi-monthly basis).

2016 Average Monthly Cost Comparison (Typical Mercer Island Household)	Monthly Amount	Note
Puget Sound Energy (electricity & gas)*	$210	3,200 square foot home
Comcast (cable TV, high speed internet & digital voice)*	$200	X1 Premier Triple Play
Verizon (cellular telephone)*	$196	3 lines, 18GB data & device payment plan
City taxes (property, sales, utility, gas & EMS levy)	**$170**	**Only includes taxes remitted to City**
City utilities (water, sewer, storm water & EMS)*	**$152**	**Includes KC sewage treatment cost**

* Excludes federal, state, and city taxes/fees.

The total monthly tax burden includes only those portions of the property tax, sales tax, utility tax, motor vehicle fuel tax, and King County EMS levy that are ultimately remitted to the City.

So, what does a typical Mercer Island household get for the $170 in monthly taxes it pays to the City?

- 24/7 police, fire, and emergency medical services;
- Street, roadside, median, and sidewalk maintenance (excluding capital projects);
- Park, path, trail, and public building maintenance (excluding capital projects);
- Recreation programs for youth, adults, and seniors (supplemented by recreation fees);
- Community planning, development code regulations, and code enforcement;
- School-based mental health counseling and substance abuse intervention/prevention services (supplemented by Thrift Shop sales and $60,000 per year from the School District); and
- Televised Council meetings, public communications, and records management.

And, what does a typical Mercer Island household get for the $152 in monthly utility charges it pays to the City?

- Water storage, distribution, and maintenance;
- Sewer collection, treatment, and maintenance;
- Storm and surface water management;
- Water, sewer, and storm water utility capital replacement (including 115 miles of water mains, 2 reservoirs, 2 booster pump stations, 86 pressure reducing valve stations, 7,776 water meters, 1,235 fire hydrants, 110 miles of sewer mains, 18 sewer pump stations, 2,277 manholes, 117 miles of storm water pipes, and 7,200 catch basins); and
- Staffing capacity (i.e., 4 firefighters) to respond to simultaneous EMS calls.

Given the infrastructure maintained and the services provided by the City, does the average monthly City tax burden ($170) and the average monthly City utility bill ($152) seem reasonable compared to the average monthly Puget Sound Energy, Comcast, and Verizon bills for a typical Mercer Island household? You be the judge.

Acknowledgements

I want to thank each City department for preparing, as usual, a biennial budget that is responsible, defensible, and cost conscious. In addition, I especially want to recognize the efforts, expertise, and endurance of Accounting Manager LaJuan Tuttle, who is responsible for the Operating Budget (excluding the City's three Utilities), and Deputy Finance Director Francie Lake, who is responsible for the six-year CIP and the Operating Budget and rates related to the City's three Utilities. Finally, I want to recognize City Clerk Ali Spietz and Senior Administrative Assistant Deborah Alexander for their work on the budget document.

Respectfully,

Charles L. Corder

Charles L. Corder
Assistant City Manager/Finance Director

Postscript

Following the November 21, 2016 Council meeting, at which the Council completed its review of the 2017-2018 Preliminary Budget, staff learned that a "non-supplanting" provision related to the criminal justice sales tax had been removed by the state legislature back in 2010. This change, which was handled as a "housekeeping" measure by the state legislature, escaped the notice of both the Finance and Police Departments.

Why is this significant? First, it removes the primary reason for having a Criminal Justice Fund, which accounts for the criminal justice sales tax and its uses for specific Police Department costs, such as two Hire Ahead Patrol Officers, a Police Support Officer, and a School Resource Officer. Second, and most importantly, it gives the City more flexibility in addressing the projected 2018 deficits in the General Fund and Youth & Family Services Fund, though the criminal justice sales tax must still be used for criminal justice purposes. As a result, the Criminal Justice Fund will be folded into the General Fund, providing the following one-time and ongoing funding sources respectively for the Police Department's 2017-2018 budget:

- Available (i.e., unreserved) fund balance at the end of 2016 of $945,173 (note: this is not a final audited number and is subject to change); and
- Net budgeted revenues of $127,284 in 2017 and $138,803 in 2018.

Doing this will free up an equivalent amount ($1.21 million) of General Fund tax revenues in 2017 and 2018, which were originally used to fund the Police Department's 2017-2018 Budget and which can now be used to:

- Bridge the 2018 projected deficits of $505,195 in the General Fund and $343,886 in the Youth & Family Services Fund ($849,081 total); and
- Bring the Contingency Fund closer to its 2017 target level, provide additional funding for I-90 loss of mobility litigation costs, or address other one-time funding needs ($362,179 balance).

Accordingly, staff will bring an agenda bill to the Council in March 2017 to close the Criminal Justice Fund, moving its 2017-2018 budget to the General Fund and its reserves to the General Fund and the Technology & Equipment Fund.

EXECUTIVE SUMMARY

Summary level information, significant changes and important details, and major budget policy issues/changes for the 2017-2018 Budget are organized as follows:

- General Government
- Utilities
- Capital Improvement Program (CIP)

General Government

Most of the City's tax revenues are used to fund general government (i.e. non-utility) operations, which are accounted for primarily in the General Fund and Youth & Family Services (YFS) Fund. Following is a summary of each fund's budget, including major revenue estimates, significant expenditure increases/decreases, service enhancements/reductions, and budget policy issues/changes.

General Fund

This is the City's largest fund, with property tax, utility taxes, and sales tax making up 72% of total revenues in 2017-2018. The following services are accounted for in the General Fund: police, fire; emergency medical; municipal court; parks and recreation; planning and community development; street maintenance; public building maintenance; and financial, legal, and administrative services.

Revenues

As noted in the table below, total budgeted resources, which include beginning fund balance, are declining 2.2% in 2017 and 0.1% in 2018, and total budgeted revenues, which exclude beginning fund balance, are increasing 0.2% in 2017 and 0.9% in 2018.

