

UNDERSTANDING WHY THE CITY
NEEDS TO RAISE REVENUE
MERCER ISLAND
OPERATING BUDGET

INITIATIVE 747

TIM EYMAN PROPERTY TAX REFORM

- Washington Initiative 747 appeared on the ballot in the state of [Washington](#) on November 6, 2001.
- It was an [Initiative to the People](#) sponsored by [Tim Eyman](#), Leo Fagen, Ray Benham, and M.J. Fagan.
- The purpose of Initiative Measure 747 was to limit [property tax](#) revenue increases to 1% per year.
- On November 8, 2007, the [Washington Supreme Court](#) by a 5-4 vote invalidated I-747 in the case of [Washington Citizens Action v. State](#), asserting that the state's voters did not understand the initiative.
- The Washington State Legislature introduced the wording as a law and passed it.

CITIES ARE SERVICE ORGANIZATIONS

EMPLOYEE BENEFITS AND SALARIES

- Cities are not like a store, law firm, or tech company.
- Cities are like airlines, or the NFL where union contracts put constraints on pay, hours, and staffing levels. Reducing city full time employee counts can increase costs when vacation, maternity, and sick leave force the city to pay overtime rates to staff at legally mandated levels.
- City employees do not earn equities like stocks, RSUs, or stock options. The recent rise in stock market value has no impact on a city employee's total compensation. Annual pay increases (often tied to inflation) are their hedge against inflation.

INFLATION

AN UNUSUAL PERIOD IN US HISTORY

- Since 2001 the annual rate of inflation in the US has been about 2.04% per year.
- In the 1990s inflation was at 2.73% per year.
- In the 1980s inflation was at 4.65% per year.
- In the 1970s inflation was at 7.21% per year.
- A normal rate of inflation for the US is about 3.6% per year. Initiative 747 allows state revenue to increase automatically with inflation, but not city property tax revenue.
- This national rate of inflation does not reflect the local rates, or the cost of employee benefits — especially healthcare benefits.

HEALTHCARE INFLATION

EMPLOYEE BENEFIT COSTS RISE FASTER THAN INFLATION

- Since 2012, the cost of providing benefits (like healthcare) to employees has grown nationally at a rate of 3%.
- The rate in 2011 (pre-Obamacare) was 6.1%.
- With the dismantling of Obamacare, the benefits costs rose about 4.3% in 2017 and are expected to rise 5.5% in 2018.

CROSSING THE REVENUE LINE

INFLATION VS INITIATIVE 747

- City revenue grows at about 2% a year because property tax revenue grows at 1% a year (747) and other taxes and fees grow at about 1% a year.
- City expenses grow at about 6% a year because benefits grow at about 4% and inflation related salary increases have been about 2% a year.
- Since 2001 the city, by being frugal and lucky, has been able to stay out of debt. This has occasionally required the city to ask for a "levy lid lift" to increase the amount of revenue from property taxes. Remember that 747 limits revenue dollars, which forces down property tax rates.
- Thanks to Initiative 747 and Inflation it is time to again vote on a levy lid lift.

WHAT ABOUT MCCLEARY?

SCHOOL DISTRICT FUNDING

- The McCleary Fix increases property tax rates in the State of Washington by 0.082%
- The median household on Mercer Island is assessed at about \$1.1MM so the increase in property taxes due to McCleary is \$902 (or about \$2.50 a day).
- None of this money benefits the City of Mercer Island Operating budget.
- The Mercer Island School District budget is not part of the City Operating Budget.

WHAT ABOUT SOUND TRANSIT 3?

LIGHT RAIL AND TRANSIT FUNDING

- In 2016, the region's voters approved the Sound Transit 3 (ST3) ballot measure (54%). This 25-year program will expand the mass transit network to connect 16 cities with light rail, 30 cities with Bus Rapid Transit and ST Express bus service and 12 cities with commuter rail.
- Car tab fees increased from 0.3% to 1.1%. The annual fees for an average car worth \$25,500 is now \$280.50. For a 2012 Tesla Model 3 (~\$50k) the car tabs are \$550.
- Sales taxes increased 140 points to 10%
- Property Taxes on homes increased 0.025%, or about \$275 a year for a \$1.1MM median priced Mercer Island home.

