



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

AB 5448
July 10, 2018
Regular Business

CITY'S FINANCIAL CHALLENGES: CONTINUED DISCUSSION AND REVIEW OF CITY'S FORECASTING MODEL	Action: Continue discussion of the City's financial challenges and provide staff with direction to address the City's projected budget deficits	<input checked="" type="checkbox"/> Discussion Only <input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
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DEPARTMENT OF	City Manager (Julie Underwood)
COUNCIL LIAISON	n/a
EXHIBITS	1. Levy Lid Lift Options: - School Based & Community Based Counseling Option - Community Safety Net Option 2. Management Partners Presentation
2018-2019 CITY COUNCIL GOAL	2. Maintain QofL/Essential Services
APPROVED BY CITY MANAGER	

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

SUMMARY

BACKGROUND

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

To exceed the 1% property tax limit, voters must approve a "levy lid lift" by a simple majority.

The City develops and maintains a six-year financial forecast that estimates resources and expenditures. This forecast and future-oriented lens provides the City's decision-makers with insight into whether the current mix and level of resources are likely to continue to be sufficient to cover the cost of maintaining current service levels. The City's current General Fund and Youth & Family Services Fund financial forecasts project budget gaps, with costs to maintain existing services exceeding revenues by \$1.95 million in 2019, increasing \$1.19 million per year, on average, to \$7.89 million in 2024.

2019-2024 Projected Operating Deficits

Operating Fund	2019	2020	2021	2022	2023	2024
General Fund	-\$1.75M	-\$2.95M	-\$4.46M	-\$5.35M	-\$6.43M	-\$7.55M
YFS Fund	-0.20M	-0.23M	-0.26M	-0.27M	-0.30M	-0.34M
Total	-\$1.95M	-\$3.18M	-\$4.72M	-\$5.62M	-\$6.73M	-\$7.89M

Please note: The General Fund forecast above assumes the following:

- No 1% property tax increase
- Temporary utility tax increase expires December 31, 2018.
- No change in the B&O tax rate, which is 0.10%
- Beautification Fund is not combined with General Fund

The Council previously discussed the City's financial challenges on May 15 ([AB 5422](#)), June 5 ([AB 5440](#)), June 9 ([Council's Mini-Planning Session](#)), and June 19 ([AB 5445](#)). Tuesday's presentation is a continuation of the Council's financial challenges discussion and a review of the City's forecasting model by an outside consultant, Management Partners.

REVIEW OF THE CITY'S FORECASTING MODEL

Providing a review of the City's forecasting model and recommendations is Steve Toler of Management Partners, who has 20 years in local government experience working for the cities of Cupertino, Foster City and Millbrae, California. He has served in management positions ranging from assistant city manager to information technology manager. Steve's relevant experience includes budgeting and revenue forecasting, financial management and reporting, water and wastewater rate modeling, and regional shared services planning. Steve lives in Eugene, Oregon, and serves clients in the Pacific Northwest and in California.

Management Partners' scope of work included reviewing the draft six-year financial forecast prepared by the City, the data used in preparing the financial forecast, and the following:

- Revenue assumptions for the City's significant revenue sources, including property tax, utility tax, sales tax, real estate excise tax, business and occupation tax, licenses and permits, recreation programs, and emergency medical support (EMS) services.
- Expenditure assumptions for the City's significant expenditure categories, including salaries and benefits, contractual services, equipment rental and intergovernmental charges, interfund transfer requirements, and the funding status of pension and other post-employment benefit obligations.
- Fund balance/reserve analyses and amounts restricted or assigned for specific purposes in accordance with City Council policy and/or generally accepted governmental accounting standards.
- Economic assumptions used in preparing the six-year financial forecast, including revenue growth trends, compensation and benefits increases (especially medical and pension projections), historical and future projected recessionary impacts, development activity, and regional economic environmental assumptions.

Additionally, Management Partners also reviewed the City's six-year Capital Improvement Program and evaluated whether there were any current and future underfunded or unfunded capital improvement needs that may require additional fiscal resources from the General Fund.

The scope of work also included identifying any significant historical trends that may inform the forecast of revenues and expenditures and determining if the forecast incorporates a comprehensive set of assumptions affecting the financial capacity of the General Fund. This analysis will provide a sound basis for understanding the City’s financial ability to fund services during the next six years.

Finally, they will prepare a slide deck of their analyses and recommendations for improving the financial forecast and present their observations and recommendations to the City Council on Tuesday evening (see Exhibit 2). ~~As of the writing of this agenda bill, the consultant’s report was not yet available it is expected by Monday, July 9 at the latest. Once received, this agenda bill will be updated.~~

COUNCIL INFORMATION REQUESTS

At the Council’s June 19 meeting, the Council requested that staff provide two levy lid lift scenarios for their consideration:

1. School-based and community-based counseling levy lid lift, and
2. Community safety net levy lid lift.

Each levy lid lift scenario has a 6-year and 4-year option. Per Council direction, it is assumed that the Mercer Island School District would cease paying the City for the following beginning in 2019:

- \$60,000 per year for school counseling services, and
- \$26,000 per year for School Resource Officer.

Exhibit 1 provides levy lid lift components and projected net costs for each levy option.

Additionally, each scenario includes a remodel and expansion of the Thrift Store option. Excluding the Thrift Shop project, these scenarios are pegged to projected cost increases ranging from 4.2% to 4.6%, rather than tied to the projected CPI-W, as another point of comparison.

Other considerations include when the City’s two current levy lid lifts are set to expire, when a potential 2018 levy lid lift would expire, and the timing of the School District’s M&O levies (see table below).

	2018	2019	2020	2021	2022	2023	2024
City Levy	<i>Proposed YFS or Community Safety Net Levy</i>			<i>Fire Station & Apparatus Levy sunsets</i>		<i>Parks M&O Levy sunsets</i>	<i>Proposed YFS or Community Safety Net Levy sunsets</i>
School District Levy	<i>M&O levy renewal</i>				<i>M&O levy renewal</i>		

BUDGET BALANCING OPTIONS

The Council is required to adopt a balanced budget. Three alternatives for balancing the budget are summarized below:

1. Revenue Enhancements

Over the next six years, to maintain existing service levels, the City must bridge an approximately 25% gap. The City Manager has recommended a levy lid lift, which was presented at the Council’s June 19 meeting ([AB 5445](#)). Additionally, other revenue enhancements are recommended, including:

- Taking the 1% optional increase in the property tax levy (would generate \$122,000 in ongoing revenue in 2019);

- Increasing the Business & Occupation (B&O) tax from 0.10% to 0.15% (would generate \$325,000 in ongoing revenue in 2019);
- Maintaining the utility tax rate at 8.0% (would generate \$500,000 in ongoing revenue in 2019);
- Consolidating the Beautification Fund into the General Fund (would free up \$225,000 in net ongoing revenue in 2019); and
- Eliminating the 1.7% water utility tax transfer to the Water Fund (would generate \$158,000 in ongoing revenue in 2019).

At the Council's June 9 Mini-Planning Session, the Council provided direction to staff to use some of the following fund balances or reserves as a temporary bridge for the next biennium budget (2019-2020):

- 2016 General Fund surplus (currently parked in the Contingency Fund)
- Beautification Fund
- Compensated Absences Reserve
- Revenue Stabilization Reserve

As staff has noted, these monies are one-time resources, and it is a sign of fiscal stress to use these funds for ongoing operations. Moreover, having sufficient fund balances or reserves can assist in addressing unforeseen expenses as illustrated with real examples: I-90 tolling lobbying efforts, Sound Transit litigation, and Island Crest Park ballfield improvements, just to name a few. In addition, they are a very important factor in maintaining the City's triple-A credit rating.

2. Expenditure Controls – Level of Service Reductions

While not an ideal option, especially given that in the most recent community survey 65% of the respondents believed the City was providing about the right amount of services (this goes up to approximately 80% when excluding the "don't know" responses), staff believes that it is not possible to reduce expenditures without impacting services; some of these services were noted in ([AB 5445](#)). Staff will be prepared to provide concrete examples during Tuesday's discussion.

3. Service Delivery Model Changes

Another option, which was discussed during the Community Advisory Group (CAG) process, is evaluating other models for delivering services. In general, there was not a majority of the CAG who supported this option, as well as some members believed that there was not enough information to provide an informed recommendation. To begin this review, staff recommends evaluating whether any one or more of the following three services could be delivered using an alternative service delivery model (e.g., contracting, regional shared services, etc.):

- Community-based counseling services
- Fire and emergency medical response
- Municipal court services

Council and staff would need to set aside sufficient time and funding to fully evaluate the costs and benefits of these potential changes. An outside consultant would be helpful in evaluating the first two services, the cost of which would likely be \$50,000-\$75,000. It is estimated that such a review would take 12-24 months, including outreach and communications to those potentially impacted. In addition, some of these services would be dependent on negotiating with bargaining groups and/or the outside agency providing the service. Staff would recommend a request for proposals (RFP) process to select a consultant, which also adds time to the process. In other words, these budget balancing options cannot be done before the next biennium budget needs to be adopted. This work would need to span over the coming biennium.

