CITY OF KIRKLAND
City Manager's Office
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MEMORANDUM

To: Dave Ramsay, City Manager

From: Marilynne Beard, Assistant City Manager

Date: November 9, 2007

Subject: POTENTIAL ANNEXATION UPDATE

RECOMMENDATION:

Council receives an update on outstanding issues with regard to potential annexation and provide direction to staff on key issues related to completing phase two.

BACKGROUND:

The City Council is currently in phase two of a four-phase process to consider the potential annexation of Finn Hill, Juanita and Kingsgate, which is Kirkland's "potential annexation area" or "PAA." We now have additional information available for Council to consider as they approach the end of phase two and a decision regarding whether or not to proceed to phase three of the annexation study. The issues to be studied in phase two and the resolution of outstanding issues from phase one presented the potential for material changes to the financial projections. The information we have today indicates a more challenging financial picture and staff needs further direction from Council as to whether to reconsider any of the key assumptions and policy direction provided earlier in the annexation study. Several options are provided later in this memo for Council consideration. By way of background, a brief recap of phase two annexation study activities and outcomes is included below.

Recap of Phase Two Activities

During phase one, we conducted outreach to the Kirkland community and developed a detailed financial model to determine how the addition of the state sales tax credit would impact the long term financial position of the City if annexation were to occur. The City Council concluded phase one in April 2007, agreeing to proceed to phase two. Activities in phase two included:

- Expanded outreach to residents in the PAA
- Continued outreach to Kirkland community
- Assessment of infrastructure condition in the PAA and capital funding sources
- Negotiation with King County regarding financial assistance to support annexation
- Completion of a public safety building feasibility analysis
- Update of the financial model to reflect the current budget and updated financial projections

- Follow-up of outstanding financial and policy issues from phase one

A variety of issues identified in phase one remained unresolved at the time that the City Council decided to move to phase two. Staff was to bring forward new information and an analysis of impacts during phase two as it became available. Some of the key issues that remained outstanding at the end of phase one included:

- Policy direction on the assumption of Fire District #41 debt related to consolidation of the North Finn Hill and Holmes Point fire stations
- Final information from the Woodinville Fire and Life Safety District regarding their future plans for station 34 that serves the Kingsgate area
- Information from the Finn Hill Parks District regarding their intent to remain intact and continue maintenance of O.O. Denny Park in Finn Hill
- Direction from the State regarding rules for applying the state sales tax credit
- Capital needs in the PAA including infrastructure improvements and the cost of city facilities needed to house new staff

All of these issues had the potential for materially impacting the results of the financial study. In addition, there were certain assumptions embedded within the financial model that the City Council confirmed as part of a series of policy statements presented to the Council early in phase two (see June 5, 2007 Council packet). Those policy issues and preliminary Council direction included:

1. Council will continue to be composed of seven members elected at large.
2. The City will not seek to change the boundaries of the PAA established in the countywide planning policies prior to an election, but may seek changes following an election (responded to requests from individuals currently outside the PAA to be included).
3. The City Council would continue its ban on commercial card rooms which would require the casino located in the Kingsgate area discontinue operation.
4. The City would pursue one annexation election of the entire PAA (instead of phasing) in order to maximize the availability of state funding.
5. The City Council would put forward one ballot measure that asked PAA voters if they wanted to annex <u>and</u> if they would accept Kirkland's current outstanding debt (instead of one ballot for each neighborhood and/or separate ballot questions for annexation and debt).

In addition to the above assumptions that were reflected in the financial model, the Council gave preliminary support for an additional assumption that had not been factored into the model.

6. The City would assume the outstanding debt of Fire District #41 for the fire station consolidation or retire the debt with available cash reserves.

It was understood that this was preliminary direction and that it may be necessary to reconsider some of these issues in later phases.

Current Situation

The attached memo from Tracy Burrows and Tracey Dunlap describes each of the outstanding issues and current status. We do not have all of the phase two work completed at this time, however, it is important to begin to report out what is known.

- The infrastructure condition of the PAA is comparable to that in Kirkland with street condition slightly better and surface water systems and developed parks in slightly worse condition. Available capital funding from the PAA indicates that the most pressing infrastructure needs can be funded and, in the case of transportation, unfunded projects are comparable in magnitude to Kirkland's existing unfunded transportation CIP.

