

City of Kirkland

Annexation Fiscal Analysis

Council Briefing

December 12, 2006

Presentation Overview

- Review of Financial Analysis to Date and changes from 2005 Analysis
- Overview of Financial Model
- Financial Results
 - Kirkland Base
 - Kirkland Base with Annexation
- Tools and Options
- Recommended Next Steps

Background

- Scope and Outcome of 2005 Financial Analysis
 - One-year snapshot (year one of annexation)
 - Maintenance of service levels
 - Projected annual deficit of \$4.8 million
- Purpose of Current Analysis
 - Update Numbers
 - Impact of State Funding
 - Long Term Financial Planning

Results of Current Analysis

- There is still a near term annexation deficit (lower)
- State funding helps significantly
- Kirkland structural problem remains
- Long term financial picture for Kirkland may be neutral or improved with annexation
- *So what changed . . . ?*

Changes Since 2005 Study

- 2005/06 public safety staffing additions and use of banked property tax and utility tax
- Improved sales tax outlook
- State sales tax funding
- More detailed and longer range analysis – the model

Outcomes of Model Development

- ***Refocused the analysis on the big picture***
 - Considers Kirkland as a whole versus just the PAA
 - Reveals impacts 10-15 years into the future
 - Takes into account interdependencies between development patterns, expenditure and revenue policies
 - Provides data to re-evaluate staffing needs such as police
 - Recognizes and reassigns real facilities costs

The Big Picture

- Kirkland has a structural imbalance between revenues and expenditures
- There is a resulting long-term gap in funding
- The Council will have to close that gap with or without annexation
- Annexation could help close the gap in the long term because there are more people contributing to whatever the solution is