CONCLUSION

To meet election requirement deadlines (previously outlined in AB 5445), Council must decide on July 10 if a levy lid lift will be placed on the November 2018 ballot. If Council would like to consider a levy lid lift ballot measure, staff will draft an ordinance for Council's review on July 17.

In addition, Council must hold a public hearing on July 17. For planning purposes and to meet publication deadlines, staff has already advertised the public hearing in the Mercer Island Reporter. If a levy lid lift is not supported; however, staff will cancel the public hearing.

The City's portion of the property tax bill is about 12%. As a predominantly residential community, the City is heavily reliant on property taxes, which is the single largest revenue source for the City. Expenses are increasing beyond the 1% property tax limitation, and forecasts project budget gaps of \$1.95 million in 2019, increasing to \$7.89 million in 2024. Without additional revenue, the community's exceptional quality of life will become increasingly difficult to sustain.

RECOMMENDATION

City Manager

Receive recommendation, discuss, and provide staff direction.

**Community Safety Net Levy Lid Lift Option
Per Council Direction at 6/19/18 Meeting**

Levy Lid Lift Cost Components	2018		Less 2018		2018	
	Budget	Revenue	Revenue	Net Budget	Budget	Net Budget
Youth & Family Services	\$1,266,110	\$242,000	\$1,024,110			
Police	345,592	25,565	320,027			
Parks & Recreation	218,634	78,000	140,634			
Intergovernmental Human Services	7,500	-	7,500			
Total	\$1,837,836	\$345,565	\$1,492,271			

Projected Net Costs	2019		2020		2021		2022		2023		2024	
	Youth & Family Services	\$1,134,754	\$1,187,425	\$1,242,202	\$1,299,170	\$1,358,416	\$1,420,033					
Police	359,416	373,792	388,744	404,294	420,466	437,284						
Parks & Recreation	149,379	158,475	167,934	177,771	188,002	198,642						
Intergovernmental Human Services	7,500	7,500	7,500	7,500	7,500	7,500						
Total net cost	\$1,651,049	\$1,727,191	\$1,806,379	\$1,888,734	\$1,974,384	\$2,063,459						
Annual % increase	N/A	4.6%	4.6%	4.6%	4.5%	4.5%						

6 Year Levy Lid Lift Cost (\$1.20M AV Home)

	2019	2020	2021	2022	2023	2024
Excluding Thrift Shop project (4.6%/yr avg growth)	\$149.59	\$156.49	\$163.66	\$171.13	\$178.89	\$186.96
Thrift Shop project (\$2.75M, 6 year term, 2.9% TIC)	\$46.12	\$46.12	\$46.12	\$46.12	\$46.12	\$46.12
Including Thrift Shop project (3.6%/yr avg growth)	\$195.71	\$202.61	\$209.78	\$217.24	\$225.00	\$233.07

4 Year Levy Lid Lift Cost (\$1.20M AV Home)

	2019	2020	2021	2022
Excluding Thrift Shop project (4.6%/yr avg growth)	\$149.59	\$156.49	\$163.66	\$171.13
Thrift Shop project (\$2.75M, 4 year term, 2.8% TIC)	\$67.05	\$67.05	\$67.05	\$67.05
Including Thrift Shop project (3.2%/yr avg growth)	\$216.64	\$223.54	\$230.71	\$238.17

Mercer Island General Fund Financial Forecast Review for FY 2019 to 2024

July 10, 2018

Presented by

Steve Toler, Senior Manager

Management
Partners



About Management Partners

We are experts at process mapping and business practice improvement

24
years

of service exclusively to local governments

**Over
1,500**
projects

successfully completed in 42 states

80+
associates

including generalists and subject-matter experts in
finance, IT public works and other areas

3
national
offices

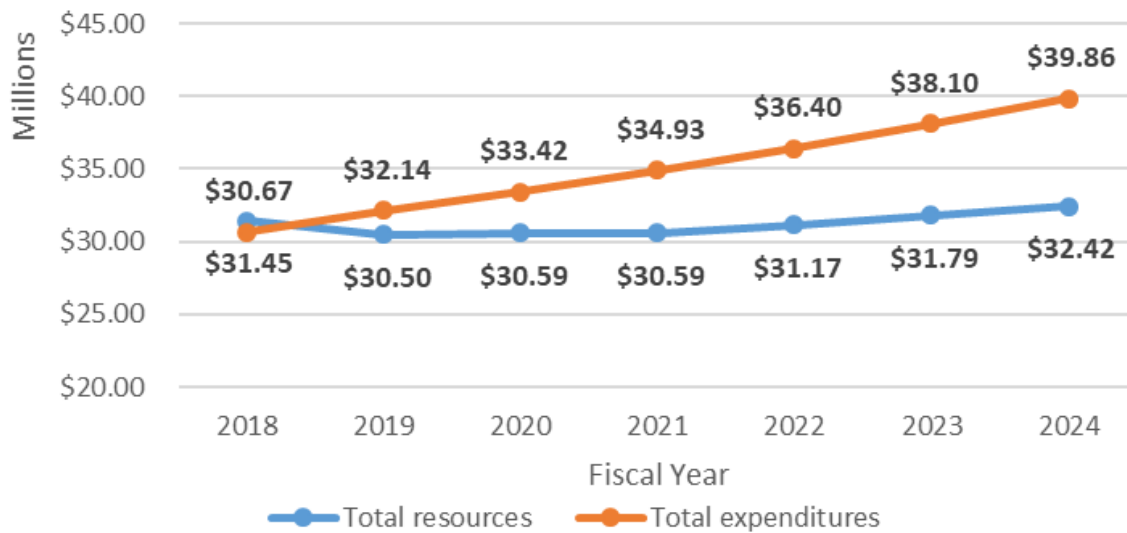
in San Jose and Costa Mesa, CA and
Cincinnati, OH

Services

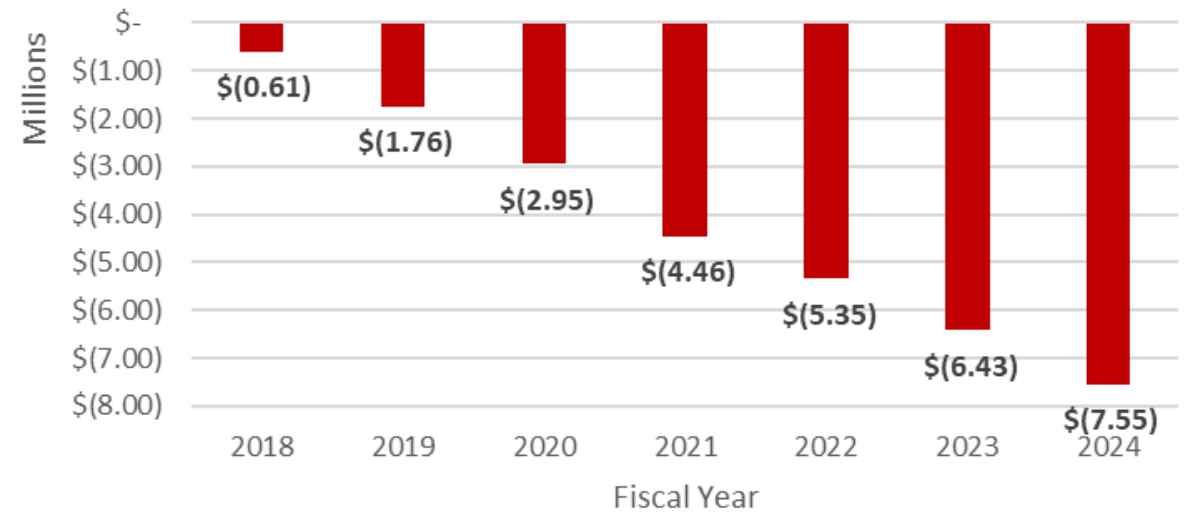
- Financial Planning/Budgeting
- Process Improvement
- Operations Improvement
- Strategic Planning
- Service Sharing
- Organization Analysis
- Organization Development
- Performance Management
- Facilitation and Training
- Executive Recruitment
- Executive Coaching

Current Financial Forecast for FY 2019-2024

Current General Fund Forecast
Total Resources and Expenditures



Current General Fund Forecast
Annual surplus (deficit)



- Forecast indicates growing structural deficit
- Forecast **includes** a beginning balance of \$1.2 million in available reserves

Summary of Key Assumptions

- **General**

- CPI will be 3.5% in FY 2019-20, tapering down to 3% thereafter
- No specific assumption regarding potential future recessions
- Maintain service levels

- **Revenues**

- Significant development activity in fiscal years 2015 through 2018 considered outside of normal; activity reduced to pre-recession historic levels (impacting sales and property taxes)
- No growth in property taxes other than new construction-related growth
- Modest baseline revenue growth in sales and utility taxes
- Modest growth in other revenue sources

Summary of Key Assumptions

- **Expenditures**

- Existing provisions in labor contracts used as basis for future salary/benefits growth
- Cost-of-living adjustments based on CPI maintained as placeholder for growth in salaries
- Salary market adjustment policy would continue
- Salary savings resulting from staff turnover are assumed to be used for unplanned overtime and/or payout of compensated absences
- Medical costs to rise at 6% per year
- Growth in other expenditures based on CPI projections