General Fund	2016 Estimate	2017 Final Budget	2018 Final Budget	Percent Change	
				16-17	17-18
Beg. fund balance (budgeted)	$1,429,726	$694,560	$408,719	-51.4%	-41.2%
Total budgeted revenues	28,783,266	28,854,440	29,113,443	0.2%	0.9%
Total budgeted resources	**$30,212,992**	**$29,549,000**	**$29,522,162**	**-2.2%**	**-0.1%**

In 2016, the $1,429,726 beginning fund balance, which was mostly generated by the high level of development activity on the Island in 2014-2015, represents funding for the following: 1) one-time, budgeted expenditures in 2016 (mostly service packages); 2) unspent budget in 2015 that needed to be "carried over" to the 2016 budget; and 3) interfund transfers of 2015 surplus revenues for various one-time purposes. The 2016 projected General Fund surplus is $1.10 million, which is being generated by the high level of development activity on the Island in 2016. Of this amount, $694,560 was budgeted as beginning fund balance in 2017 to balance the General Fund and YFS Fund, which have projected deficits of $501,729 and $192,831 respectively ($192,831 will be transferred from the General Fund to the YFS Fund in 2017). The remaining $408,719 was budgeted as beginning fund balance in 2018 to reduce the projected deficit from $913,914 to $505,195.

There are six major revenues in the General Fund, comprising 93% of total budgeted revenues in 2017-2018. Taken together, they are projected to grow only 0.7% in 2017 and 0.9% in 2018, as noted in the table below. Each of these revenues is discussed in greater detail in Section D (Major Revenues).

General Fund	2016 Estimate	2017 Final Budget	2018 Final Budget	Percent Change		Percent of Total	
				16-17	17-18	2017	2018
Property tax	$11,516,550	$11,873,878	$12,159,785	3.1%	2.4%	41.2%	41.8%
Sales tax	4,600,000	4,521,000	4,580,000	-1.7%	1.3%	15.7%	15.7%
Utility taxes	4,122,800	4,164,200	4,216,700	1.0%	1.3%	14.4%	14.5%
Licenses & permits	3,623,100	3,491,500	3,257,500	-3.6%	-6.7%	12.1%	11.2%
Recreation program fees	1,639,095	1,630,318	1,668,815	-0.5%	2.4%	5.6%	5.7%
EMS revenues	1,289,320	1,290,369	1,323,578	0.1%	2.6%	4.5%	4.5%
Total major revenues	**$26,790,865**	**$26,971,265**	**$27,206,378**	**0.7%**	**0.9%**	**93.5%**	**93.4%**

Of particular note are the following:

- **Property tax** is the largest revenue source in the General Fund, accounting for 41% of total budgeted revenues in 2017-2018. It is projected to grow 3.1% in 2017 and 2.4% in 2018, encompassing "new construction" additions to the property tax rolls and a 1% optional increase each year.

- **Sales tax** is the second largest revenue source in the General Fund, accounting for 16% of total budgeted revenues in 2017-2018. It is projected to decline 1.7% in 2017 and grow 1.3% in 2018 primarily due to the projected downturn in development activity relative to the spike in 2015-2016. It should be noted that construction-related sales tax makes up 52% of the City's total sales tax receipts in 2016.

- **Utility taxes** are the third largest revenue source in the General Fund, accounting for 14% of total budgeted revenues in 2017-2018. Collectively, they are projected to grow only 1.0% in 2017 and 1.3% in 2018 primarily due to cable TV utility tax, which is projected to be flat, and to cellular utility tax, which is projected to continue its double digit decline. A breakdown by type of utility is provided in the table below.

Utility Tax	2016 Estimate	2017 Final Budget	2018 Final Budget	Percent Change	
				16-17	17-18
Electric/gas	$1,620,000	$1,668,000	$1,718,000	3.0%	3.0%
Water, sewer & storm water	936,000	988,000	1,043,000	5.6%	5.6%
Cable TV	704,000	704,000	704,000	0.0%	0.0%
Telephone (cellular)	412,000	363,000	319,000	-11.9%	-12.1%
Garbage	268,000	273,000	278,000	1.9%	1.8%
Telephone (land line & long distance)	182,800	168,200	154,700	-8.0%	-8.0%
Total	**$4,122,800**	**$4,164,200**	**$4,216,700**	**1.0%**	**1.3%**

- **Licenses & permits** are the fourth largest revenue source in the General Fund, accounting for 12% of total budgeted revenues in 2017-2018. They are projected to decline 3.6% in 2017 and 6.7% in 2018 based on development activity, which is projected to slow down relative to the spike in 2015-2016. However, the projected development activity level in 2017-2018 is still higher than normal. Five measures of development activity for 2009-2016 (actual) and 2017-2018 (projected) are shown in the table below.

Development Activity Metric	2009 Act	2010 Act	2011 Act	2012 Act	2013 Act	2014 Act	2015 Act	2016 Act	2017 Proj	2018 Proj
Total valuation (millions)*	$30.9	$51.6	$60.6	$59.4	$74.0	$90.2	$130.6	$96.9	$80.0	$70.0
Single family residential permits	252	271	268	248	337	332	334	366	340	310
Commercial/multi-family/other permits	54	64	62	77	74	62	40	52	60	55
Over-the-counter permits	1,511	1,498	1,666	1,783	2,189	2,316	2,511	2,690	2,400	2,200
Pre-application meetings	91	62	76	141	184	205	194	212	175	160

* Total valuation includes single family, multi-family, commercial, mixed use, and public development.

The City's ability to maintain current service levels, which are reflected in the budgeted expenditures below, is directly tied to the annual growth of these major revenues.

Expenditures

Total budgeted expenditures are increasing 1.5% in 2017 and 1.6% in 2018, as noted in the table below.

General Fund	2016 Adopted Budget	2017 Final Budget	2018 Final Budget	Percent Change	
				16-17	17-18
Total budgeted expenditures	$28,987,713	$29,436,000	$29,918,357	1.5%	1.6%

The 1.5% overall increase in 2017 is primarily driven by the net effect of the following:

- **Service enhancements in 2017:** $497,172 increase

  These include $493,672 in one-time costs and $3,500 in ongoing costs. Noteworthy service enhancements are highlighted below.

- **I-90 loss of mobility negotiations:** $400,000 increase

  The Council directed staff to add this one-time cost to the budget in 2017.

- **Salaries & wages:** $261,407 increase

  This increase reflects the net effect of the following: 1) 2.33% COLA for Police (Commissioned and Support) and Fire employees; 2) 2.1% COLA for all other employees; 3) contractual step increases for represented employees; and 4) salary savings from six employee retirements in 2015 (with new employees starting at the lower end of their respective salary scales).