- Council supported a policy recommendation to assume Fire District #41 outstanding debt resulting from the station consolidation project. The debt and estimated ground lease payment for the station property adds an annual operating cost of $290,000.

- The Finn Hill Park District commissioners have indicated that they would prefer that the district discontinue its special levy for parks maintenance and that the City of Kirkland assume responsibility for maintenance of O.O. Denny Park. Assuming that the City maintains the park to Kirkland standards, an additional $205,000 would be added to the annual operating costs of the PAA.

- The Woodinville Fire and Life Safety District indicated early in phase two that it is their intent to move Fire Station #34 (located in Kingsgate) to a different location east of the PAA. Kirkland Fire Chief Jeff Blake had indicated in phase one that, if the station were moved to the farther location, an additional engine company would need to be added at Station #27 in Juanita in order to maintain acceptable response times in the PAA and in Kirkland. Since that time, we received a more definitive statement from Woodinville Fire and Life Safety confirming their intent to move Station #34 to the more eastern location. Kirkland's Fire staff have mapped and modeled response times with and without the Kingsgate Station and/or a new engine company at Station #27. They have concluded that response times would be unacceptably degraded unless we add the engine company at Station #27. This adds approximately $1.5 million of annual operating costs to the annexation area and about $3.5 million in capital improvements to Station #27.

- The annexation financial model was updated to reflect the 2007-2008 adopted budget which included new positions approved by Council. Those changes were added to the model along with updated known changes and refinements in revenues and expenditures. The net results of the updated budget information had a greater impact on Kirkland's projected financial condition, however it adds to the combined bottom line deficit that would need to be addressed.

There are additional outstanding issues that may impact the financial position but that are not known as of the writing of this staff report:

- King County's contribution is not known, however, it would not impact the annual operating budget because their contribution is one-time in nature.

- The outcome of the facilities study (Public Safety Building Feasibility Study) may have a positive impact on the financial picture, depending on how we redefine our capital needs and/or phase into the construction of new facilities. The strategy for financing new annexation-related facilities and other municipal building needs (unrelated to annexation) can have a significant impact on the "bottom line." Unfortunately, it is unlikely that findings from the facilities' study will completely offset the added costs identified above.

The cumulative impact of this new information creates a more difficult financial challenge for us to overcome. Although we believe that the resulting impacts are not insurmountable, we will need to reconsider our underlying assumptions or fundamental approach to serving the PAA to get back on track.

Conclusions, Options and Recommendations

Throughout the annexation study, we have been consistent in acknowledging that there was more information and study needed and that it may be necessary to rethink our assumptions or the annexation itself. Staff believes that we have reached a point where it is necessary to reassess the underlying assumptions in our approach to annexation in order to achieve a financial balance using the tools available to the Council. Examples of underlying assumptions that may be discussed are listed below.

- The financial model assumes that service levels in the annexation area will be equivalent to existing Kirkland and that Kirkland's existing services levels will not be impacted. Although we have acknowledged that services would need to be phased in over time, for the sake of the long-term projection, it was assumed that the full service level would be phased in within 10 years.

- The City will assume Fire District #41's debt if annexation occurs.

- The City will assume maintenance of O.O. Denny Park at Kirkland standards.

- The City will not allow card rooms (e.g. there will be no revenue from gambling taxes).

- The City will consider annexation of the entire PAA as one area.

- Although the City Council did not choose a particular scenario from the fiscal study that identified how they would balance future budgets (with or without annexation), the Council believe they have sufficient tools to balance future budgets.

The results of the Public Safety Building feasibility study are pending and it is not known to what degree that study will materially change the financial contingencies identified in this memo.

Options

There are three potential approaches for proceeding with the annexation study:

1. **Revise Selected Assumptions and Continue with the Current Strategy** – The Council could identify which of the key assumptions can be reconsidered and, if so, provide guidance about what parameters should be applied. Further direction is needed regarding which

assumptions the Council would like more information about in order to reconsider the assumption or to better understand the implications.