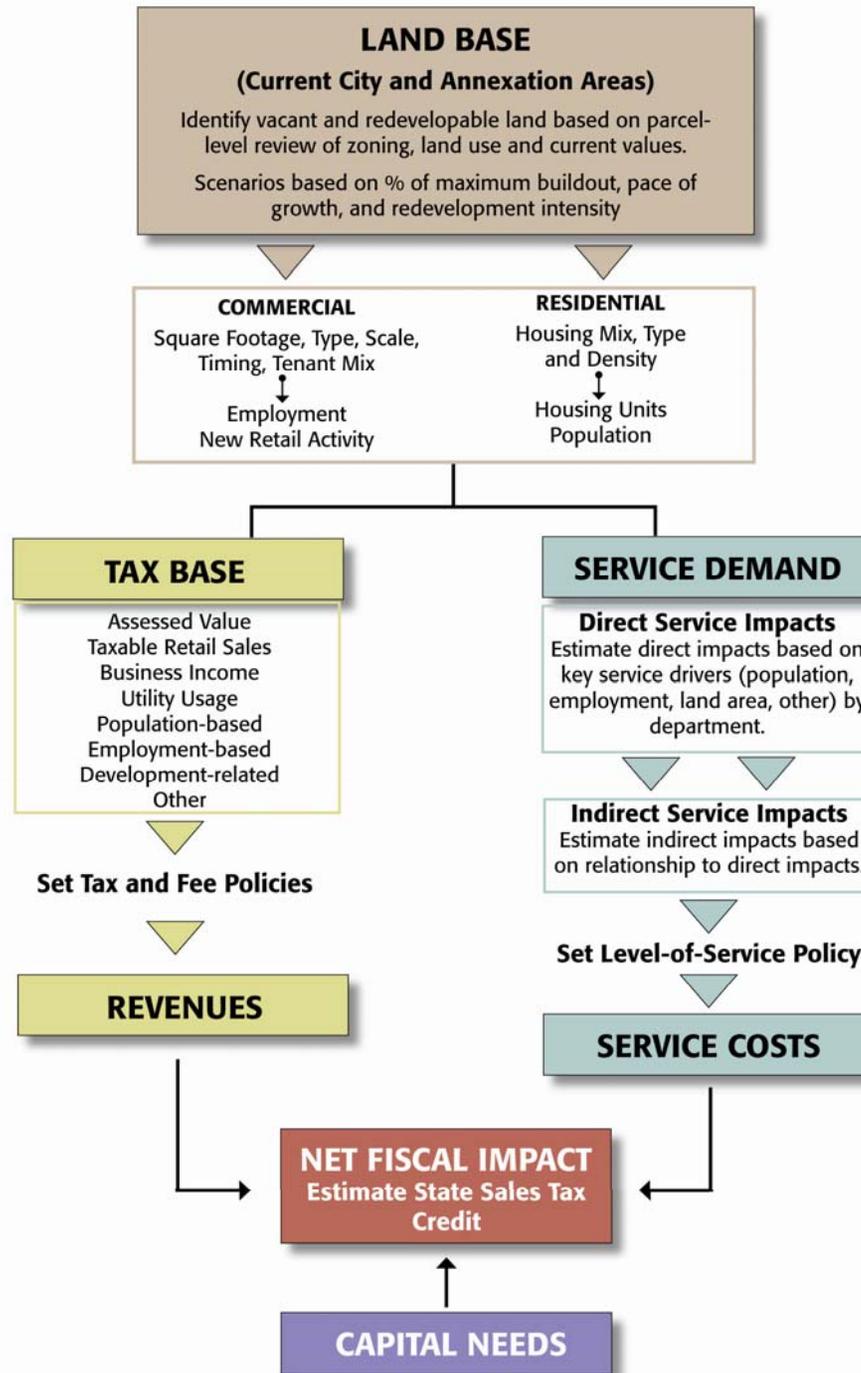
Overview of Financial Model

Purpose of Study

- Fiscal model is designed to estimate revenues and expenses for the current City of Kirkland and the PAA
- Model focuses on the budget components funded through general tax and fee revenues (excludes the utility enterprise funds)
- Capital costs included only for the equipment, fleet and facility costs associated with increasing staff levels; capital implications related to new public infrastructure are excluded (but potential funding sources are estimated)
- Model includes an estimate of the new sales tax credit funding enacted by the State Legislature for annexation scenarios

Model Schematic

- Key fiscal model elements include:
 - The land base which drives both demand for services and the tax base
 - Choices regarding level of service, driving demand for services/costs
 - Fiscal and taxing policy (limited by tax laws), leading to tax and fee revenues