- **Employee benefits:** $238,757 increase

  This increase includes the following: 1) 5.5% increase in medical insurance costs for Fire employees; 2) 4.5% increase in medical insurance costs for all other employees; and 3) significant increase in the PERS 2 retirement rate paid by the employer (which applies to all employees except for Police and Fire) beginning July 1, 2017.

- **General Fund support of YFS Fund:** $192,831 increase

  This amount is needed to balance the YFS Fund budget in 2017. It is funded by the 2016 projected surplus in the General Fund.

- **NORCOM (Police and Fire dispatch) costs:** $179,312 increase

  Contracted dispatch costs are going up 8.8% in 2017 based on historical calls for service, which have been proportionately higher for Mercer Island compared to other NORCOM members.

- **Liability and property insurance costs:** $133,717 increase

  This increase, which mostly relates to liability insurance, is based on the City's historical claims experience over the past five years.

- **Internal information technology (IT) rates:** $74,200 increase

  This increase is primarily driven by the following: 1) increase in software maintenance and support services (e.g., Microsoft Office 365); and 2) information security services, which is a recommended service enhancement.

- **ARCH Trust fund contribution:** $44,000 increase

  The Council directed staff to increase the annual contribution from $20,000 to $64,000 in 2017.

- **Internal fleet rates:** $55,911 decrease

  This decrease is primarily driven by the following: 1) extension of the replacement life cycle for Police patrol vehicles from 3 to 4 years and for general vehicles from 8 to 10 years, based on the recommendations of the City's fleet consultant; and 2) reduction in fuel costs relative to what was budgeted in 2015-2016.

- **Service reduction:** $142,354 decrease

  The Eastside Narcotics Task Force (ENTF) Detective position is being eliminated following the dissolution of the ENTF in 2016.

- **Salary reserve:** $184,728 decrease

  The reduction in this reserve is due to the AFSCME and Police (Commissioned and Support) labor contracts, which are in effect through December 31, 2017.

- **One-time costs and carryovers in 2016:** $1,354,340 decrease

  This encompasses the following: 1) one-time service enhancement costs budgeted in 2016; 2) expenditure carryovers from the 2015 budget to the 2016 budget (for purchases and contracted services that were budgeted in 2015 but not completed); 3) the disposition of the 2015 General Fund year-end surplus (resulting from actual revenues exceeding budgeted revenues and expenditure savings); and 4) other one-time budget adjustments (typically related to grants).

The 1.6% overall increase in 2018 is primarily driven by the net effect of the following:

- **General inflationary increases:** $918,906 increase

  This equates to a 3.1% increase and includes the following: 1) 2.5% estimated COLA for Police (Commissioned and Support) and Fire employees; 2) 2.25% estimated COLA for all other employees; 3) contractual step increases for represented employees; 4) 6.0% projected increase in medical insurance costs; 5) 5.0% projected increase in dental insurance costs; and 6) inflationary increases for contracted services and supplies.

- **Service enhancements in 2018:** $177,526 increase

  These include $75,000 in one-time costs and $102,526 in ongoing costs. Noteworthy service enhancements are highlighted below.

- **Salary reserve:** $109,000 increase

  The increase in this reserve is due to the AFSCME and Police (Commissioned and Support) labor contracts, which expire after December 31, 2017.

- **NORCOM (Police and Fire dispatch) costs:** $56,079 increase

  Contracted dispatch costs are projected to go up 7.2% in 2018 based on historical calls for service, which have been proportionately higher for Mercer Island compared to other NORCOM members.

- **ARCH Trust fund contribution:** $32,000 increase

  The Council directed staff to increase the annual contribution from $64,000 to $96,000 in 2018.

- **General Fund support of YFS Fund:** $192,831 decrease

  This one-time, additional transfer was needed to balance the YFS Fund budget in 2017.

- **One-time service enhancement costs in 2017:** $275,000 decrease

  These service enhancement costs are not budgeted again in 2018.

- **I-90 loss of mobility negotiations:** $400,000 decrease

  This Council directed one-time cost in 2017 is not budgeted again in 2018.

- **Potential service reductions:** $505,195 decrease

  This corresponds to the projected General Fund deficit in 2018, which equates to 1.7% of total budgeted expenditures. The 2018 budget was balanced assuming that an equivalent amount of expenditure reductions would have to be made.

Service Enhancements/Reductions

Council approved service enhancements/reductions are summarized in the table below.

Service Enhancements/ Reductions	One-Time Costs		Ongoing Costs		Funding Source/Note
	2017	2018	2017	2018	
SERVICE ENHANCEMENTS					
City Manager's Office:					
Community engagement on projected budget deficits	$30,000				2016 General Fund surplus
Development Services:					
Continuation of contract permitting staff (2.5 FTEs + casual labor)	222,472	$227,917			Development fees
Communications access real-time translation (CART) services	6,200	6,200			Development fees
Cost of service and cost recovery fee analysis		20,000			2016 General Fund surplus
Public outreach on DSG projects	45,000	40,000			2016 General Fund surplus
Transportation concurrency		20,000			2016 General Fund surplus
Shoreline master program update		35,000			2016 General Fund surplus
Environmentally critical areas update	125,000	35,000			2016 General Fund surplus
Information & Geographic Services:					
Information security services			$33,000	$23,000	IT rental rates (primarily affects General Fund)
Helpdesk Technician (1.0 FTE)				102,526	Cost savings from eliminating ENTF Detective position
Parks & Recreation:					
Conversion of seasonal parks maintenance positions to 2.0 FTEs			0	0	Cost savings from eliminating 4 seasonal park maintenance positions
Expand Senior Social program			18,500	18,500	Senior social program fees
Public Works:					
Right-of-way tree assessment plan	50,000				2016 General Fund surplus
Total Service Enhancements	**$478,672**	**$384,117**	**$51,500**	**$144,026**	
SERVICE REDUCTIONS					
Police:					
Eliminate ENTF Detective (1.0 FTE)			-$142,354	-$146,395	Eastside Narcotics Task Force disbanded in 2016
Total Service Reductions	**$0**	**$0**	**-$142,354**	**-$146,395**	

Following is additional information on selected service enhancements/reductions:

- **Community engagement on projected budget deficits**

  This public engagement process will utilize a diverse community stakeholder group appointed by the City Manager to review the City's operating and capital funding challenges and to make a recommendation to the Council regarding: 1) an operating levy lid lift to maintain current service levels in Parks and Recreation and Youth & Family Services; and 2) a capital levy lid lift to address partially funded and unfunded capital projects primarily related to the Maintenance Building, pedestrian/bicycle facilities, and parks.