- **Other**

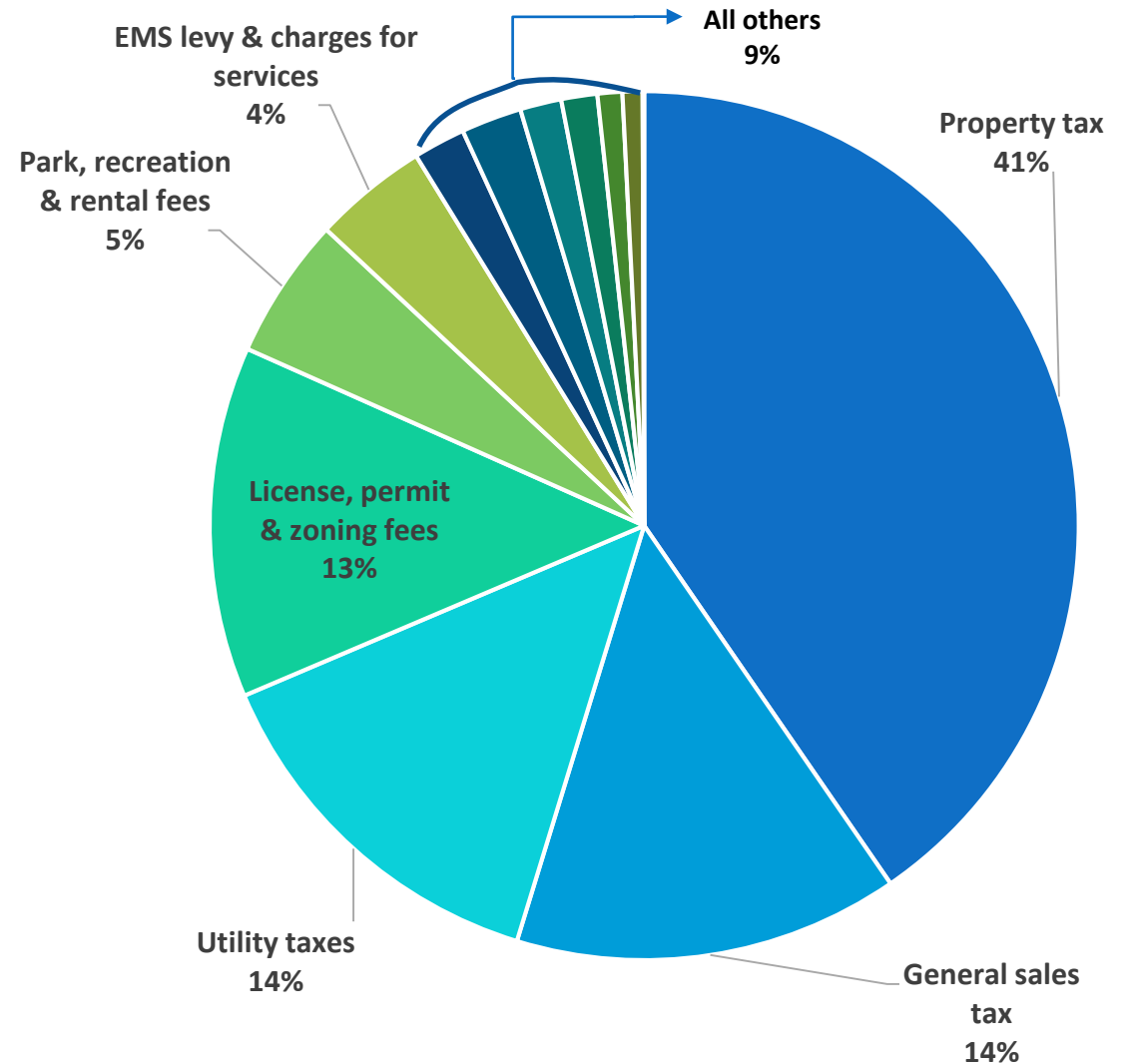
- Fund structure will remain the same based on prior Council policy (e.g., Youth and Family Services and Beautification funds retained as separate funds)

Summary of Initial Observations

- City's baseline forecast provides a reasonable basis to identify the future financial trends and to support Council and staff in policy decisions
- Strong likelihood of modest recession in six-year forecast based on historic trends that is not incorporated into baseline forecast
- General Fund reserves do not identify funds under minimum reserve policy as available
- Annual structural deficit grows to \$7.5 million in 2024 due to largest tax revenue sources (property, sales and utility users taxes) not keeping pace with projected increases in providing services

General Fund Revenues

- Total projected revenues for FY 2018: \$30,189,569
- Property, sales and utility taxes combined total 69% of General Fund revenues
- Top four revenue categories comprise 82% of General Fund revenues
- Our analysis primarily focused on these top four categories



Property Taxes

- Single largest General Fund revenue source
- Regular levy – ongoing as allowed per state law
 - Generates \$11.45 million per year
 - Growth limited to lesser of Implicit Price Deflator or 1%
 - ***Growth of 1% assumed in forecast***
- Excess levies – two existing levies sunset during the six-year forecast
 - 2008 Parks M&O – \$694,000 in FY 2018 to fund parks maintenance and operations; sunsets in 2023
 - 2012 Fire Station and Fire Rescue Truck – \$252,000 and \$52,000 in FY 2018 to fund debt service and future truck replacement, respectively; sunsets in 2021
 - ***Baseline forecast assumes the 2008 Parks M&O levy would be renewed after sunset period***
- **Recommendation:** indicate 2008 Parks M&O Levy as expiring after 2023

Real Estate Excise Tax (REET)

- REET 1 (RCW 82.46.015)
 - Limited to 0.25% of selling price of property
 - Restricted to **capital projects** listed in City's comprehensive plan
 - Use for operations/maintenance costs was allowed from July 2011 to December 2016 during Recession
- REET 2 (RCW 82.465.035)
 - Limited to 0.25% of selling price of property
 - Restricted to **capital projects** required under Growth Management Act
 - Use for operations/maintenance costs was allowed from July 2012 to December 2016 during Recession

Capital Projects definition under REET 1

- Uses - planning, acquisition, construction, reconstruction, repair, replacement, rehabilitation, or improvement
- Project Types - streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks; recreational facilities; law enforcement facilities; fire protection facilities; trails; libraries; administrative facilities; judicial facilities

Capital Projects definition under REET 2

- Uses - planning, acquisition (except parks), construction, reconstruction, repair, replacement (except parks), rehabilitation, or improvement
- Project Types - streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks

Real Estate Excise Tax (REET)

- Can it be used to fund operations and maintenance?
 - No, not without legislative changes to Revenue Code (e.g., allowance during Recession)
 - Exception: maintenance that extends useful life of asset would be allowed
- Are any General Fund costs eligible to be expended out of REET funds?
 - No. Based on our review, all General Fund costs are related to operations and maintenance, or do not otherwise meet definition of “capital projects” under the legislation

Capital Projects definition under REET 1

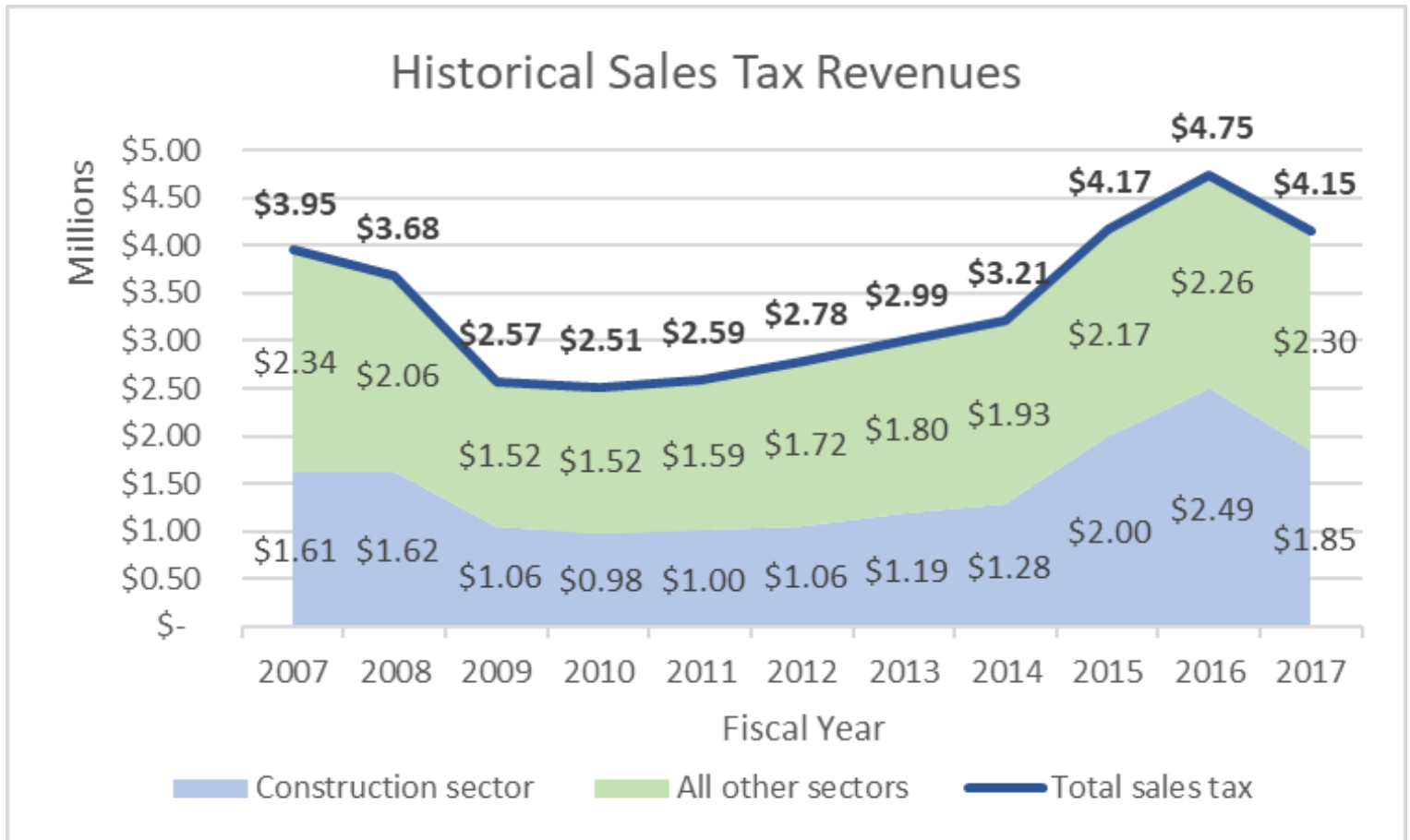
- Uses - planning, acquisition, construction, reconstruction, repair, replacement, rehabilitation, or improvement
- Project Types - streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks; recreational facilities; law enforcement facilities; fire protection facilities; trails; libraries; administrative facilities; judicial facilities

