



MEMORANDUM

To: Dave Ramsay, City Manager

From: Marilynne Beard, Assistant City Manager
Tracy Burrows, Senior Management Analyst
Sandi Miller, Financial Planning Manager

Date: March 6, 2006

Subject: STATUS OF ANNEXATION LEGISLATION AND UPDATE OF FISCAL ANALYSIS

The City completed a fiscal study of the annexation of Finn Hill, Juanita and Kingsgate last June. The report was presented to City Council at their Mid-Year Budget Review session in early July. The fiscal study employed a “mini budget process” and asked departments to prepare recommended staffing and support service packages needed to meet service delivery needs in the annexation area. At the same time, finance staff worked with King County to develop updated revenue estimates for the area. The fiscal study was presented with a breakdown of cost and revenue by neighborhood. The study concluded that the financial impact of annexation left an unfunded need of nearly \$5 million – the difference between the cost of providing services and the new revenue that could be expected to be generated from the annexation area. A copy of the executive summary of the report is included as Attachment A.

The tables below summarize the results of the 2005 fiscal study compared to the 1999 study (and reflecting updated cost and population figures) and a comparison of revenues and expenditures by neighborhood:

Ongoing Revenues/Costs & Staffing Needed	Current Analysis (2005)	Prior Analysis (1999)	Difference
Revenues (Net of Fire District #41 Payment)	12,521,852	9,265,000	3,256,852
Less Cost of Services (Direct & Indirect)	17,300,808	12,710,000	4,590,808
Operating Deficit	(4,778,956)	(3,445,000)	(1,333,956)
Staffing Needed	151.96	116.45	35.51
Operating Deficit Per Capita	\$147	\$100	\$47

Ongoing Revenues/Costs & Staffing Needed	Finn Hill Only	Juanita Only	Kingsgate Only
Revenues (Net of Fire District #41 Payment)	5,553,611	2,086,279	4,881,962
Less Cost of Services (Direct & Indirect)	8,761,256	3,725,690	7,408,931
Operating Deficit	(3,207,645)	(1,639,411)	(2,526,969)
Staffing Needed	76.87	32.73	65.15
Operating Deficit Per Capita	\$210	\$293	\$216

The deficit amount from annexing one neighborhood at a time is greater than if all three areas are annexed at once due to the lost economies achieved with the larger annexation. **If all three areas are annexed at once, the combined deficit is estimated at \$4,778,956.**

Since the study was completed, two changes (or potential changes) occurred:

- The City Council approved the addition of fourteen new public safety positions, using banked property tax capacity and a utility tax rate increase to pay for the additions. This decision potentially changes the fiscal analysis in two ways. First, it increases the level of service in the annexation area although the fire improvements and proactive unit do not necessarily need to be “extended” as a new cost in the annexation area. For the purposes of this analysis, the proactive unit is assumed to remain at the five FTE’s approved and not be increased for the annexation area at this time. Second, the use of banked property tax increased the tax rate that can be applied in the annexation area and the revenue available to support services.
- The state legislature has approved a bill that would provide funding for up to ten years to cities annexing unincorporated areas within their urban growth boundaries and where the fiscal impact can be demonstrated to be a burden. The proposed legislation utilizes a credit to the existing state sales tax and does not require local voter action to implement. This legislation potentially closes the financial gap identified in the original study and makes the annexation feasible.

This memo describes the fiscal impact of these two events on Kirkland’s annexation of its potential annexation area (PAA).