- **Continuation of contract permitting staff (2.5 FTEs + casual labor)**

  The re-authorization of DSG contract staff, which were originally approved for 2013-2014, is directly tied to the projected level of development activity on the Island, which is lower than 2015-2016 but still higher than normal. Also, it should be noted that DSG was actually understaffed in 2015-2016 as evidenced by slower than normal permit turnaround times and development revenues that exceeded cost recovery targets in 2015-2016 for Building Services and Planning Services.

- **Public outreach on DSG projects**

  DSG's 2017-2018 work plan includes the following: 1) updating the single family residential code, 2) updating the environmentally critical areas regulations, 3) updating the shoreline master program, 4) updating growth targets, and 5) adopting a traffic concurrency ordinance. It is anticipated that these work plan items will generate significant public interest and comments. Accordingly, significant public outreach efforts are planned.

- **Shoreline master program update**

  The Shoreline Management Act requires the City to periodically review and update its shoreline master program. While the City updated its program in 2015, a cumulative impact analysis is required in 2018.

- **Environmentally critical areas update**

  The Growth Management Act requires the City to periodically review and update its environmentally critical area development regulations (usually every 8 years). The last time this was done was in 2005. The "best available science" review, which would be performed in 2017, is required by state law, followed by a cumulative impact analysis in 2018.

- **Helpdesk Technician (1.0 FTE)**

  This is the City's greatest staffing need according to the Leadership Team. Adding this position in 2018 will increase the City's IT staffing ratio from 2.0% to 2.4%. The recommended IT staffing ratio (IT FTEs relative to total FTEs) for state and local government is 3-5% according to Gartner, the leading technology research firm in the U.S. The primary benefit to the organization is that senior IT staff time will be freed up to help departments better utilize their business systems, enhancing staff decision making and productivity.

- **Conversion of seasonal parks maintenance positions to 2.0 FTEs**

  The Parks Maintenance Division has had difficulty finding people to fill four 9-month seasonal positions each year, with staff turnover being significant. Converting these seasonal positions to 2.0 regular FTEs will improve stability, in terms of staffing and service levels.

- **Eliminate ENTF Detective (1.0 FTE)**

  Following the dissolution of the Eastside Narcotics Task Force (ENTF) in 2016, the Council formally approved the elimination of the ENTF Detective position in 2017, with the cost savings used to fund a new Helpdesk Technician in 2018.

All service enhancement requests and service reduction proposals are included in Section H (Service Requests & Reductions) of the budget document.

Budget Policy Issues/Changes

There is one major budget policy issue that was identified two years ago in the 2015-2016 Budget Message and that is addressed at length in the 2017-2018 Budget Message:

- **Projected deficits in 2017 and 2018 in the General Fund**

  The projected deficits in 2017 and 2018 are the result of expenditures growing faster than revenues. This is evident in the 2017-2018 Budget, with total revenues projected to grow only 0.2% in 2017 and 0.9% in 2018 and total expenditures projected to grow 1.5% in 2017 and 1.6% in 2018. At the root of the revenue growth problem is property tax, which makes up 41% of the General Fund's total revenues in 2017-2018 and is limited by state law to 1% growth per year plus an allowance for "new construction" (which generates an additional 1% per year on average). **To balance the 2017-2018 Budget, the City had to: 1) use $910,448 of the 2016 projected General Fund surplus; and 2) assume that $505,195 in expenditure reductions would have to be made in 2018 unless actual revenues are significantly better than projected and/or a new revenue source is identified.** Looking forward, the projected deficits in 2019 and 2020 are $1.84 million and $2.67 million respectively, which equate to 5.9% and 8.2% of total budgeted expenditures in those years.

Youth & Family Services (YFS) Fund

The YFS Fund accounts for all revenues and expenditures directly related to the YFS Department. The revenues include: Thrift Shop sales, General Fund support, MIYFS Foundation support, programs fees and donations, Communities That Care (CTC) grant funding, and Mercer Island School District support. The YFS programs supported by these revenues include: Thrift Shop operations, school counseling, family counseling, Communities That Care, senior outreach, VOICE/SVP, JobLink, and emergency assistance.

Revenues

As noted in the table below, total budgeted resources, which include beginning fund balance, are increasing 13.0% in 2017 and declining 10.3% in 2018, and total budgeted revenues, which exclude beginning fund balance, are increasing 11.5% in 2017 and declining 7.9% in 2018.

YFS Fund	2016 Estimate	2017 Final Budget	2018 Final Budget	Percent Change	
				16-17	17-18
Beg. fund balance (budgeted)	$32,938	$72,804	$0	121.0%	-100.0%
Total budgeted revenues	2,400,096	2,675,915	2,464,250	11.5%	-7.9%
Total budgeted resources	**$2,433,034**	**$2,748,719**	**$2,464,250**	**13.0%**	**-10.3%**

The beginning fund balances of $32,938 in 2016 and $72,804 in 2017 represent the amounts needed to balance the 2016 budget and to reduce the projected 2017 deficit to $192,831, which will be bridged by transferring an equivalent amount of the 2016 projected General Fund surplus to the YFS Fund. In 2018, total budgeted revenues fall short of total budgeted expenditures, resulting in a projected deficit of $343,886.

There are five major revenues in the YFS Fund, comprising 96% of total budgeted revenues in 2017-2018, as noted in the table below. Collectively, they are increasing 11.9% in 2017 and declining 8.2% in 2018. For more information, see Thrift Shop Sales in Section D (Major Revenues) of the budget document.