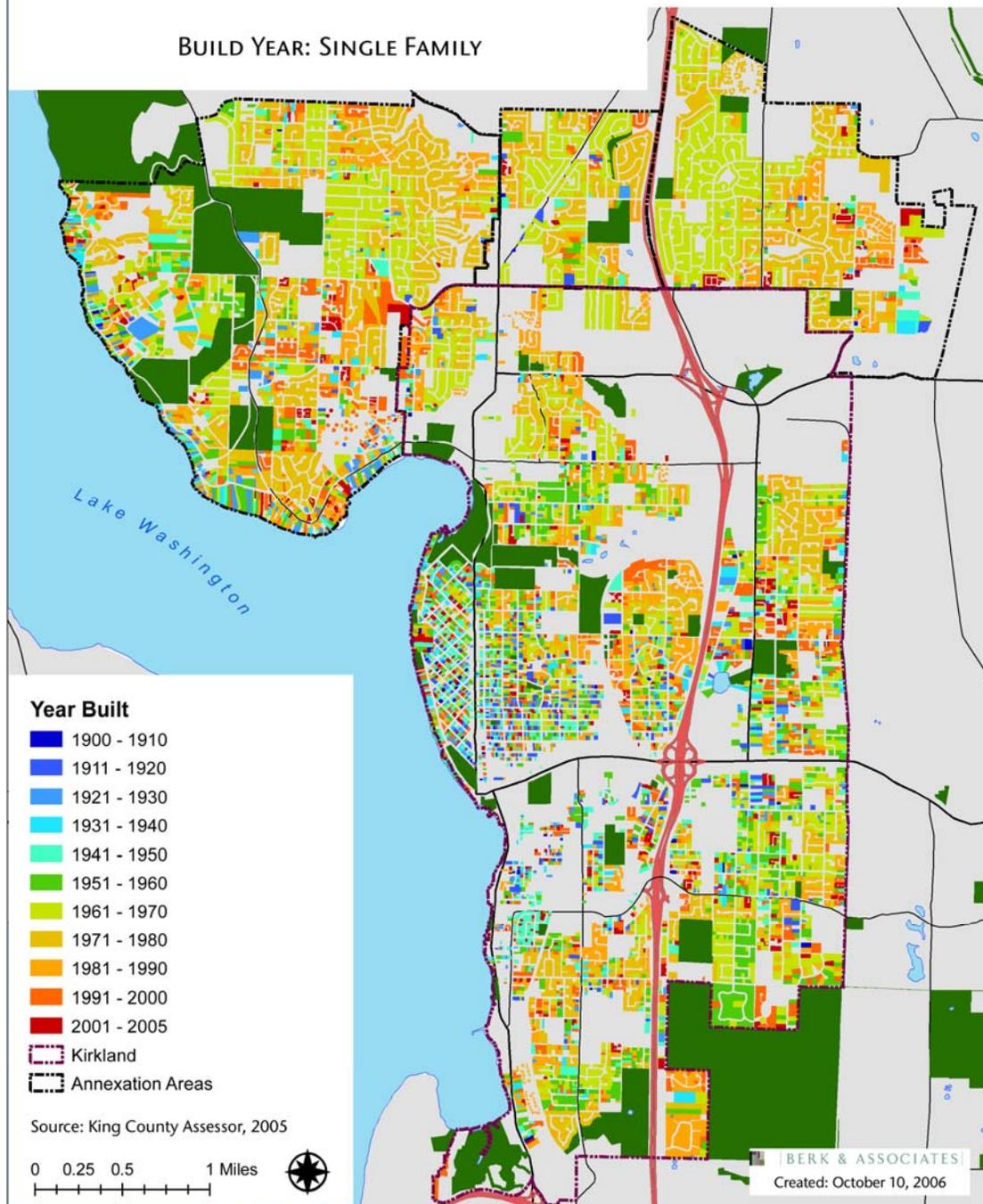


Development Scenarios

- Revenues and costs dependent on the type and quantity of development over the next 20 years
- Test different development scenarios to evaluate fiscal implications and annexation policy choices of growth on the City
- Model includes development scenarios based on:
 - Current zoning in the City and PAA
 - Settings for redevelopment (low, medium and high)
 - Adjustments for environmental factors (such as steep slopes) impacting development capacity

DRAFT: KIRKLAND LONG-TERM FISCAL MODEL DEVELOPMENT

BUILD YEAR: SINGLE FAMILY



Cost of Service Policy Options

- Model estimates changes in the cost of services based on relationships between direct services and underlying demographic and community changes
- The policy options available to change the cost of service include changing assumptions about:
 - Demand drivers that generate the need for staff to provide services (rate of hiring)
 - The expected escalation of salary and benefit costs per FTE

Revenue Choices

- Tax and fee revenue estimates based on changes in components of the City's tax base resulting from growth (with or without annexation)
- Estimated tax base is included for all major potential City taxes (even those not currently imposed)
- Model assesses changes in potential tax and fee revenues on properties, businesses, and utilities. For example, options are available to:
 - Assess different property tax scenarios including levy lid lifts and excess levies (which would require voter approval)
 - Change the tax and fee rates of existing sources (some of which would require voter approval)
 - Add new taxes and fees

Approach to Annexation Analysis

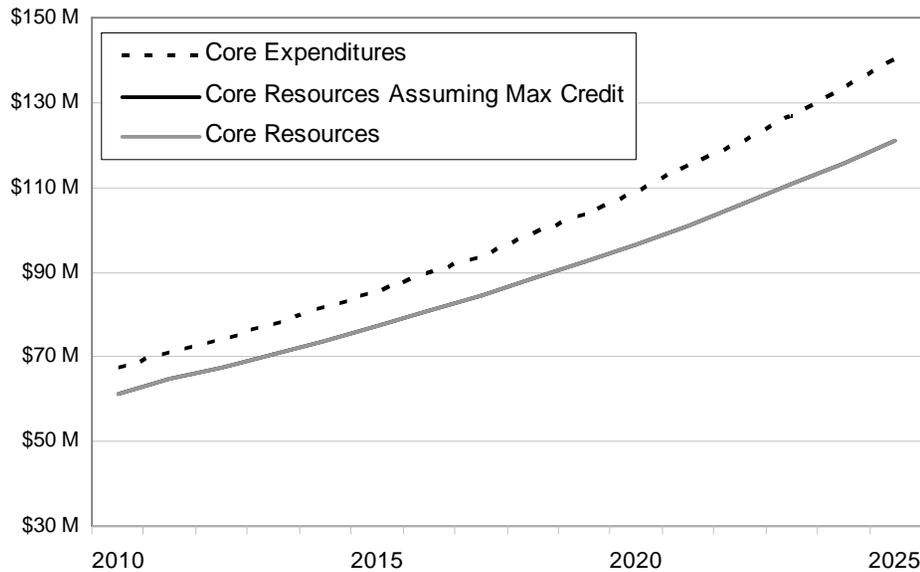
- Current fiscal outlook (baseline) for existing City projects ongoing budget gap
- Previous annexation analyses suggested that annexation would result in a net loss
- Solutions to projected future City deficits (with or without annexation) will have an impact on the economics of annexation
- Impact of annexation on the baseline to be evaluated by:
 - Assessing the impact on the baseline fiscal challenge if annexation were pursued
 - Assessing the policy implications of balancing future budgets and whether annexation makes these options better or worse