Impact of City Council Public Safety Additions

As mentioned earlier, the addition of public safety improvements potentially impact both the expenditure and revenue estimates prepared for the annexation fiscal study last year. For the purposes of this memo,

staff did not attempt to update all costs and revenues based on normal inflationary changes. All costs and revenues are expressed in terms of 2005 dollars. The changes noted below represent the 2006 estimated impact of the Council's actions:

Property Tax

In order to determine the impact of the use of banked property tax, staff needed to obtain updated assessed valuation figures from King County for the annexation area. In 2006, the City's tax rate itself didn't change much – the combined effect of the City increasing the levy and the assessor's office increasing the assessed valuation of properties. Had the Council not increased the levy, the rate would have decreased (because valuations rose at a faster rate than the property tax levy). The lower rate applied to a higher valuation in the annexation area wouldn't necessarily have yielded any new revenue. Because the levy rate did not decrease, we would have been able to apply the same rate to a higher valuation to achieve a property tax revenue gain of \$408,971 (assuming assessed valuation increased at the same rate as Fire District #41).

In order to obtain the most accurate information, we contacted King County to get actual assessed valuation data for the annexation area. As it turns out, the assessed value figures provided last year by King County (for the purpose of the annexation study) were incorrect. The correction decreased the valuation somewhat. After using the most current AV figures from King County and our current levy rate, we achieve a net property tax increase of \$142,154.

Utility Tax

In June of 2005, the City Council increased the utility tax rate on City utilities from 6.5% to 7.5% and increased surface water utility charges. Both actions result in additional estimated revenue for annexation. The increased utility tax rate was already factored into the annexation fiscal analysis completed last year. However, the change in surface water rates should yield another \$31,118.

Gas Tax

In 2005, the state legislature approved additional gas tax funding. Although Kirkland chose to use the additional funding to supplement funding for the transportation CIP, this portion of the gas tax is not legally restricted to capital purposes. The new gas tax could be used to fund street maintenance operating costs which are largely financed through property taxes. The estimated amount of new gas tax available from the annexation area is \$132,630.

Public Safety Costs and Fire District Revenue

The cost of adding an additional aid car at the Totem Lake/Juanita fire station positively impacts the service level in the existing city limits and the annexation area. No additional cost is required to extend this service level after annexation. What is impacted is the loss of Fire District #41 contract revenue that is offsetting 26% of the new costs. This results in a negative revenue offset to the property tax levy of \$203,069.

The proactive unit was approved with five new FTE's. Because the proactive unit is supplemental service and not needed to provide basic patrol and investigative services to the annexation area, it is not considered an additional cost for this analysis but could be considered for addition later.

Impact of Legislation – Potential Source of State Funding for Annexation

As of the date of this memo, the prospects for the final approval of Senate Bill 6686, related to annexation funding, appear favorable. Senate Bill 6686 applies to cities under 400,000 population in King, Pierce, and Snohomish Counties. It provides annexing cities with a credit on the State sales tax that varies depending on the population of the annexation area. The rate of the credit is .1 percent for annexation areas with a population between 10,000 and 20,000. The rate of the credit is .2 percent for annexation areas with a population greater than 20,000. The credit applies to sales taxes collected within the existing city limits and within the boundaries of the annexation area and is effective for a period of ten years.

To be eligible for the credit, Kirkland must commence annexation of an area of at least 10,000 population prior to January 1, 2010. Under the election form of annexation, the City must adopt an annexation resolution and file a certified copy of the resolution with the King County Council to commence annexation. The City must also adopt a resolution or ordinance establishing that the projected cost to provide municipal services to the area exceeds the projected revenue from the area.

The revenues from the credit on the state sales tax cannot exceed that which the city deems necessary to generate revenue equal to the annexation deficit. Each year, the City must report a threshold amount of revenue that is necessary to close the annexation deficit. Once the sales tax credit revenues reach that threshold amount, the City must notify the Department of Revenue and the tax distribution shall be suspended for the remainder of the year.

Phasing of Annexation Under SB 6686

The populations of Kirkland's annexation areas are as follows:

Kingsgate	11,700
Juanita	5,600
Finn Hill	15,300

Both the Kingsgate and Finn Hill areas individually meet the 10,000 population threshold for eligibility for the .1 percent sales tax credit. In order to be eligible for the .2 percent sales tax credit, Kirkland would have to annex both Juanita and Finn Hill, or Kingsgate and Finn Hill or all three annexation sub-areas.