YFS Fund	2016 Estimate	2017 Final Budget	2018 Final Budget	Percent Change		Percent of Total	
				16-17	17-18	2017	2018
Thrift Shop sales	$1,413,651	$1,498,334	$1,573,250	6.0%	5.0%	56.0%	63.8%
General Fund support	400,000	592,831	400,000	48.2%	-32.5%	22.2%	16.2%
MIYFS Foundation support	174,445	202,000	202,000	15.8%	0.0%	7.5%	8.2%
Program fees & donations	190,500	190,500	190,500	0.0%	0.0%	7.1%	7.7%
CTC grant funding	125,000	93,750	0	-25.0%	-100.0%	3.5%	0.0%
Total major revenues	**$2,303,596**	**$2,577,415**	**$2,365,750**	**11.9%**	**-8.2%**	**96.3%**	**96.0%**

Of particular note are the following:

- **Thrift Shop sales** are the largest revenue source in the YFS Fund, accounting for 60% of total budgeted revenues in 2017-2018. They are projected to grow 6.0% in 2017 and 5.0% in 2018.

- **General Fund support** is the second largest revenue source in the YFS Fund, accounting for 19% of total budgeted revenues in 2017-2018. The annual support was increased from $200,000 in 2014 to $400,000 annually beginning in 2015. However, this increase is insufficient to keep the fund balance positive in 2017-2018. As noted previously, a one-time, additional transfer of $192,831 from the General Fund is required to balance the YFS Fund in 2017.

- **MIYFS Foundation support** is the third largest revenue source in the YFS Fund, accounting for 8% of total budgeted revenues in 2017-2018. In 2015-2016, the annual financial commitment of the MIYFS Foundation was $155,000. An additional $19,445 was contributed to the YFS Department in 2016 to increase a Thrift Shop position from part-time to full-time for a one-year trial period (to see if the additional sales generated would exceed the additional staffing cost). Beginning in 2017, the MIYFS Foundation will increase its annual financial commitment to $202,000.

- **Communities That Care (CTC) federal grant** funding, which was for a five-year period, will end September 30, 2017.

Expenditures

Total budgeted expenditures are increasing 6.8% in 2017 and 1.4% in 2018, as noted in the table below.

YFS Fund	2016 Adopted Budget	2017 Final Budget	2018 Final Budget	Percent Change	
				16-17	17-18
Total budgeted expenditures	$2,574,790	$2,748,719	$2,788,136	6.8%	1.4%

The 6.8% overall increase in 2017 is primarily driven by the net effect of the following:

- **Salaries & benefits:** $99,555 increase

  This increase includes the following: 1) full year cost impact of new Elementary School Counselor, which started September 2016; 2) 2.1% COLA; 3) 4.5% increase in medical insurance costs; and 4) significant increase in the PERS 2 retirement rate paid by the employer (which applies to all employees except for Police and Fire) beginning July 1, 2017.

- **Casual labor:** $54,313 increase

  To increase Thrift Shop sales, work study hours were converted to three part-time positions in 2016, and one of these part-time positions was converted to a full-time position for a one-year trial period (funded by the MIYFS Foundation).

- **Service enhancements in 2017:** $19,143 increase

  This relates to just one service enhancement, which constitutes an ongoing cost that is fully offset by a projected increase in Thrift Shop sales and an additional MIYFS Foundation contribution. This service enhancement is highlighted below.

- **Thrift Shop building repairs:** $15,000 decrease

  This cost, which varies from year to year, represents an interfund transfer to the Capital Improvement Fund, which accounts for all capital repairs to public buildings.

- **One-time costs and carryovers in 2016:** $19,445 decrease

  This corresponds to the additional MIYFS Foundation contribution in 2016, which was used to increase a Thrift Shop position from part-time to full-time status for a one-year trial period.

The 1.4% overall increase in 2018 is primarily driven by the net effect of the following:

- **General inflationary increases:** $73,484 increase

  This equates to a 2.7% increase and includes the following: 1) 2.25% estimated COLA; 2) 6.0% projected increase in medical insurance costs; 3) 5.0% projected increase in dental insurance costs; and 4) inflationary increases for contracted services and supplies.

- **Salary reserve:** $25,000 increase

  In 2018, YFS staff will be due for a market study, which is performed every three years. This amount represents an estimate of the market adjustments, if warranted.

- **CTC grant program:** $73,067 decrease

  As noted above, this federal grant ends on September 30, 2017. Accordingly, the program costs will cease as well.

- **Potential service reductions:** $343,886 decrease

  This corresponds to the projected YFS Fund deficit in 2018, which equates to 12.3% of total budgeted expenditures. The 2018 budget was balanced assuming that an equivalent amount of expenditure reductions would have to be made.

Service Enhancements

The one Council approved service enhancement is summarized in the table below.

Service Enhancements	One-Time Costs		Ongoing Costs		Funding Source
	2017	2018	2017	2018	
Youth & Family Services:					
Thrift Shop Apparel Assistant (1.0 contract FTE)			$19,143	$18,894	MIYFS Foundation support & Thrift Shop sales
Total Service Enhancements			**$19,143**	**$18,894**	

Following is additional information on this service enhancement:

- **Thrift Shop Apparel Assistant (1.0 contract FTE)**

  This will extend the current one-year trial conversion of a part-time employee to full-time status through December 31, 2018. It should be noted that less than six months into the one-year trial period there has been a marked increase in Thrift Shop sales, more than covering the cost increases associated with this and other staffing changes.

Budget Policy Issues/Changes

There is one major budget policy issue that was identified two years ago in the 2015-2016 Budget Message and that is addressed at length in the 2017-2018 Budget Message:

- **Projected deficits in 2017 and 2018 in the YFS Fund**

  The projected deficits in 2017 and 2018 are due to the following: 1) significant reduction in Thrift Shop annual sales growth from 17% per year, on average, in 2009-2012 to 3% per year, on average, in 2013-2015; 2) significant reduction in annual General Fund support to the YFS Fund from $465,000 in 2009 to $200,000 in 2014 due to the Great Recession (it was subsequently increased to $400,000 beginning in 2015); 3) significant reduction in School District annual financial support for school-based mental health counselors from 42% of the total cost to a fixed annual sum of $60,000 beginning in 2010 due to the Great Recession; and 4) addition of a fourth Elementary School Counselor by the City Council to the YFS Department budget beginning September 2016, funded 100% by the City. **To balance the 2017-2018 Budget, the City had to: 1) use $192,831 of the 2016 projected General Fund surplus in 2017; and 2) assume that $343,886 in expenditure reductions would have to be made in 2018 unless a new revenue source is identified.** Looking forward, the projected deficits in 2019 and 2020 are $397,696 and $431,501 respectively, which equate to 13.0% and 16.7% of total budgeted expenditures in those years.