Preliminary Financial Results

Preliminary Fiscal Findings

- Kirkland has a long-term fiscal challenge regardless of the decision to annex
- Initial increase in overall City deficit due to annexation, however, the operating deficit in the PAAs is proportionally less than the existing City operating imbalance resulting from:
 - Incremental costs of annexation are lower than the 2005 analysis because of fewer FTEs added
 - Starting revenues are somewhat higher (property tax and sales tax) and, over time, growth in incremental revenues from the PAA's is expected to keep up with cost inflation

Scenario: Baseline Without Annexation

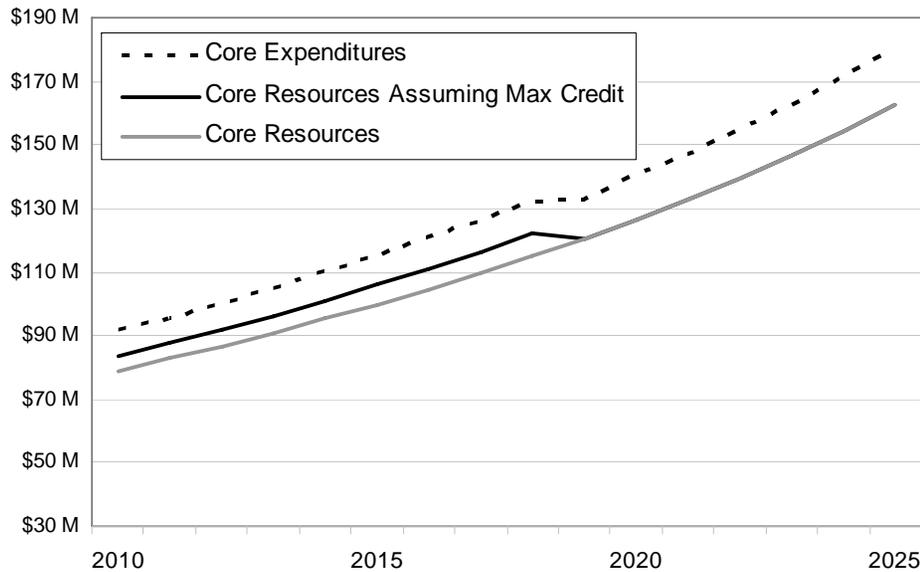


Current Kirkland	2010	2015	2020	2025
Core Expenditures (000's)	65,376	83,153	106,792	137,791
Facility Debt Service (000's)	2,295	2,295	2,295	2,295
Subtotal Expenditures	67,671	85,448	109,087	140,085
Core Resources (000's)	61,446	77,250	96,545	121,009
State Sales Tax Credit ('000's)	0	0	0	0
Subtotal Revenues	61,446	77,250	96,545	121,009
Net Resources (000's)	(6,225)	(8,198)	(12,543)	(19,076)
Deficit as % of Expenditures	-10%	-10%	-12%	-14%

Increment from PAAs	2010	2015	2020	2025
Core Expenditures (000's)	0	0	0	0
Facility Debt Service (000's)	0	0	0	0
Subtotal Expenditures	0	0	0	0
Core Resources (000's)	0	0	0	0
State Sales Tax Credit ('000's)	0	0	0	0
Subtotal Revenues	0	0	0	0
Net Resources (000's)	0	0	0	0
Deficit as % of Expenditures	N/A	N/A	N/A	N/A

Entire City	2010	2015	2020	2025
Core Expenditures (000's)	65,376	83,153	106,792	137,791
Facility Debt Service (000's)	2,295	2,295	2,295	2,295
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Net Resources (000's)	(6,225)	(8,198)	(12,543)	(19,076)
Deficit as % of Core Expenditures	-10%	-10%	-12%	-14%

Scenario: Baseline With Annexation



Current Kirkland	2010	2015	2020	2025
Core Expenditures (000's)	65,368	83,387	106,972	137,783
Facility Debt Service (000's)	2,297	2,297	2,278	2,236
Subtotal Expenditures	67,664	85,685	109,249	140,019
Core Resources (000's)	61,802	77,619	96,990	121,565
State Sales Tax Credit ('000's)	0	0	0	0
Subtotal Revenues	61,802	77,619	96,990	121,565
Net Resources (000's)	(5,863)	(8,065)	(12,259)	(18,454)
Deficit as % of Expenditures	-9%	-10%	-11%	-13%