Assuming all three areas are annexed at once, estimated revenue from the state sales tax and a comparison to updated revenue and expenditure "gaps" is shown below:

Neighborhood	Estimated Fiscal Gap	Estimated Sales Tax Credit @ .20%
Kingsgate	1,715,146	145,483
Juanita	820,925	87,000
Finn Hill	2,242,885	105,086
Kirkland	-	3,703,712
Total	4,778,956	4,041,281

The cost of annexing one area at a time is higher than if all three areas are annexed at once because we do not achieve the economies of scale for staffing increases. If the City were to annex the Kingsgate area only, it appears that the .1 percent sales tax credit would be sufficient to close most of the \$2.5 million identified annexation gap in that sub-area as shown in the table below.

Neighborhood	Estimated Fiscal Gap	Estimated Sales Tax Credit @ .10%
Kingsgate	2,526,969	1,924,598

However, if a phasing option is chosen, the City should consider the likelihood that the County and the Boundary Review Board would seek to enlarge the boundaries of the annexation area. In addition, because of the short window of opportunity within which the annexation sales tax credit is available, it would not be possible to phase annexation over a period of five years and still be able to claim the State annexation funding provided under SB 6686. It could well be more efficient and cost-effective to annex the entire area than to undertake two separate annexations in successive years.

Summary and Considerations and Conclusion

The following table summarizes the net impact of the revenue changes discussed above.

	Estimated Fiscal Gap	Property Tax	Gas Tax	Utility Tax	Fire District Revenue	Sales Tax Credit	Revised Fiscal Gap
Kingsgate	(1,715,146)	43,238	47,600	11,823	(11,248)	145,483	(1,478,250)
Juanita	(820,925)	18,140	22,783	5,621	(34,297)	87,000	(721,678)
Finn Hill	(2,242,885)	80,776	62,247	13,674	(157,524)	105,086	(2,138,626)
Subtotal	(4,778,956)	142,154	132,630	31,118	(203,069)	337,569	(4,338,554)
Kirkland						3,703,712	3,703,712
Total						4,041,281	(634,842)

The contribution from the State sales tax credit closes the financial gap considerably. The remaining \$634,842 would need to be addressed, most likely by identifying reductions in our expenditures. If Council

wants to proceed with annexation in the near future, staff would develop a list of proposed changes to the fiscal analysis that fully closes the deficit.

It should be noted that the state legislation eliminates the sales tax credit after ten years. In the intervening years, the City should plan for gradual replacement of this revenue either through commercial redevelopment efforts or other revenue enhancements or expenditure reductions. Another consideration in annexation is the capital facility costs associated with the construction or purchase of a new public safety building and/or enlarged City Hall that is needed to relieve current overcrowding. The annexation study assumes that the cost borne by annexation is related only to staff added as a result of annexation. Existing City resources would need to be tapped to pay for the non-annexation facility additions.

Given that the legislation passed, most of the financial burden is eliminated for the ten-year funding horizon. In order for the City to take maximum advantage of this funding source, we would need to annex the entire area. If it is the City Council's intent to eventually annex the entire area, it makes sense to do it all at once to achieve the economies of scale that it provides and to minimize the organizational impact that an undertaking of this size can be expected to have. If the City Council directs staff to proceed with pursuing annexation of the entire PAA, staff recommends the following actions:

- **Develop an annexation implementation work plan** that establishes a timeline for key activities including a communications strategy, an election and effective date, pre-annexation hiring activities, facility planning and services phase-in plan. Annexation of the entire PAA will be the single most time-intensive project for the entire City organization and all other major initiatives should be evaluated for possible deferral. We would also develop an annexation transition budget for consideration in the 2007/2008 Biennial Budget process.
- **Develop a Communications Strategy** for both the annexation area and within the existing City. An annexation campaign committee will need to be assembled separate and apart from the City's communication strategy to provide information to interested residents and to obtain citizen input during the transition.
- **Update the fiscal study** to provide a basis for documenting the funding need to be met by the state sales tax credit. Develop a model that is easily updated and make sure that it meets the requirements set forth in the legislation.
- **Pursue one-time funding from King County** to assist with one-time costs associated with annexation. Significant one-time costs will result from the need to hire public safety staff in advance of the effective date of annexation so that services can be provided by City staff as soon as possible. In the interim, pursue interim contracted services from King County. As much funding as possible from King County will also help defray one-time equipment acquisition costs and provide seed money for capital projects.
- **Work with the state** to determine the exact timing and means of securing available funding.

Annexation is clearly the most complex and significant undertaking that this City will be involved in for the next five years. Staff will be contacting other cities that have undertaken large annexations to get ideas about best practices related to annexation efforts.

Executive Summary

Background & Purpose

In 2000, the City contracted with Henderson, Young & Company to prepare an analysis of the fiscal impacts of annexing the Finn Hill, Juanita, and Kingsgate neighborhoods, which comprise the City's potential annexation area (PAA). Since then there have been a number of significant revenue changes (in terms of new revenues, new rates, and lost or diminished revenues) and staffing/program changes that render the previous analysis out of date. In addition, the prior study generated a number of questions regarding the projected operating costs and staffing needed to service Finn Hill, Juanita, and Kingsgate. Accordingly, during the 2005-2006 budget process, the City Council directed staff to prepare a more detailed annexation fiscal analysis in 2005. To accomplish this, staff engaged in a "mini-budget" process detailing out projected revenues, additional staffing needed, and the cost of extending current service levels to the three annexation sub-areas.

Description of Potential Annexation Area

A map of Kirkland's PAA is included on the following page. It encompasses almost all of the unincorporated area to the north of Kirkland, to the south of Kenmore, Bothell, and Woodinville, to the east of Lake Washington, and to the west of the Burlington Northern railroad right-of-way and Woodinville. Key 2004 statistics for the PAA and Kirkland are presented in Table 1 below:

Table 1: Key 2004 Statistics for Annexation Sub-Areas and Kirkland

Area	Population	Square Miles	Population Density	Taxable Assessed Value	Housing Units	Businesses
Finn Hill	15,300	4.08	3,750/sq mi	\$2.23 billion	5,945	173
Juanita	5,600	.97	5,773/sq mi	\$.49 billion	2,078	88
Kingsgate	11,700	1.95	6,000/sq mi	\$1.14 billion	3,924	202
Total PAA	32,600	7.00	4,657/sq mi	\$3.86 billion	11,947	463
Kirkland	45,800	11.00	4,164/sq mi	\$7.87 billion	22,524	3,414

The key 1999 statistics used in the prior fiscal analysis prepared by Henderson, Young & Company are summarized in Table 2 below:

Table 2: Key 1999 Statistics for Annexation Sub-Areas and Kirkland

Area	Population	Square Miles	Population Density	Taxable Assessed Value (1998)	Housing Units	Businesses
Finn Hill	15,900	4.08	3,897/sq mi	\$1.20 billion	5,900	34
Juanita	5,800	.97	5,979/sq mi	\$.29 billion	2,150	59
Kingsgate	12,600	1.95	6,462/sq mi	\$.66 billion	4,800	131
Total PAA	34,300	7.00	4,900/sq mi	\$2.15 billion	12,850	224
Kirkland	44,860	11.00	4,078/sq mi	\$4.78 billion	22,289	3,100

Noteworthy differences between Table 1 and Table 2 include the following:

- The PAA population used in the prior fiscal analysis was 34,300 compared to 32,600 in the current fiscal analysis. King County didn't have the geographical information system capability back in 2000 that it has now. The population used by Henderson, Young & Company was an estimate provided by King County. The population figure used in this fiscal analysis is a more refined estimate that is used by King County and the Washington State Department of Revenue.
- The taxable assessed valuation for the PAA and Kirkland increased 80 percent and 65 percent respectively from 1998 to 2004. That means that property values in the PAA and Kirkland increased about 10 percent and 9 percent respectively each year during this timeframe. Because the 2004 assessed valuation of the PAA is higher than expected, staff has asked the Assessor's Office to verify the figure provided by the King County Budget Office. No confirmation has been received yet.
- The number of businesses domiciled in the PAA was estimated to be 224 in the prior fiscal analysis compared to 463 in the current fiscal analysis. Most of this change is believed to be related to King County's improved geographical information system capability.