Capital Projects definition under REET 2

- Uses - planning, acquisition (except parks), construction, reconstruction, repair, replacement (except parks), rehabilitation, or improvement
- Project Types - streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks

Sales Taxes

- Two sources
 - Tax on value of construction
 - Sale of consumer goods (“all other sectors”)
- Volatile revenue source
- Sensitive to economic environment

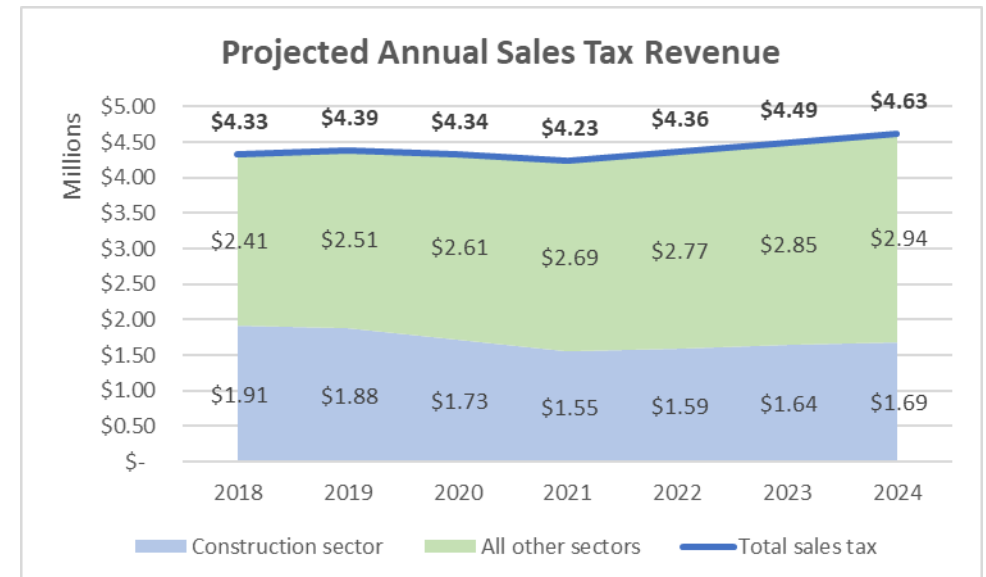


Sales Taxes

- Mercer Island portion of sales taxes is 0.85%
- Growth projections
 - Construction
 - Sales taxes on value of construction assumed to decline to pre-recession levels by 2021
 - Modest growth of 3% thereafter
 - Other sales tax
 - Sectors are combined for a composite growth factor of 4% per year through 2020, 3% per year thereafter
- **Recommendation:** no changes, but incorporate assumption for recession starting in 2021

Sales Tax Rate in Mercer Island

Jurisdiction	Rate %
State of Washington	6.50%
King County	1.15%
Regional Transit	0.90%
City of Mercer Island	0.85%
Criminal Justice	0.10%
Total General Sales Tax	9.50%
Auto Sales/Leases	0.30%
Total Auto Sales/Leases Rate	9.80%



Utility Taxes

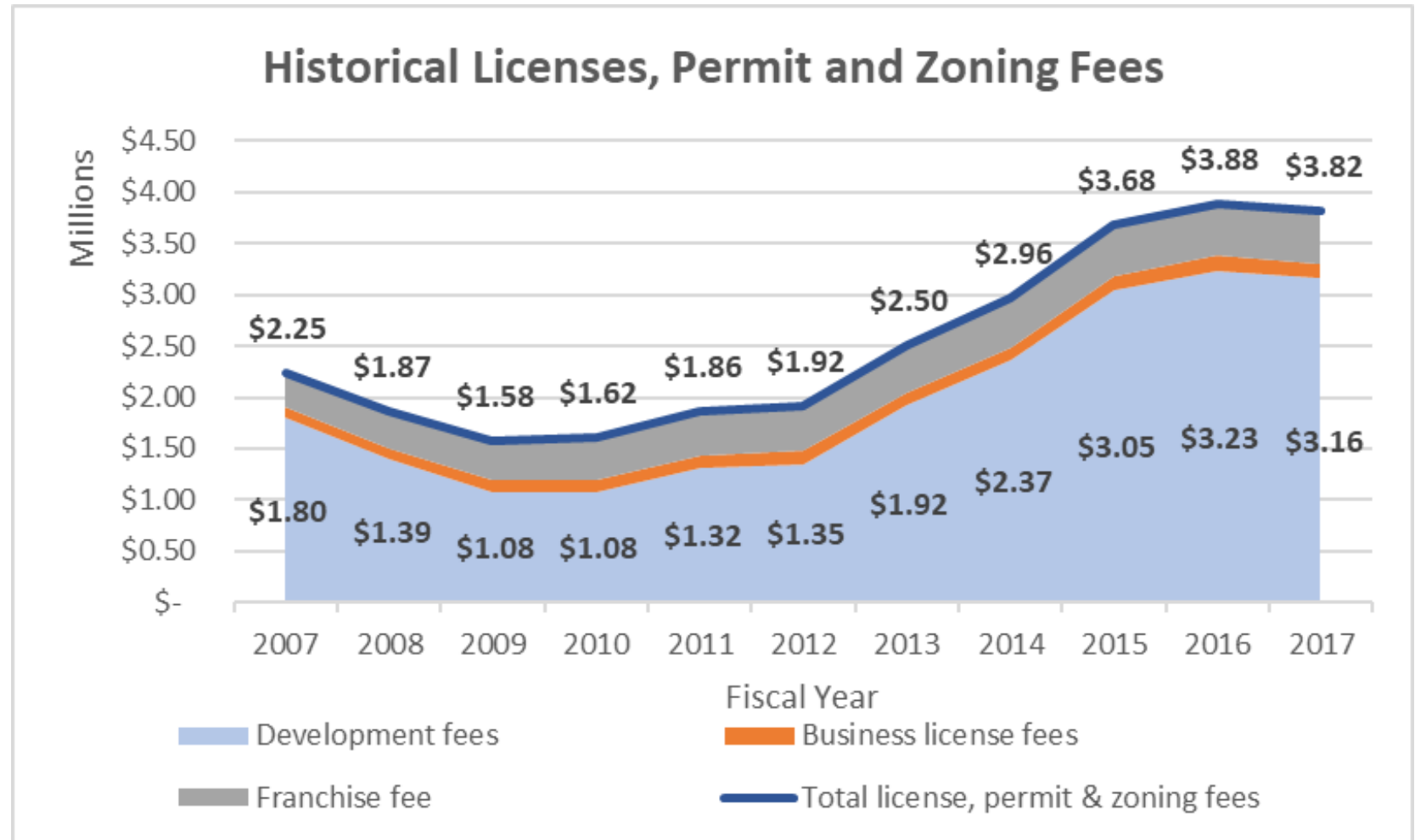
- Utility users tax levied on utilities operating in the City
- Generates nearly \$4.4 million annual General Fund revenue
- Trends and Projected Changes
 - Electric/gas – rate increases offset by consumption reduction due to solar and energy efficiency upgrades
 - Water/Sewer/Storm – rate will be reduced from 8% to 5.3% based on City Council action (MIMC 4.12.030)
 - Garbage – change in recycling acceptance will likely cause increases in garbage rates in 2019 and anticipated new solid waste franchise agreement
 - Cable TV, Cellular, Telephony – reduced revenues as consumers find alternative providers at lower cost and/or not regulated by City (e.g., price competition among cellular providers; homes eliminating land-based phone services; satellite TV providers; streaming video services)