Increment from PAAs	2010	2015	2020	2025
Core Expenditures (000's)	17,107	22,716	30,182	39,235
Facility Debt Service (000's)	6,887	6,887	1,034	1,076
Subtotal Expenditures	23,994	29,603	31,216	40,311
Core Resources (000's)	16,983	22,060	29,487	41,023
State Sales Tax Credit ('000's)	4,468	6,166	0	0
Subtotal Revenues	21,450	28,226	29,487	41,023
Net Resources (000's)	(2,544)	(1,377)	(1,729)	712
Deficit as % of Expenditures	-15%	-6%	-6%	2%

Entire City	2010	2015	2020	2025
Core Expenditures (000's)	82,475	106,104	137,154	177,018
Facility Debt Service (000's)	9,184	9,184	3,312	3,312
Subtotal Expenditures	91,658	115,287	140,466	180,330
Core Resources (000's)	78,784	99,679	126,477	162,588
State Sales Tax Credit ('000's)	4,468	6,166	0	0
Subtotal Revenues	83,252	105,845	126,477	162,588
Net Resources (000's)	(8,406)	(9,443)	(13,989)	(17,741)
Deficit as % of Core Expenditures	-10%	-9%	-10%	-10%

Preliminary Fiscal Findings

- The operating and maintenance deficit in the annexation areas is lower than previously estimated due to:
 - Refined police staffing. Police Department reduced its annexation FTE request based on more detailed review,
 - The police change lowers the added Municipal Court staffing,
 - These FTE changes reduce ongoing costs by \$1.8 M, or 12%, and one-time costs by \$450,000, or 7%,
 - Newer information resulted in somewhat higher sales tax revenues and property tax revenues than assumed in the 2005 study,
 - The baseline assumes that there is no incremental impact to fire staffing, pending future decisions regarding potential relocation of the Kingsgate station

Preliminary Fiscal Findings

- The incremental cost of new facilities (City Hall, Public Safety and Maintenance Center) that are necessary to support the larger post-annexation city will be a substantial challenge, as they are significantly higher than those for a no annexation scenario:
 - Without annexation, the City faces an unfunded facility need of \$30 million
 - With annexation, the unfunded need is estimated at \$80 million (note that the incremental portion attributed to the PAA recognizes the contributions to City debt service from those areas)

Preliminary Fiscal Findings

- Without the State Sales Tax Credit, the impact of annexation (operations plus facilities) would result in a significant fiscal impact to existing City taxpayers
- Assuming the City will qualify for all of its potential Sales Tax Credit revenue, the overall fiscal impact of annexation is likely to be neutral to positive in the long term due to:
 - The sales tax credit largely offsets the impacts of annexation in the 10-year period of the credit.
 - Over the longer-term, a larger City of Kirkland provides greater policy leverage to address future fiscal challenges, in terms of a larger tax base and potential for greater economies of scale.

Tools and Strategies

What's Next?

- Test strategies for closing the gap and estimate the likely impacts of annexation on those strategies
- Evaluate the effectiveness of various potential combinations
- To begin, let's review the strategies used by the City in the past...

Strategies Implemented in the Recent Past

Strategy	< 1999	1999	2000	2001	2002	2003	2004	2005-06
New revenue source:								
Surface water management fee	X							X
Revenue generating regulatory license fee						X		
Surface water utility tax					X			
Cost of service interfund charge	X							
Increased tax rate or fee:								
Increased property tax rate	X		X			X	X	X
Increased utility tax rate						X		X
Increased parking fines			X		X			
Increased development fees		X	X		X			
Changes to sales tax:								
Reduced CIP allocation			X					
Reduced sales tax lag to 1 year								X
Used one-time revenue source:								
Sales tax audit proceeds							X	
Interest income								X
Planned use of Rainy Day reserve						X	X	X
Expenditure reductions					X	X	X	
Other strategies:								
Used new construction growth	X	X						
Reduced budgeted benefit rate to citywide average					X			X
Reduction in state retirement rates					X			

Fiscal Balancing Tools

1. Development-related revenue

- new construction property tax
- sales tax

2. Tax policy revenue

- property tax
- utility tax
- business tax

3. Expenditure management

- level of service – staffing levels
- efficiency/productivity
- compensation

Scenario Options

- Varying emphasis on specific tools:
 - High (H)
 - Medium (M)
 - Low (L)
- Options (as examples)