Assumptions

Underlying the development of this annexation budget were the following assumptions:

- The annexation area will be **primarily considered as a whole, though an approximate allocation by sub-area** (i.e. Finn Hill, Juanita, and Kingsgate) will be provided.
- The focus of this budget process will be on the **operations and maintenance impact, not on the capital improvement program (CIP) needs**, with the exception of new facilities costs related to annexation staff.
- **Current staffing and service deficiencies reflected in Kirkland's adopted 2005 budget will not be addressed** in this annexation fiscal analysis. In other words, staffing and service levels in the annexation area will mirror the City's current service levels.
- **No impact on the Northshore Utility District and, therefore, on Kirkland's water/sewer utility** is assumed for purposes of this budget process.
- **Only the City's governmental funds (i.e. General Fund, Street Operating Fund, etc.) will be considered in this analysis.** All utility funds (i.e. water/sewer, surface water, and solid waste) are excluded from this analysis, because their operations are fully supported by user charges.

- The annexation budget will be **based on 2005 costs and 2005 budgeted revenues**. In addition, the recent water, sewer, surface water, and solid waste utility tax rate increases adopted by the Kirkland City Council in June 2005 (increasing them to 7.5 percent) to fund a partial implementation of the police strategic plan are reflected in the 2005 revenue estimates.

Budget Process

In approaching the development of the annexation budget, the City's services were divided into "**direct service**" and "**internal support**" functions. The direct service functions, which represent the services delivered to Kirkland's citizens and businesses, include the following:

- Fire & Building
- Municipal Court (including prosecution and public defense)
- Parks & Community Services
- Planning & Community Development
- Police
- Public Works (including street maintenance but excluding facilities maintenance and fleet)

The internal support functions, which primarily support the direct service functions or provide organization-wide oversight, consist of the following:

- City Attorney's Office
- City Manager's Office
- Facilities Maintenance
- Finance & Administration (excluding the Municipal Court)
- Human Resources
- Fleet
- Information Technology

The internal budget development process was essentially divided into three phases:

1. The **first phase** focused on the following:
 - **Gathering annexation area data**, in terms of general demographic information (e.g. population, number of businesses, and number of dwelling units), activity levels (e.g. crime statistics, and types and number of development permits processed), infrastructure inventory (e.g. centerline street miles, number of signalized intersections, and number of feet of sidewalks), and infrastructure condition. The direct service functions worked through Karen Reed, the consultant contracted by King County to deal with annexation issues and information requests, to gather the relevant data from King County. The development services related departments (i.e. Public Works, Planning & Community Development, and Fire & Building) worked

together during this phase to ensure that each department used the same projected activity levels in the annexation area.

- **Developing 2004 service metrics**, in which approved 2004 staffing levels for each program or functional area were related to a specific 2004 activity level (e.g. calls for service, permits processed, and acres of parks maintained) or to another meaningful measure (e.g. population, square miles, and number of households). The purpose of these metrics is to reflect the current service levels provided by the City's direct service and internal support functions. Metrics for 2004 were used for the most part, since that is the most recently completed year.

2. The **second phase** primarily involved the **preparation of the annexation budget by the direct service departments**. This phase also included the following:

- Preparation of certain 2005 revenue estimates by the direct service departments.
- Preparation of all other 2005 revenue estimates by King County and the City's financial planning staff.