Utility Taxes

Source	Current Baseline Forecast	Proposed Changes to Baseline Forecast
Electric/gas	No growth	No changes; rate increases offset by reduced consumption
Water, sewer, storm	7.5% growth rate based on projected City utility increases	No change
Cable TV	3% decline per year	3% decline through 2021; assume stabilized revenues and no further growth thereafter
Cellular	10% decline per year	10% decline through 2021; assume stabilized revenues and no further growth thereafter
Garbage	4% in 2019; 9% in 2020 based on likely new franchise agreement and increased revenues required for reduced recycling; 3% thereafter	No changes
Long distance	Flat in 2019; 1% decline in 2020 increasing to 5% decline by 2024	No changes
Telephone	8% decline per year	No changes

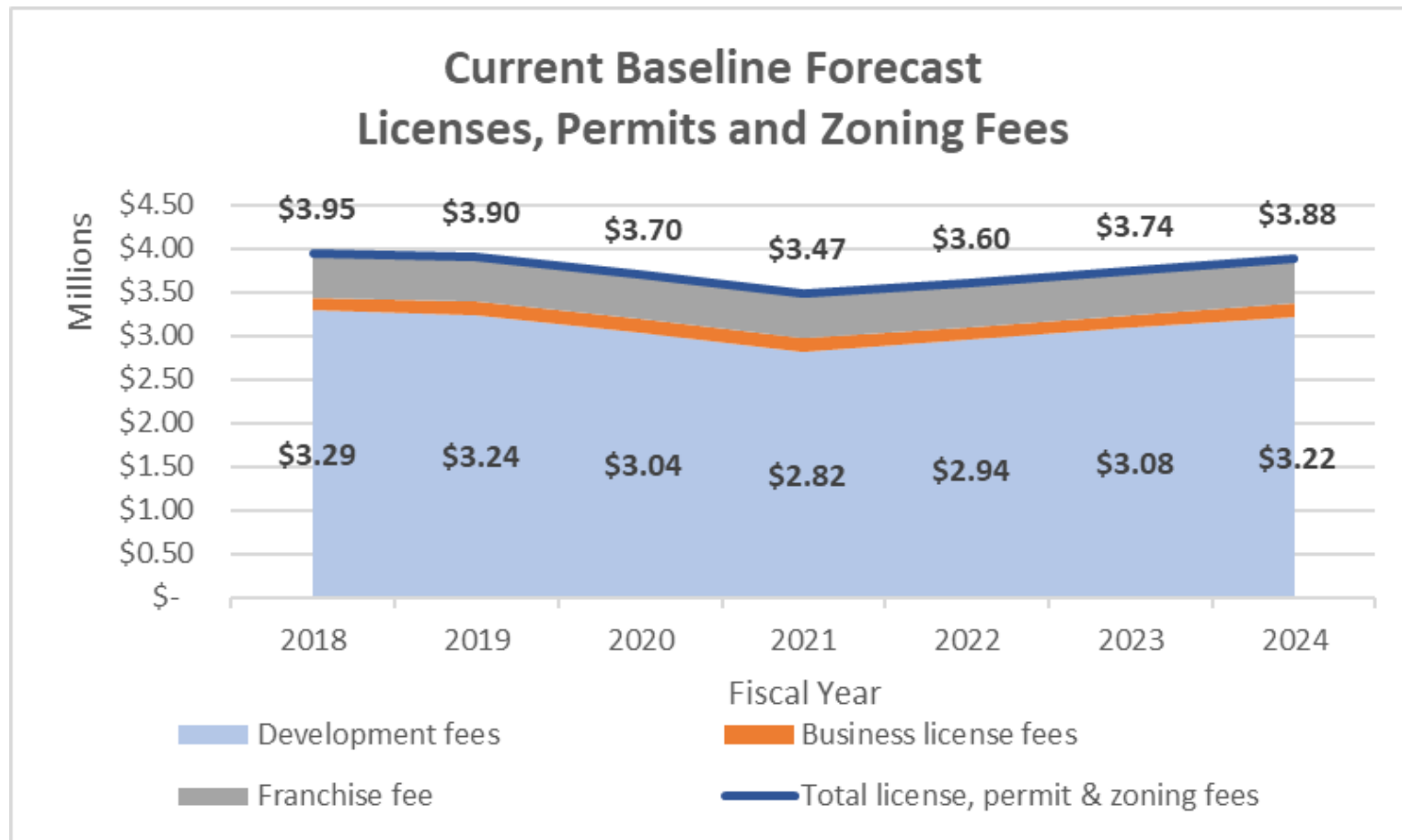
Licenses, Permits and Fees

- Development fees are most sensitive to economic trends
- No breakout of significant/one-time versus recurring revenue sources



Licenses, Permits and Fees

- Development fees are largest source in this group
- Best practice is to break out development for significant projects versus recurring permit revenues

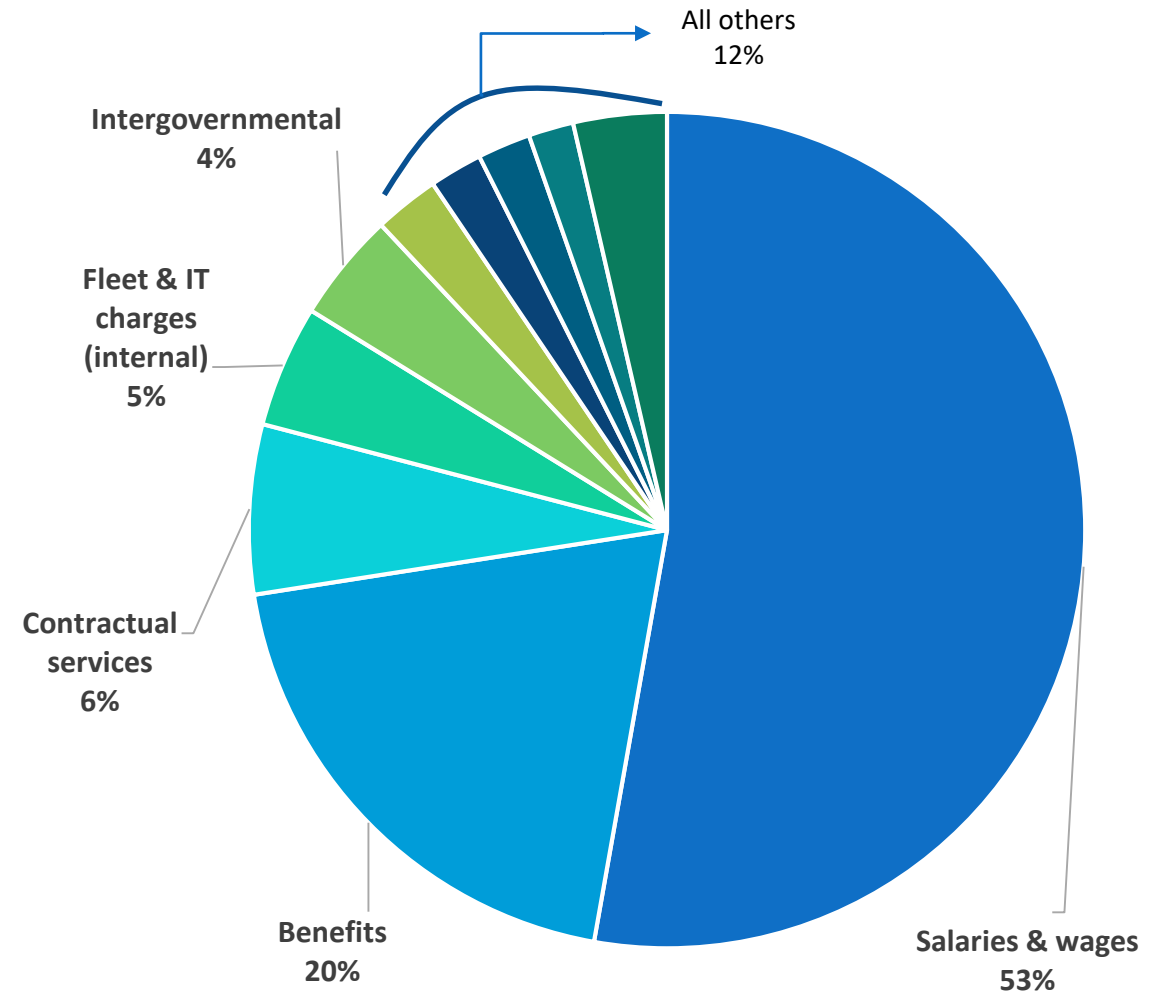


Licenses, Permits and Fees

Source	Current Baseline Forecast	Proposed Changes to Baseline Forecast
Development fees	Revenues expected to drop by \$905,000 over three years in 2019, 2020 and 2021 to return to 2015 levels; future increases based on cost of service delivery	No changes to baseline forecast; consider isolating development fees and associated development services group expenditures as a separate fund within the General Fund to match revenues and expenditures related to development services
Business license fees	No growth	3% growth consistent with CPI as business license tax is based on gross receipts
Franchise fees	No growth	No changes; overall consistent with approach on utility user taxes
Recessionary Impact	N/A	Incorporate a 5% reduction in revenues beyond forecast due to modest recession in 2021, with revenues recovering within three years