PROPERTY TAXES ON A \$1.2MM HOME

11.6% OF PROPERTY TAXES GOES TO CITY

Taxing Jurisdiction	2017 Levy Rate	2017 Levy Amount	% of Levy
School District	\$2.30117	\$2,733	26.5%
State School Fund	\$2.91820	\$3,516	33.7%
King County	\$1.32735	\$1,599	15.3%
City of Mercer Island	\$1.00313	\$1,209	11.6%
Library	\$0.41190	\$496	4.8%
EMS	\$0.23940	\$288	2.8%
Sound Transit	\$0.22745	\$274	2.6%
Port	\$0.13515	\$163	1.6%
Flood Zone	\$0.10708	\$129	1.2%
Total	\$8.67086	\$10,448	100.0%

IS THE CITY WASTING MONEY?

WHAT THE CAG LEARNED ABOUT FRUGALITY

- The city provided an enormous amount of data about their budget, financing, and projections. All of this data is available on mercergov.org and was reviewed by the entire CAG.
- Managers of all city departments met with the CAG and took questions. They were asked what they would cut if required to meet a 5%, 10% budget reduction.
- The majority of CAG members agreed that the city is well managed and the staff is acting in a responsible and professional manner. There was no evidence of systematic or wide-spread waste.
- The city council is constantly pressed by constituents to be frugal and avoid raising ANY taxes.

THE CAG RECOMMENDATION

HOW TO RAISE REVENUE

- The only lever the city has, like most cities, is a levy lid lift. The majority of the CAG discussion focused on what additional means there are to reduce the overall increase in property tax revenue. The levy lid lift cannot be avoided.
- Real Estate Excise Tax increases to match neighboring cities. Only impacts citizens when they sell their homes. Would cover XX% of the shortfall.
- Business and Occupancy Tax can be increased to match neighboring cities. Does not impact small businesses with revenue less than \$120k. Would cover XX% of the shortfall.
- Utility Tax levels can be retained beyond the planned expiration. This keeps them in-line with neighboring cities and encourages behavior that benefits the environment. Would cover XX% of the shortfall after 2020.
- One time restructuring of city budget reserve accounts. This only helps the 2019 budget, but appears to be a reasonable change that does not endanger the city.

TIMING

- The one-time movement of money between accounts can be executed by the City Council immediately.
- REET & B&O taxes can be increased this year by the City Council. The sooner they do this the better.
- Levy Lid Lift will require a vote of the people in November and would take effect in January 2019.
- The benefits of retaining the Utility Tax would not be realized until the lawsuit over I-90 is paid off.

CAG EXPECTATIONS FOR THE LEVY LIFT

LEAST POSSIBLE LIFT

- The city can choose to only take a portion of the voter approved lift in property tax revenue, and bank the rest for later.
- The CAG expects the city to remain frugal and well managed.
- As a responsible city council, we expect our elected officials to only increase property taxes to the extent required, and bank the remaining in the event of a major expense or emergency.
- The city will educate citizens about options for property tax relief from the county to reduce the tax burden on fixed income households.

BACKUP SLIDES

OUT OF BOUNDS TOPICS

TOPICS DISCUSSED BUT TABLED

- King Country Library System - Leaving the KCLS would save the city some money and drastically reduce the resources available through the library.
- Regional Fire Authority - Being able to move resources and people across city lines would reduce over-time and gain efficiencies, but other cities need to agree and it would result in a new tax authority and loss of local control. City has already begun working on this possibility.
- Business Development - Long term and would go against the recent moves to restrict building heights, etc.
- School District Frugality - The school district is not part of city financing or under city control.
- Increasing taxes beyond current levels to improve and expand city services.
- I-90 Legal Settlement - required to be spent on mitigation of i-90 impact.

WHY NOT RAISE SALES TAX?

- City receives 1/10th of the revenue from sales tax. The rest goes to voter approved funds largely controlled by the county.
- To meet city revenue funding needs every household on Mercer Island would need to increase their on-island spending by \$88k per year.
- The policy of the majority of the city council in recent years has been to restrict the growth of buildings and discourage big box retailers like Costco from moving to Mercer Island.
- How could you spend \$88k more than you are currently spending at the stores and service providers already on the island.
- Amazon pays sales tax just like a Mercer Island store.

I HEARD THAT...

DATA VS RUMORS

- The data about the city budget, how it raises money, and everything provided to the CAG is available on mercergov.org.
- Many of the misconceptions raised during the CAG process were due to a misunderstanding of the legal and contractual (unions) restrictions and requirements on city financing.
- The city is required to maintain a reserve, and during a time of economic growth it would be unwise to spend it. The existence of hedges against the next recession is evidence of the city being responsible.