Using the annexation area data and their 2004 service metrics, each direct service function prepared annexation service packages for each of its program or functional areas for the annexation area as a whole. In addition, a sub-area allocation summary was prepared so that a phased approach to annexation could be considered. This sub-area allocation is not intended to be definitive, but rather instructive as to the approximate cost of servicing Finn Hill, Juanita, and Kingsgate. After the budgets for the direct service functions were prepared, they were reviewed first by the financial planning staff and then by the Finance and Administration Director and Assistant City Manager during a series of budget review meetings.

3. The **third phase** focused on the **preparation of the annexation budget by the internal support functions**, whose operations are primarily driven by the direct service functions. This phase began after the budget review meetings with the direct service functions were completed. The primary drivers of the internal support function budgets included the number and type of staffing, number of computers, and number and type of vehicles requested by the direct service functions. Using this information along with their 2004 service metrics, each internal service function prepared annexation service packages for each of its program or functional areas for the annexation area as a whole and prepared a sub-area allocation summary as well. Finally, the internal support functions were subjected to the same review process as the direct service functions.

This phase also included an **assessment of the facilities space needs** of the direct service and internal support functions, encompassing the cost of land,

building construction, and parking. The total capital outlay associated with the new facilities space was incorporated into this analysis by determining the annual debt service cost over a 30 year term assuming a 5 percent rate of interest. In addition, the financial planning staff estimated the **non-departmental and general liability insurance costs** associated with annexing the three sub-areas. All of these costs were treated as overhead layers.

Finally, the 2005 projected expenditures of the direct service and internal support functions were compared to the 2005 projected revenues. In addition, these 2005 projected costs and revenues were compared to the previous annexation fiscal analysis by Henderson, Young & Company.

Because of the complexities surrounding special districts, of which there are two in Kirkland's PAA, the City contracted with Berk and Associates, a Seattle-based consulting firm, to work through the annexation impacts on the City and the special districts. The questions that Berk and Associates was hired to answer primarily relate to the following:

- If the City opted to do a partial annexation, how would Fire District #41 be impacted (i.e. would the district still be financially viable?) and how would the contract change? In addition, what would be the impacts on Fire District #36 and #34, which both partly serve the Kingsgate area?
- What if the City opted to annex into the Fire District #41 instead? What would be the impact?
- How would the Finn Hill Park District be impacted by the annexation?

Summary of Analysis

Table 3 on the next page summarizes the ongoing revenues, ongoing costs, and staffing associated with annexing Kirkland's entire PAA. In addition, Table 3 also compares the results of the current fiscal analysis to the prior one prepared by Henderson, Young & Company, answering the following question: **What would be the ongoing impact of annexing the entire PAA at once?**

Table 3: Summary Comparison of Current vs. Prior Analysis of Annexing Entire PAA

Ongoing Revenues/Costs & Staffing Needed	Current Analysis (2005)	Prior Analysis (1999)	Difference
Revenues (Net of Fire District #41 Payment)	12,521,852	9,265,000	3,256,852
Less Cost of Services (Direct & Indirect)	17,300,808	12,710,000	4,590,808
Operating Deficit	-4,778,956	-3,445,000	-1,333,956
Staffing Needed	151.96	116.45	35.51
Operating Deficit Per Capita	\$147	\$100	\$47

Overall, the **estimated operating deficit increased significantly from \$3.45 million in 1999 (per the prior study) to \$4.78 million in 2005 (per the current analysis)**. In addition, the 2005 annexation budget developed by staff consists of **about 151 employees, or 35 employees more than was estimated by Henderson, Young & Company**. Accordingly, **the operating deficit per capita has grown from \$100 to \$147**. These significant differences from the prior study can be primarily attributed to the following:

- King County didn't have the geographical information system capability back in 2000 that it has now. As a result, staff was able to get significantly more (and better) data from King County regarding the annexation area's demographics, service activity levels, and infrastructure inventory. This data was a primary driver of the annexation budgets that were prepared by staff. A prime example of the budgetary impact of having good data available was the street-related inventory information, which was very incomplete back in 2000. Based on that incomplete data, Henderson, Young & Company estimated that 7 employees were needed for street maintenance and operations. Using vastly improved data for the current fiscal analysis, Public Works staff estimated that about 11 employees were needed instead to maintain current service levels.
- The City's service levels haven't remained static since 2000. There have been service level increases in development services, police support, emergency services, and information technology during the past six years.
- The annexation fiscal analysis prepared by staff represents a detailed budget development effort; whereas, the 2000 fiscal analysis was really a feasibility study. No one service area demonstrates the resulting difference more than police. The previous annexation study estimated that almost 55 employees were needed to serve Finn Hill, Juanita, and Kingsgate. According to the Police Department, almost 78 employees (or 23 more) are required to maintain Kirkland's current level of service. While police service levels have increased since 1999, much of this annexation staffing increase relates to (or is driven by)

patrol services. There were a number of key factors that were not taken into consideration in the prior study that the police command staff used in putting the patrol budget together. Those factors included a street network comprised of few arterials and many dead-end streets (especially in Finn Hill), higher population density in Juanita (5,773 residents per square mile) and Kingsgate (6,000 residents per square mile) than in Kirkland (4,164 residents per square mile), two junior high schools and five elementary schools, and anecdotal information from the King County Sheriff's Office regarding criminal activity in certain pockets of the PAA.

- The growth in costs has outpaced the growth in revenues from 1999 to 2005. More specifically, personnel costs, which make up about two-thirds of the City's General Fund budget, have risen significantly because of double-digit healthcare cost increases, cost of living adjustments, and market adjustments to employee wages that were necessary to maintain the City's compensation policy of paying at the mid-point of comparable cities in the region. As for revenues, property tax initiatives and the recent economic recession have significantly curbed their growth during this period.
- The cost of land acquisition and building construction has increased significantly since 1999 driving up the cost of adding office space. The annexation-related capital facilities costs were based on the assumption that City Hall and the Maintenance Center would be expanded and that a new Public Safety building would be constructed. These costs were incorporated into the current fiscal analysis as an annual debt service cost of \$1.67 million (based on the issuance of 30 year bonds at a 5 percent rate of interest). It should be noted that the \$1.67 million represents the portion of the total annual debt service cost attributable to the PAA only (based on square footage needed for additional staff).

Specifically excluded from the costs presented in Table 3 are those of a one-time nature, such as the purchase of vehicles, computers, furniture, and equipment. For the 2005 annexation budget that was developed, this totaled \$6.81 million. Also, it bears repeating that the infrastructure needs of the PAA were excluded from this analysis, with the exception of the new facilities space required to house the additional staffing.

The "mini-budget" process that staff went through also considered the following question: **What would be the ongoing impact of annexing only one sub-area?** Table 4 on the following page addresses that question.

Table 4: Summary Comparison of Annexing Only One Sub-Area

Ongoing Revenues/Costs & Staffing Needed	Finn Hill Only	Juanita Only	Kingsgate Only
Revenues (Net of Fire District #41 Payment)	5,553,611	2,086,279	4,881,962
Less Cost of Services (Direct & Indirect)	8,761,256	3,725,690	7,408,931
Operating Deficit	-3,207,645	-1,639,414	-2,526,969
Staffing Needed	76.87	32.73	65.15
Operating Deficit Per Capita	\$210	\$293	\$216

While the revenues for each sub-area tie to the total revenues generated by the PAA, the costs and staffing across all three sub-areas don't correspond to the totals in Table 3 above. Simply put, there are scaling efficiencies achieved by annexing all three sub-areas at once. Further, consideration was given to the likelihood of being able to hire qualified part-time staff for certain positions (e.g. police officers). In some cases, annexing just one sub-area triggers the need for a certain number of staff that can't be hired in increments. Department estimates for staffing based on annexing one area at a time resulted in a scaling variance in excess of 30 percent. Finance staff, in consultation with the City Manager, reduced that scaling factor by half (to 15 percent). Accordingly, a scaling factor of 15 percent was applied to the staffing and cost estimates for each sub-area.