General Fund Expenditures (2018)

- Total operating budget for FY 2018: \$30,672,280
- Salaries and wages comprise 73% of General Fund expenditures
- Top five expenditure categories comprise 88% of General Fund expenditures
- Our analysis primarily focused on these top five categories

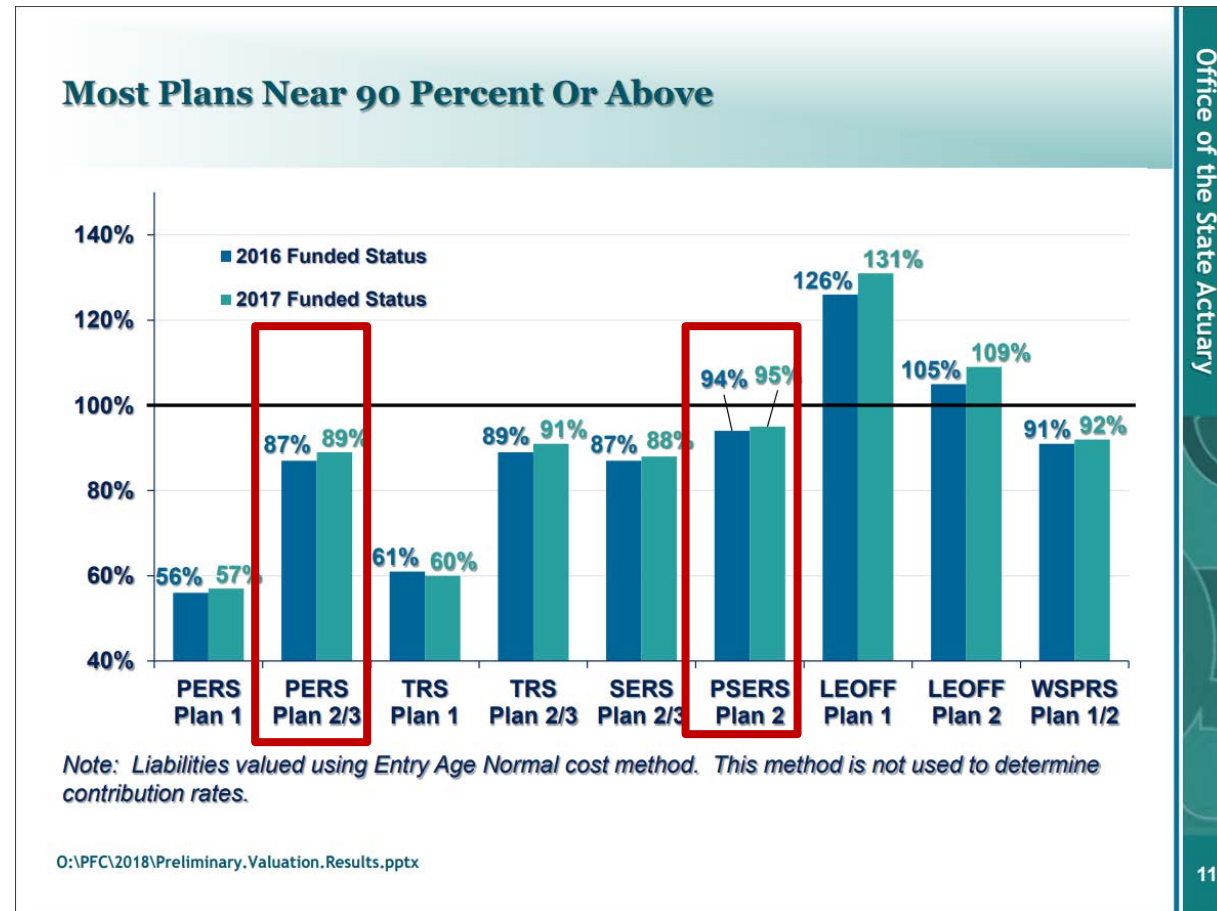


Salaries and Benefits

	Current Baseline Forecast	Proposed Changes to Baseline Forecast
Salaries	Salaries are projected based on detailed analysis by position and incorporates MOU provisions for additional pays. Forecast assumes salary growth based on two factors: 1) CPI, and 2) Step increases and other equity adjustments	
• CPI	3.5% growth 2019 to 2021, reduced to 3% growth 2022 to 2024	3.5% growth in 2019; 3% growth 2020 to 2024 based on current economic/inflation forecasts
• Step increases, pay for performance, market adjustments	1.75 to 1.8% growth	Reduce to 1.25% growth based on employee turnover and newer employees starting at lower steps in pay plan; assumes current compensation policy remains in effect

Pension Obligations – PERS/PSERS Plans

- Pension Funding Council (PFC) June 19, 2018 Meeting
 - Funded status at/near 90%
 - Phase-in of change in mortality rate assumptions
 - Reflects reduction in investment return rate from 7.7% to 7.5%



Source: Preliminary Actuarial Valuation Results, June 19, 2018, Office of the State Actuary Presentation to Pension Funding Council

Pension Obligations – LEOFF 2 Plan

- Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 Board Meeting on June 25, 2018
 - Funded status at 109%
 - Funded at 100% of Entry Age Normal (EAN) funding method
 - Return on investments assumption reduced from 7.5% to 7.4%
 - Contribution rate options to be established at July 25, 2018 meeting

Attachment A – Preliminary 2019-21 Contribution Rate Options

	Current Adopted Rates	2017 Valuation*		
		Aggregate	90% EANC	100% EANC
Member	8.75%	6.44%	7.74%	8.59%
Local Employer**	5.25%	3.86%	4.64%	5.16%
State	3.50%	2.58%	3.10%	3.44%

*Includes laws of 2018 supplemental rate of 0.05% member, 0.03% employer, and 0.02% state from SSB 6214.

**Excludes DRS administrative expense rate of 0.18%.

Source: Preliminary Actuarial Valuation Results, June 19, 2018, Office of the State Actuary Presentation to Pension Funding Council

Pension Obligations – Preliminary Rates

Fiscal Year	PERS 2 Plan		PSERS Plan		LEOFF 2 Plan	
	Current Forecast	Preliminary Rates per PFC Mtg	Current Forecast	Preliminary Rates per PFC Mtg	Current Forecast	Preliminary Rates per LEOFF Board Mtg
2019	12.880%	12.680%	11.930%	11.960%	5.430%	5.160%
2020	13.050%	12.680%	11.910%	11.960%	5.430%	5.160%
2021	12.060%	12.680%	11.270%	11.960%	5.120%	5.160%
Thereafter	11.060%	N/A	10.620%	N/A	4.800%	N/A

Pension Obligations – Investment Rates

- Markets believe 7.5% investment return rate is unattainable long-term
- Discussion to reduce investment return rate, but no action taken
- Reduced return assumptions from 7.5% to 6.5% would reduce funded status to 76% and could increase employer pension costs by at least 30%

Funded Status With Different Interest Rate Assumption

Funded Status at a 1% Lower Interest Rate Assumption*										
(Dollars in Millions)	PERS		TRS		SERS	PSERS	LEOFF		WSPRS	Total
	Plan 1	Plan 2/3	Plan 1	Plan 2/3	Plan 2/3	Plan 2	Plan 1	Plan 2		
Accrued Liability	\$13,371	\$42,785	\$9,664	\$15,233	\$6,001	\$613	\$4,495	\$11,809	\$1,422	\$105,393
Valuation Assets	\$7,042	\$33,191	\$5,371	\$11,885	\$4,613	\$480	\$5,403	\$11,037	\$1,144	\$80,168
Unfunded Liability	\$6,329	\$9,594	\$4,293	\$3,348	\$1,388	\$132	(\$908)	\$772	\$278	\$25,226
Funded Ratio										
2017	53%	78%	56%	78%	77%	78%	120%	93%	80%	76%
2016	52%	76%	56%	77%	76%	78%	115%	90%	80%	74%

Note: Totals may not agree due to rounding.

*Liabilities valued using the EAN cost method at an interest rate of 6.5% (6.4% for LEOFF 2). All assets have been valued under the actuarial asset method.