Tools	Development	Tax	Expenditure
Option 1	M	L	H
2	L	H	M
3	M	M	M
4	H	L	L

Preliminary Matrix of Options

	Tools			Long-Term Fiscal Outlook		
	Tax Policies	Expenditure Management Policies	Development	Fiscal Analysis Findings		Net Impact of Annexation
Baseline No Annexation	No change in tax policy 1% property tax limit	Hiring rate reflects current policies	Baseline	O&M Impacts Deficits in all years Deficit grows to \$15.5M by 2025 Def. as % of exp.: 3% to 14% Cost growth: 5.2%/yr Revenue growth: 4.5%/yr	Facilities \$30 M unfunded need Annual D/S: \$2.3 M	Surplus/Deficit in 2025 Current Kirkland: (\$17.9M) PAA: 0.0M Total City: (\$17.9M)
Annexation Scenarios						
Baseline With Annexation	Same as above	Same as above	City: Baseline PAA: Baseline	O&M Impacts Citywide deficit marginally reduced PAA deficit starts at 1% and ends balanced Cost growth: 5.7%/yr Revenue growth: 6.0%/yr	Facilities \$80 M need citywide \$38 M impact from annexation 30-year bond -- \$3.3M/yr (all city) 10-year bond -- \$5.9M/yr (PAA impact)	Surplus/Deficit in 2025 Current Kirkland: (\$17.3M) PAA: 0.6M Total City: (\$16.7M)
Balanced Scenarios (closes fiscal gap to withing 1% of Expenditures in 2020)						
Property-Tax Focused (75% of deficit)	High Same as baseline plus annual levy increases greater than 1%	Medium Hire 13% fewer FTEs than baseline	Medium City: Baseline PAA: Baseline	Balancing with primarily property tax results in net gains from the annexation areas which help offset base City structural deficit issues. Without annexation, tax rates would need to be higher to achieve the same ends.		If the City qualifies for maximum state sales tax credit, overall impact is neutral to small positive.
Business-Tax Focused (75% of deficit)	High Same as baseline plus a new business tax	Medium Hire 13% fewer FTEs than baseline	Medium City: Baseline PAA: Baseline	This scenario is similar to the property tax based scenario except the net contribution from annexation is smaller, since the tax is based on businesses only.		If the City qualifies for maximum state sales tax credit, overall impact is neutral to small positive.
No growth-related hiring, balance with property tax	Medium Same as baseline plus annual levy increases greater than 1% but less than High scenario	High Hire 25% fewer FTEs than baseline	Medium City: Baseline PAA: Baseline	The impact of much lower hiring reduces the need for new taxes, though at a likely cost in terms of level-of-service. The impact of annexation is even more positive as the rate of growth in the annexation areas is somewhat higher than current Kirkland.		If the City qualifies for maximum state sales tax credit, overall impact is neutral to small positive.
Low Development PAAs, Balance With Property-Tax	High Same as baseline plus annual levy increases greater than 1%	Medium Hire 13% fewer FTEs than baseline	Low City: Baseline PAA: Low	The impact of lower PAA development is higher tax rates and a lower FTE's demand overall, though the PAA fiscal impact remains positive and the taxes lower than a no annexation scenario.		If the City qualifies for maximum state sales tax credit, overall impact is neutral to small positive.
High Development Current City, Balance With Property-Tax	Low Same as baseline plus annual levy increases greater than 1% for first six years only	Low Hire 3% fewer FTEs than baseline	High City: High PAA: Baseline	The impact of high development in current Kirkland is a much lower tax need and the ability to fund closer to the full FTE demand. The impact of annexation remains positive, but to a much lower degree, since most of the funding gap is solved by development in current Kirkland.		If the City qualifies for maximum state sales tax credit, overall impact likely to be neutral.

Phase II Financial Issues

- Stability of state sales tax credit and method for demonstrating eligibility for the full credit
- The infrastructure needs of the PAA
- The availability of funds from King County to assist with transition
- The impacts of adding fire staffing to meet the needs of the area currently served by the Kingsgate station if the station is relocated
- The ultimate sizing and configuration of the new Public Safety/Jail facilities
- The Northshore Utility District provides water and sewer services in most of the PAA. The analysis assumes that the District will continue to provide service, but that the franchise fee will keep pace with the City utility tax rate

Proposed Next Steps

- January 1-15 Council Special Study Session on the Fiscal Model
- January/February Kirkland Outreach/Financial Information
- February Public Forum
- March Phase One Go/No Go Decision to Proceed to Phase Two