Utilities

The City operates four utilities: water, sewer, storm water, and emergency medical services (EMS). The first three are accounted for in the Water, Sewer, and Storm Water Funds and are completely self-supporting, with customer charges funding all operating, maintenance, and capital costs. Also included in the Water Fund and the Sewer Fund are the following significant "pass through" charges: 1) water purchases from the City of Seattle; and 2) sewage treatment services provided by the King County Wastewater Treatment Division. The EMS utility is accounted for in the General Fund and is a very narrowly focused utility, with customer charges funding four firefighter positions, which were hired back in 1996 to provide capacity to handle simultaneous EMS calls.

In September-October 2016, the Utility Board reviewed and made rate recommendations for the 2017 fiscal year, which were adopted by the Council on November 21, 2016. Specific information relative to the 2017 adopted and 2018 planned rate increases is provided below:

- **Water rates:** 5.5% adopted increase in 2017 & 5.5% planned increase in 2018

  The 2017-2018 rate increases are driven by three things: 1) the capital replacement needs of an aging water system, with approximately 59% of the City's water mains being over 50 years old; 2) the need to upsize water mains that do not meet the City's flow capacity standards; and 3) the need to cover the water utility's mostly fixed costs amidst a declining trend in water usage, with more efficient home appliances being installed.

- **Sewer maintenance rates:** 5.7% adopted increase in 2017 & 5.7% planned increase in 2018

  This covers the City's portion of operating and maintaining the sanitary sewer system, which equates to about 50% of the total bi-monthly sewer bill paid by a typical single family residential customer. During the period 2004-2012, the City Council approved significant annual increases in the sanitary sewer rate to fund the repair and replacement of the lake line along the northwest shore of Mercer Island. The 2017-2018 rate increases are driven by two things: 1) the capital reinvestment needs of the rest of the system, which were held to a minimum during the sewer lake line replacement project; and 2) the future replacement of Reach 4 of the sewer lake line, with $2.5 million in funding being accumulated for this purpose by the end of 2022.

- **Sewage treatment rates:** 5.2% adopted increase in 2017 & 0.0% planned increase in 2018

  This is a "pass through" charge assessed by King County, which includes the cost to finance the Brightwater sewage treatment plant.

- **Storm water rates:** 3.8% adopted increase in 2017 & 3.8% planned increase in 2018

  This covers all operating, maintenance, and capital costs related to the drainage system. Of particular note, water quality improvements continue to be a major focus area of the Storm Water Utility. The 2017-2018 rate increases are driven by two things: 1) capital projects planned in 2017-2022, including water quality improvements; and 2) the institution of a closed circuit television (CCTV) Storm Water Pipe Inspection program beginning in 2017 ($75,000 per year), which is an essential practice to maintaining the storm water conveyance system and to meeting the requirements of the National Pollution Discharge Elimination System (NPDES) permit. For more information on this service enhancement, see Section H (Service Requests & Reductions) of the budget document.

- **Emergency medical services (EMS) rates:** 4.1% adopted increase in 2017 & 4.1% planned increase in 2018

  These rates are based on the following: 1) 2016 and 2017 average salary and benefit costs, excluding overtime, of four firefighters (the EMS rate in the coming year is tied to the current year's average budgeted firefighter costs); 2) EMS call history over the past two years; and 3) updated customer account data. The current EMS utility rate structure was significantly impacted by the Council's decision in 2010 to institute a BLS ambulance transport fee to help balance the 2011-2012 Budget in the General Fund. This action had an unintended consequence, driven entirely by Washington State law, of replacing the long standing variable EMS rate structure, which had different rates for each customer class based on actual historical experience, with the same flat rate per equivalent service unit.

The 2016 actual, 2017 adopted, and 2018 planned bi-monthly utility charges for water, sewer, storm water, and EMS services are broken down in the table below (excluding utility taxes, which are a General Fund revenue source) for a typical single family residential customer.

Utility Rate Component	2016 Actual	2017 Adopted	2018 Planned	$ Change		% Change	
				2017	2018	2017	2018
Water	$99.36	$104.82	$110.59	$5.46	$5.77	5.5%	5.5%
Sewer Maintenance (City)	80.47	85.06	89.91	4.59	4.85	5.7%	5.7%
Sewage Treatment (King County)	84.06	88.44	88.44	4.38	0.00	5.2%	0.0%
Storm Water	31.88	33.09	34.35	1.21	1.26	3.8%	3.8%
EMS	8.53	8.88	9.24	0.35	0.36	4.1%	4.1%
Total Bi-Monthly Bill	**$304.30**	**$320.29**	**$332.53**	**$15.99**	**$12.24**	**5.3%**	**3.8%**

Overall, the total bi-monthly utility bill for a typical single family residential customer is increasing 5.3%, or $15.99, in 2017, with a planned increase of 3.8%, or $12.24, in 2018.

For more information, see Utility Rates in Section D (Major Revenues) of the budget document.

Capital Improvement Program (CIP)

This section is organized as follows: background information, real estate excise tax (REET) forecast, 2017-2018 project highlights, partially funded and unfunded capital projects, and budget policy issues/changes. For more information, see Section G (Capital Improvement Program) and Section I (Budget Policies) of the budget document.

Background Information

The 2017-2018 Capital Budget represents the appropriated portion of the 2017-2022 Capital Improvement Program (CIP). The CIP continues to be mostly a pay-as-you-go program. Water, sewer, and storm water projects are funded by utility rates. Street and pedestrian/bicycle facility projects are funded by REET, motor vehicle fuel tax, and Transportation Benefit District license fees. Public building, park, and open space projects are funded primarily by REET. Major technology system and public safety equipment costs are funded by General Fund revenues. Finally, fleet and computer replacements are funded by annual replacement charges assessed to each City department, which are ultimately funded by General Fund tax revenues and Water, Sewer, and Storm Water Fund utility rates for the most part.

REET Forecast

The actual (2011-2015) and projected (2016-2022) number of property sales ($5.0 million or less), average sales price, and annual REET revenue are summarized in the following table.