Source: Preliminary Actuarial Valuation Results, June 19, 2018, Office of the State Actuary Presentation to Pension Funding Council

Salaries and Benefits

	Current Baseline Forecast	Proposed Changes to Baseline Forecast
Benefits	Analyzes benefits growth based on increases in variable (pension plan enrollment, payroll taxes) and fixed (medical) benefits changes as follows:	
<ul style="list-style-type: none"> Variable benefits 	Rate adjusted based on pension cost changes, reduced by ~ 2% from 2020 to 2022 and thereafter due to expected reduced pension costs	Incorporate updated preliminary rates from PFC/LEOFF meetings; keep rates static for 2022 to 2024 pending final rates to be adopted by respective boards
<ul style="list-style-type: none"> Fixed benefits 	Assumes 6% growth in medical premiums, 3% in dental premiums, and 8% in life and other insurance benefits	No changes; premiums are based on latest available information from Association of Washington Cities

Fleet Charges

- Costs include
 - Maintenance and Operations (M&O)
 - Replacement costs
- M&O Costs
 - Anticipated hours for each vehicle
 - Shop labor rates based on cost of employees servicing vehicles
- Replacement Costs
 - Replacement value based on estimated future replacement costs
 - Estimated useful lives
 - Typical units (cars, vans, etc.) – 10 years
 - Police vehicles – 4 to 6 year replacement cycle
 - Specialized equipment – 3 to 20 years
- Replacement Costs (continued)
 - Long-term (20-year) cash flow methodology used
 - Replacement costs exclude replacement of fire apparatus
 - Current projections increase replacement funding by 2.5% every biennium, will exhaust replacement funding within 23 years based on current projections
- Observations
 - Council establishes policy regarding replacement funding methodologies
 - Current methodology is a best practice
 - No changes recommended

Other Expenditure Categories

Category	Current Baseline Forecast	Proposed Changes to Baseline Forecast
Fleet & IT charges	Assumes 5% growth based on M&O and replacement costs anticipated in future years	No change; maintain 5% growth factor, which appears reasonable based on replacement methodology and forecasted maintenance and operations growth factors
Contractual services	Assumes 3% growth based on typical inflationary impacts	No change; maintain 3% growth consistent with long-range CPI factors (excludes any potential significant future projects that may require contractual services)
Intergovernmental	Assumes 3% growth based on typical inflationary impacts	No change; maintain 3% growth consistent with long-range CPI factors

General Fund Reserves

- Certain General Fund reserves have been assigned by Council policy for various needs
- Level of authority should be better defined
- Contingency fund (“rainy day” reserve) is considered an available resource when projecting general fund reserves
 - Rainy Day reserve balance is \$2.4 million as of December 31, 2017
 - Excess surplus of \$1.0 million as of December 31, 2017
- Minimum reserve policy is 10% of annual operating expenditures plus transfers (lower than best practice recommendation of two months or 17%)

Fund Balance Composition, 12/31/17	Amount
LEOFF I long-term care reserve	1,406,196
Budgeted fund balance (2018 budget)	1,265,000
Compensated absences reserve	1,252,228
Deferred development fee revenue	629,287
Revenue stabilization reserve	300,000
Expenditure carryovers to 2018 budget	209,382
Deferred recreation fee revenue	126,404
Inventory of supplies	120,857
DSG technology fee reserve	97,483
JAG reserve	79,437
Customer deposits	34,069
Petty cash	2,950
Subtotal (restricted)	5,523,293
2017 surplus (already allocated by Council)	358,268
Total	5,881,561

Recommendations

- Revenues
 - Modify property tax projections to assume that 2008 Parks M&O excess levy sunsets in 2023 without renewal (requires Council to place on ballot and voter approval)
 - Incorporate modest recession within the six-year forecast (not later than 2021)
 - 5% reduction in sales tax and licensing/permit/zoning fees, with recovery over three-year period
 - Modify utility tax projections
 - Assume flatline growth for cable TV and cellular services
 - Modify business license fees to assume 3% growth throughout forecast
 - Analyze and breakout development fee revenues in forecast to identify one-time/significant projects from recurring projects based on review of historical revenue sources

Recommendations

- Expenditures
 - Reduce growth factors for salaries/wages for both CPI assumptions (maintain 3.5% for 2019 but reduce growth factor to 3% per year starting in 2020) and step increases and other adjustments (1.25% net growth throughout forecast)
 - Incorporate preliminary employer pension rates based on PFC and LEOFF meetings and maintain the contribution rate throughout the forecast due to concerns over future investment return
 - Review long-term capital improvement projects to ensure that projects will not require funding from the General Fund

Recommendations

- Fund Balance Reserves
 - Incorporate the total unassigned General Fund reserves that includes the Council's minimum reserve policy ("contingency/rainy day funds") into the model to fully disclose all unassigned available reserves, but disclose the reserve policy in the forecast to show funds over (under) the minimum reserve policy
 - Disclose assigned fund balances in a separate chart that identifies the authority (e.g., City Council, City Manager, legally required) under which those funds were assigned
 - Increase minimum reserve policy over time to achieve a minimum of two months (17%) of annual operating expenditures

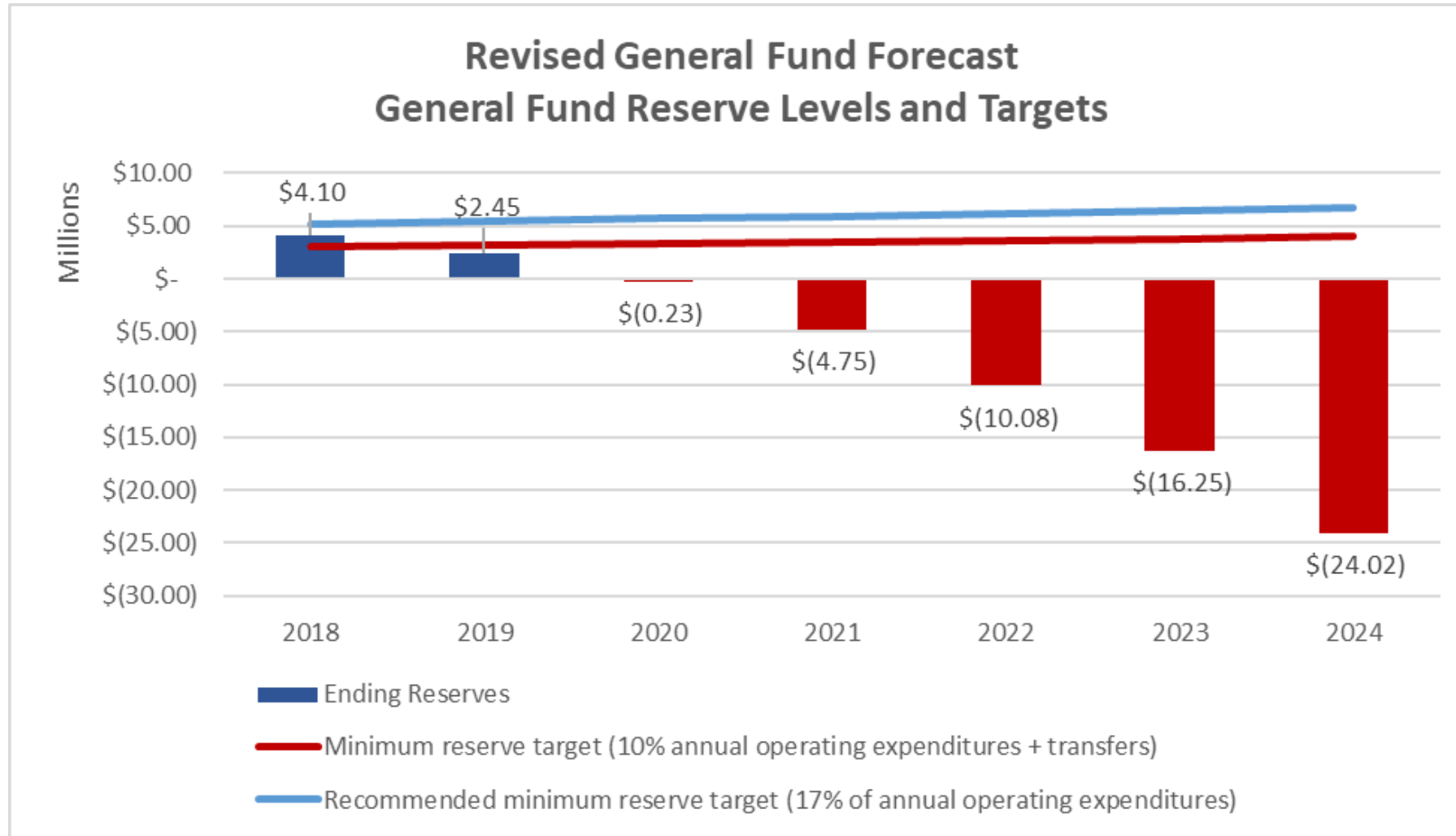
Recommendations

- Other Considerations
 - Use the existing forecast as a “baseline scenario” and develop alternative scenarios based on a set of possible solutions to solve future structural deficits. Scenarios may include a combination of budgetary solutions such as:
 - Revenue enhancements
 - Expenditure controls and cost shifts
 - Service delivery changes
 - Expenditure/service level reductions
 - Develop a fiscal sustainability plan to address the long-term structural deficit identified in the baseline forecast