From highest to lowest, **the projected operating deficits are \$3.21 million in Finn Hill, \$2.53 million in Kingsgate, and \$1.64 million in Juanita**, assuming that only one sub-area is annexed instead of all three at once. **On a per capita basis, Finn Hill has the lowest operating deficit at \$210, which is significantly higher than the \$147 operating deficit per capita if all three sub-areas are annexed at once.**

Two special reports were prepared by Berk and Associates relative to the impact of annexation on special districts currently serving the PAA. Fire services are provided by Fire District #41 (through a contract with the City of Kirkland), Fire District #36 (Woodinville Fire and Life Safety) serving a part of Kingsgate and Fire District #34 (through a contract with the City of Redmond) serving a smaller part of Kingsgate. The Finn Hill Park District was formed in 2002 to provide maintenance services to local parks. The district currently maintains O.O. Denny Park and is expected to take ownership of three additional parks in the area from King County.

Fire District

The special report on the fire district impact evaluated the varying impacts of annexing the PAA in stages versus in its entirety. Fire District #41 is essentially within Kirkland's PAA. When a City annexes fire district property, the properties cease to be part of the fire district and become part of the incorporated city. Depending on the amount of the

fire district assumed by the city, an asset transfer occurs between the two entities. The Berk report details the laws governing the annexation of fire districts and the asset transfers that would take place. In reality, asset transfers are negotiated transactions between fire districts and the annexing city and can involve exchanges of cash, properties, equipment and/or services.

For Finn Hill and Juanita, the ongoing impact to the city is essentially the loss of fire district revenue paid to the city. In exchange, the city's taxing base is extended to the area to compensate for the fire district's levy. Because there are three different fire districts serving Kingsgate, the scenario is more complicated. Fire District #36 currently has a fire station located in Kingsgate and serves an area that includes part of Fire District #41. The service is provided on an automatic aid basis and there is no payment from one fire district to the other for services. It should be noted that Kirkland Fire responds into Fire District #36 from station 27 so there is a reciprocal service. However, District #36 is considering moving the station located in Kingsgate to another location which will impact fire service to the area. This is a pending issue that may have significant financial implications for annexing the Kingsgate area.

The Berk report also discusses the feasibility of Kirkland annexing to Fire District #41. In this scenario, the citizens of Kirkland would have to vote to annex to the district which would authorize an additional property tax levy of \$1.20. This would nearly double the current City levy of \$1.30. Unless the City of Kirkland reduced its own operating levy by the \$1.20 (reducing the City levy to \$.10), it is unlikely that voters would approve a tax for a service they are already receiving.

Park District

The Finn Hill Park District currently levies \$.07 per \$1,000 assessed valuation to raise money for maintenance of local parks within the area. Unlike the fire district, the park district can continue to exist within the incorporated boundaries of Kirkland. Three post-annexation scenarios are presented:

1. The district continues to levy its tax, operates the parks within its area and contracts for maintenance.
2. The district continues to levy its tax and operates the parks within its area but contracts with the City of Kirkland to maintain the parks at a level of service negotiated between the City and the district.
3. The district dissolves upon annexation and the City assumes maintenance and operations of all parks in the area within the City's tax base.

One of the key policy issues in this report relates to varying service levels within the City. Under option 1 (or even option 2), the park district can opt for a lower level of maintenance than the standard that Kirkland uses for its own parks. Having two different service levels within the City is potentially problematic if residents of the annexed area request a comparable level of service.

Another interesting and unique aspect of the park district report relates to O.O. Denny Park which is owned by the City of Seattle and maintained by the park district (this property was formerly maintained by King County). The property was willed to the City of Seattle with the stipulation that it be used only as a park property. A full explanation of the restrictions on this property is included in the Berk report.