REET	2011 Act	2012 Act	2013 Act	2014 Act	2015 Act	2016 Proj	2017 Proj	2018 Proj	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Number of property sales ($5.0M or less)	367	418	492	493	499	450	450	450	450	450	450	450
Average sales price ($5.0M or less)	$0.92M	$0.90M	$1.05M	$1.12M	$1.18M	$1.28M	$1.33M	$1.38M	$1.44M	$1.50M	$1.56M	$1.62M
REET revenue	$1.83M	$2.16M	$2.61M	$3.27M	$3.27M	$3.55M	$3.17M	$3.28M	$3.41M	$3.54M	$3.67M	$3.81M

For more information, see Real Estate Excise Tax in Section D (Major Revenues) of the budget document.

2017-2018 Project Highlights

The 2017-2018 Capital Budget consists of capital reinvestment projects (CRP), which maintain the City's existing infrastructure, and capital facilities projects (CFP), which enhance or add to the City's existing infrastructure. Approved 2017-2018 CRP and CFP projects total $23.04 million (80% of the total capital budget) and $5.66 million (20% of the total capital budget) respectively.

The following highlighted projects are organized by project category:

- **Parks, Recreation & Open Space**
  - **South Mercer Playfields Park Improvements:** The Islander Middle School synthetic turf will reach the end of its useful life in 2018 ($743,000). Ballfield user fees have been reserved over the life of the field to fund its replacement. See page G-27.
- **Streets & Pedestrian/Bicycle Facilities**
  - **SE 40th Street at 86th Ave SE:** Two projects (West Leg, $914,000, and East Leg, $344,000) are planned to enhance the traffic flow at this intersection near Northwood Elementary School. Traffic volumes indicate the need for additional lanes and curbing to facilitate the safe movement of pedestrians, cyclists, and vehicles. See pages G-50 and G-51.
  - **East Mercer Way Shoulders Phase 10:** This project will continue the addition of roadside shoulders on East Mercer Way from SE 71st to approximately Clarke Beach Park in 2018. One final phase of shoulder work (Phase 11) is anticipated in 2022 to reach the south tip of the Island. See page G-133.
- **General Government**
  - **Self-Contained Breathing Apparatus (SCBA) Replacement:** SCBA equipment ($266,000) includes air tanks, packs, and masks used by firefighters while performing duties that put their life and health in immediate danger. This equipment will reach the end of its useful life in 2018. Annual contributions are made to a sinking fund for the replacement of this equipment. See page G-63.
  - **Maintenance Management System:** This project will replace the existing Maintenance work order system with a fully functional Maintenance Management System ($500,000) in 2017 to support staff in maintaining the City's public infrastructure, including streets, rights of way, parks and open space, three public utilities (water, sewer, and storm water), and public buildings. See page G-74.

- **Water, Sewer & Storm Water Utilities**
    - o **Backyard Sewer System Improvements:** Design is scheduled for 2017 ($25,000), and construction, which may include installation of access points or clean-outs for future maintenance activities, repairs, or rehabilitation of pipe, is planned for 2018 ($175,000). Improvements are also planned for the 2019-2020 and 2021-2022 biennia. See page G-88.
    - o **Sewer System Special Catch Basins:** Special Catch Basins are the City's last line of defense to keep grit and debris from getting into the sewer lake line. Ten new special catch basins ($300,000) will be installed in 2017. See page G-90.
    - o **Storm Water Sub-Basin 6 (Madrona Crest West) Drainage System:** This neighborhood is in need of additional catch basins and piping ($205,000) to collect and convey roadway runoff. This project (2017) is outside the limits of the 2016 Madrona Crest safe routes to school, utilities, and roadway paving project. See page G-107.
    - o **EMW 5400 to 6000 Block Water Main and PRV Stations:** The City will replace the aging 4-inch cast iron water main and install pressure reducing valve (PRV) stations at three individual locations on East Mercer Way to provide adequate water pressure in 2017 ($1.3 million). Design of the project, which has many challenges and complexities, started in 2016. See page G-117.
    - o **Booster Chlorination Station:** One of the Department of Health's (DOH) follow-up items to the 2014 water contamination event is the design of a booster disinfection system at the City's reservoir to help reduce the risk of potential future contamination of the water system. Staff and DOH have determined that construction of this facility ($810,000 in 2017-2018) is needed to ensure that additional chlorine can be added to the City's water system as conditions dictate. See page G-129.

Partially Funded and Unfunded Capital Projects (2017-2022)

Included in the 6 Year Plan (2017-2022)

Sixteen (16) of the projects included in the 2017-2022 CIP are partially funded or unfunded. Receipt of grant funding, contributions from Sound Transit or WSDOT, private contributions, or inclusion in a capital levy are needed for these projects to move forward to construction. The funding status of these projects is summarized in chronological order in the table below, which continues on the following page.

Project Description	Funded 2017-2022	Unfunded 2017-2022	Total Cost 2017-2022	Potential Funding Source for Unfunded Portion
Island Crest Park Improvements (South Field), 2017	$1,200,000	$150,000	$1,350,000	Private contributions
Aubrey Davis Park Regional Multiuse Corridor Plan, 2017	150,000	200,000	350,000	Sound Transit and WSDOT
Community Connectivity Assessment, 2017	-	60,000	60,000	Technology & Equipment Fund (after Council review)
Maintenance Building Addition (Construction), 2018	-	3,900,000	3,900,000	Capital levy and utility rates
Lincoln Landing Storm Water & Park Improvements, 2018	-	650,000	650,000	KC Flood Control District grant
Island Crest Park Improvements (Adventure Play), 2018	-	64,000	64,000	Private contributions

Project Description	Funded 2017-2022	Unfunded 2017-2022	Total Cost 2017-2022	Potential Funding Source for Unfunded Portion
Luther Burbank Shoreline Restoration (Phase 3), 2019	100,000	820,000	920,000	RCO ALEA grant or capital levy
Safe Routes to School (Madrona Crest Phase II), 2019	-	340,000	340,000	Street Fund (based on need)
Safe Routes to School (92nd Ave SE), 2019	-	200,000	200,000	Street Fund (based on need)
Luther Burbank Boiler House Remediation, 2019	-	135,000	135,000	Surplus REET
North Mercer Way Re-channelization at 77th Ave SE, 2019	-	90,000	90,000	Sound Transit and/or WSDOT
Small Parks (Pioneer Park Path Lighting), 2020	-	100,000	100,000	Private contributions
Island Crest Park Improvements (North Outfield), 2021	-	1,550,000	1,550,000	Capital levy
Luther Burbank Shoreline Restoration (Phase 4), 2021	500,000	500,000	1,000,000	RCO ALEA grant or capital levy
Clarke Beach Shoreline Restoration, 2022	-	2,000,000	2,000,000	Capital levy
Aubrey Davis Park Area B Sports Field, 2022	414,000	413,000	827,000	RCO or youth sports grant
Total	**$2,364,000**	**$11,172,000**	**$13,536,000**	