Revised Baseline Financial Forecast

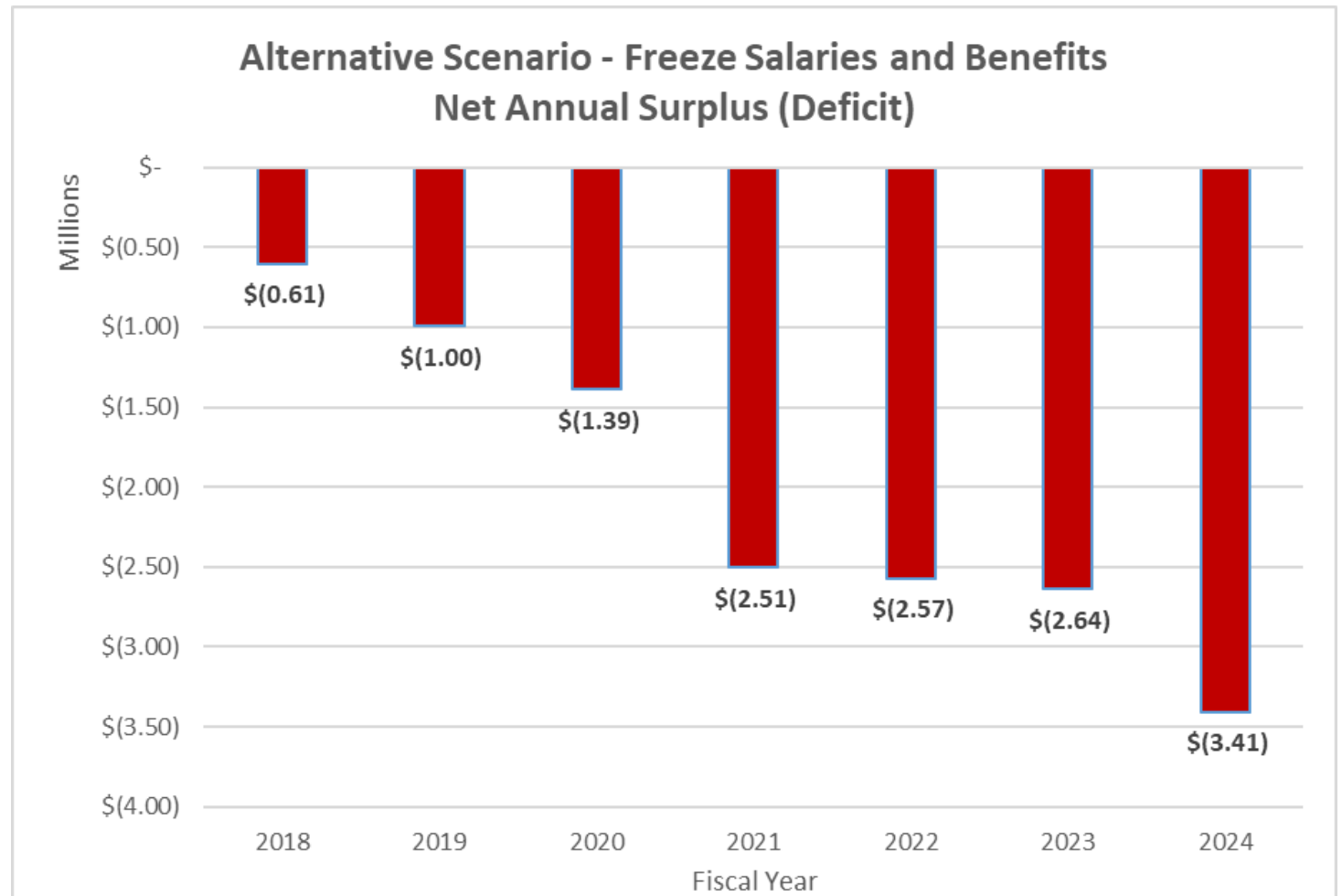
Fiscal Year	Current Baseline Forecast Deficit	Revised Baseline Forecast Deficit	Revised Forecast Smaller (Larger) Deficit
2018	\$ (605,700)	\$ (605,700)	\$ -
2019	(1,755,900)	(1,652,800)	103,100
2020	(2,951,100)	(2,679,300)	271,800
2021	(4,458,100)	(4,518,600)	(60,500)
2022	(5,348,400)	(5,324,200)	24,200
2023	(6,425,200)	(6,173,300)	251,900
2024	(7,551,800)	(7,767,900)	(216,100)

Revised Baseline Forecast



Sample Alternative Scenario

- **Alternative Scenario:** assumes no salary or benefits changes other than step increases and required pension and workers' compensation (L&I) obligations
- **Result:** City's structural deficit remains; other options must be explored to provide fiscal sustainability to General Fund



Concluding Remarks

- Recommended changes will refine the existing forecast tool
- Annual structural deficit in the General Fund continues to grow
- Solutions identified in June Mini-Planning Session will resolve the fiscal gap through December 31, 2020
- Long-term fiscal sustainability plans must be developed to maintain City's fiscal health for future years

Questions?

Management
Partners



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BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND, WA

AB 5450
July, 10 2018
Regular Business

DUE DILIGENCE COSTS FOR THE CITY'S PROPOSED COMMUTER PARKING PROJECT

Action: Appropriate funds for a Phase II Environmental Site Assessment for the Tully's site and adjacent portion of Sunset Highway and for additional work related to providing long-term transit commuter parking.

- Discussion Only
Action Needed:
Motion
Ordinance
Resolution

Table with 2 columns: Category and Value. Rows include DEPARTMENT OF (City Manager), COUNCIL LIAISON (n/a), EXHIBITS (n/a), 2018-2019 CITY COUNCIL GOAL (1. Prepare for Light Rail/Improve Mobility), and APPROVED BY CITY MANAGER.

Table with 3 columns: Category, Amount, and Unit. Rows include AMOUNT OF EXPENDITURE (\$ 225,750), AMOUNT BUDGETED (\$ 0), and APPROPRIATION REQUIRED (\$ 225,750).

SUMMARY

The purpose of this agenda bill is to appropriate funds for due diligence work related to the Purchase and Sale Agreement ("PSA") of the property located at 7810 SE 27th Street, also known as the Tully's property.

As part of the PSA between the City of Mercer Island and Parkway Management Group approved by the City Council on June 5, 2018 (see AB 5434), the City has a six-month due diligence period to evaluate the suitability of the property for a future, long-term transit commuter parking and mixed-use development project.

Although the City has a current contract with another environmental consulting firm, Farallon Consulting, LLC, for remediation work at the Honeywell site adjacent to City Hall, Farallon had a conflict that prevented them from conducting this Phase II ESA work, and the City's outside environmental counsel, Jeff Kray with Marten Law Group, recommended Aspect Consulting for this work based on Aspect's extensive experience on similar sites with petroleum-based contamination.

ENVIRONMENTAL SITE ASSESSMENT WORK PLAN

The Aspect Consulting Phase II ESA Work Plan ("Work Plan") for 7810 SE 27th Street and the adjacent portion of Sunset Highway to the north (collectively, "Site") will provide a snapshot of the Site background,

geology, hydrogeology, and the nature and extent of documented contamination at the Site based on the consultant's review of the previous environmental reports provided by the City. The Work Plan will also resolve the data gaps at the Site and facilitate a better understanding of the potential cleanup costs. The City will use this data in negotiations for reimbursement of cleanup costs from the known, prior polluter of the site, BP/ARCO. The cleanup objective for the Site is to obtain a No Further Action opinion from the Washington State Department of Ecology.

Aspect Consulting will complete at least ten explorations which could be a combination of soil borings and monitoring wells depending on field observations during drilling. Additionally, Aspect will attempt to sample the three existing monitoring wells to supplement the proposed groundwater monitoring wells. Given the explorations are taking place during the dry season, it is possible that one or more of the existing wells could be dry and may need to be re-tested during the wet season.

DUE DILIGENCE COSTS

Staff is requesting that the Council appropriate \$225,750 from the Sound Transit Settlement Funds to be used for additional due diligence work such as surveys, appraisals, environmental assessment, legal fees, etc. Staff recommends that the funds be allocated from the Beautification Fund's available fund balance until the long-term commuter parking project is constructed and the City is reimbursed by Sound Transit.

2018 Due Diligence Work	Previously Appropriated (June 5)	Paid to Date (July 5)	Appropriation Request (July 10)
Environmental Work	\$18,000	\$21,100	\$132,000
Professional Services (appraisal, survey, etc.)		\$600	\$30,750
Legal (outside construction financing counsel)			\$25,000
Rent to Parkway Management per PSA		\$13,700	\$38,000
Stowe Development Strategies	\$56,250	\$18,600	
Total:	\$74,250	\$54,000	\$225,750

RECOMMENDATION

City Manager

- MOVE TO:
1. Authorize the City Manager to enter into a professional services agreement with Aspect Consulting, LLC to conduct a Phase II Environmental Site Assessment at the Former Fuji Auto property located at 7810 SE 27th Street and in a portion of Sunset Highway (the north, adjacent right-of-way) in Mercer Island.
 2. Appropriate \$225,750 from the Sound Transit Settlement Funds to be used for due diligence work such as surveys, appraisals, environmental assessment, legal fees, etc. and allocate the funds from the Beautification Fund's available fund balance until the long-term commuter parking project is constructed and the City is reimbursed by Sound Transit.