Not Included in the 6 Year Plan (2017-2022)

In addition to the projects listed above, there are a number of significant capital projects that are not included in the 2017-2022 CIP due to a lack of funding. They include the following:

- **Luther Burbank Master Plan Implementation:** Design and construction costs to implement master plan improvements identified in the 2005-2006 planning process were originally estimated at $8.0 million. In November 2008, a $12.0 million parks bond levy, which included master plan elements for Luther Burbank Park, was put to a vote and failed. Two Luther Burbank master plan elements were addressed in 2007-2008 (Shoreline Restoration Phase I and Off-Leash Area) at a cost of $1.25 million. Calkins Point (Shoreline Restoration Phase 2) was completed in 2016 at a cost of $364,000. Other master plan improvements are on hold subject to future available funding.

- **Park Improvements:** Examples of unfunded projects not included in the 2017-2022 CIP include the following: 1) Sports Field Upgrades (synthetic turf and ball field backstops); 2) Groveland Beach Improvements (bulkhead removal, beach re-grading, and restroom/lifeguard office); 3) Recreation Trails (Hollerbach and I-90 Lid connector); and 4) Kids, Families, and Arts Improvements (skate park redevelopment and Kite Hill Gardens at MICEC).

- **Open Space Acquisition (5-6 acres):** This consists of one-time purchases of open space property as opportunities arise. The preferred funding sources are a capital levy lid lift (simple majority voter approval required, 9 year term), Councilmanic bonds (non-voted, 20 year term), or voted bonds (60% voter approval required, 20 year term). When current park bond issues are retired, REET could be freed up to fund the annual debt service on new Councilmanic bonds.

- **Utility Projects:** There is a long list of capital reinvestment projects (substandard water mains, sewer lake line clean-outs, aging sewer pipe, storm water basins, and conveyance pipe), which could be tackled at a faster pace with higher rate increases.

Budget Policy Issues/Changes

There are two significant budget policy issues that are summarized below:

- **CIP-related fund balances**

  Projected fund balances (shown in thousands), excluding working capital and reserves, are presented in the following table for all CIP-related funds.

CIP-Related Fund	2016 Proj	2017 Proj	2018 Proj	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Street Fund	1,979	1,793	867	438	**(48)**	**(107)**	**(596)**
Capital Improvement Fund	1,771	155	240	**(20)**	**(28)**	**(4)**	143
Technology & Equipment Fund	168	123	**(42)**	**(216)**	**(215)**	**(162)**	**(129)**
Water Fund	3,091	2,562	2,576	2,094	1,221	907	**(94)**
Sewer Fund	1,610	1,293	1,479	1,509	1,747	1,538	2,500
Storm Water Fund	2,270	1,739	1,850	1,518	1,040	526	110

The Street Fund is projected to go negative in 2020-2022 primarily due to the following projects:

- o **SE 40th Street at 86th Avenue SE (West and East Legs)**, which is budgeted in 2017-2018 for $1.26 million and which was not on the City's radar until 2014 when the 2015-2020 CIP was developed;
- o **Gallagher Hill Road Sidewalk Improvement**, which is budgeted in 2022 for $465,000 and which represents new, additional infrastructure; and
- o **East Mercer Way Roadside Shoulders (Phase 11)**, which is budgeted in 2022 for $465,000 and which represents new, additional infrastructure.

An increase in the vehicle license fee (Transportation Benefit District funding) from $20 to $30 per vehicle beginning in 2019 would generate $175,000 per year and would erase the projected Street Fund deficits in 2020-2022.

The Capital Improvement Fund is projected to dip modestly and temporarily into reserves in 2019-2021, but a positive fund balance of $142,633 is projected in 2022. Of greater concern is the number of projects that depend on funding from grants that have not been awarded and private contributions that have not been received.

The Technology and Equipment Fund is projected to go negative in 2018-2022 primarily due to the following projects:

- o **Maintenance Management System**, which is budgeted in 2017 for $500,000, with $125,000 coming from the annual interfund transfer from the General Fund and $375,000 coming from the Utility Funds;
- o **Financial System Upgrades**, which is budgeted in 2019 for $98,000;
- o **Mobile Asset Data Collection**, which is budgeted in 2019 for $84,000;

- **Website Refresh/Redesign**, which is budgeted in 2019 for $65,000; and
- **Technology Strategic plan**, which is budgeted in 2020 for $75,000.

The projected deficit in 2018 is modest and could be erased if the Maintenance Management System project costs come in under budget in 2017. The projected deficit in 2019 will require $216,000 in one-time supplemental funding, which will also erase the projected deficits in 2020-2022.

Rates are set for the Water, Sewer, and Storm Water Funds at levels to fund daily operations, routine maintenance, and capital reinvestment planned for 2017-2022. Available fund balances are used in conjunction with new revenues generated from rates and occasional bond proceeds to meet the capital funding needs of each utility. Generally speaking, staff's goal is to identify a "smoothed" rate increase for each utility that will result in a modest available fund balance (i.e. excluding working capital and reserves) at the end of the six-year period. Regarding the Sewer Fund, the projected ending fund balance of $2.5 million in 2022 is intentional, providing partial funding for the planned replacement of Reach 4 of the sewer lake line in 2023 or later.

- **Capital levy lid lift**

  As noted previously, the 2017-2022 CIP includes 16 partially funded and unfunded projects. It is unlikely that the needed grants and/or private contributions will be received for all of these projects. In addition, the Technology and Equipment Fund has a significant funding need in 2019. If the City Council wants to ensure funding for or accelerate the planned pace of these projects, a new revenue source, such as a capital levy lid lift, will be needed.

This concludes the Executive Summary of the 2017-2018 Budget.