2. **Pursue a "Revenue-Based Approach"** – This would be a fundamental shift in strategy with regard to serving the annexation area and would entail developing a service level proposal that is achievable within the current revenue available from the PAA. This would necessarily result in a lower level of service for the PAA. Staff would provide an estimate of the level of service we could provide with available resources, compare that to Kirkland service levels and note what, if any, impacts the lower service level might have on existing Kirkland.

3. **Do Not Proceed to Phase Three** – The next go/no go decision was scheduled for the December 11th meeting and the Council could make a preliminary determination at this time not to proceed.

Each option clearly has different implications for the annexation timeline and other annexation activities occurring concurrently with the phase two decision process (e.g. preparation of zoning, operational planning). Under option one, staff could continue to prepare zoning recommendations as if we were proceeding to the Boundary Review Board so that we could maintain our existing timeline. Option two would take longer to accomplish and would necessitate the delay of an election from 2008 to 2009.

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MEMORANDUM

To: David Ramsay, City Manager

From: Tracy Burrows, Intergovernmental Relations Manager
Tracey Dunlap, Director of Finance and Administration

Date: November 7, 2007

Subject: Annexation Update - Phase II Information

At the conclusion of Phase I of the annexation process earlier this year, the City recognized that there were several outstanding issues whose outcome would impact annexation finances. While we have not yet resolved all of the outstanding issues, we now have enough information to begin to present a more complete picture of Kirkland's financial position if annexation goes forward. This new information confirms that there are financial challenges ahead for the City with or without annexation. It also reveals that, given current assumptions about service levels and revenue sources, it will likely be more challenging for the City to balance revenues and expenditures if we move forward to annex the Kingsgate, Juanita, and Finn Hill areas.

The outstanding issues from Phase I included: (1) the assumption of Fire District 41's debt; (2) the post-annexation status of Fire Station 34 in the Woodinville Fire and Life Safety District; (3) the post-annexation status of the Finn Hill Park District; (4) the capital needs and revenues associated with the Potential Annexation Area (PAA); (5) King County's annexation funding; (6) the application of the rules associated with the State sales tax credit; and (6) completion of the public safety facility feasibility analysis. This memo outlines the new information that we have gathered since the conclusion of the Phase I analysis and discusses the implications of this new information.

Outstanding Issues

Kirkland's Assumption of Fire District 41's Debt

Issue: King County Fire District #41 contracts with the City of Kirkland for fire and emergency medical services. Under the terms of the contract between the City and the District, construction of new fire facilities is the financial responsibility of the jurisdiction within which the facility will be located. In 2005, the District decided to consolidate the current facilities located in North Finn Hill and at Holmes Point to a more central location that will improve response times in the area due to the accessibility it provides.

If the City does not proceed with annexation, the District would be responsible for financing the new fire station. If the City does annex the Fire District, all of the District's assets and liabilities would transfer to the City and the District would cease to exist. At the conclusion of Phase 1, the City was considering two options to retire the Fire District debt if there were outstanding debt at the time of annexation:

(1) The City could continue to impose a property tax levy on the former district residents in order to retire the debt. This option would be in place regardless of whether the debt was voted or non-voted. Or,
(2) The City Council could choose to retire the debt through means such as defeasing the outstanding debt (paying it off with cash resources), retiring the debt through general City revenues or refunding (refinancing the debt).

New Information: Since the conclusion of Phase I, the City Council has given a preliminary policy direction to assume the Fire District debt rather than continuing to impose a property tax on the former district residents. This policy direction was established provided that the PAA voters agree to accept a share of the City's voted debt. The annual debt service commitment for the consolidated station would be about $265,000 (assuming 20 year bonds at 4.4%) and the annual land lease costs associated with the station would be about $25,000. If the City opts to assume that debt and pay the debt service through other general fund resources, the annual $290,000 cost of the debt and land lease is additive to the impacts of annexation.

Woodinville Fire and Life Safety - Fire Station 34

Issue: The Kingsgate neighborhood includes portions of three different fire districts: Fire District 41, the Woodinville Fire & Life Safety District, and, in much smaller part, Fire District 34 (operated by the Redmond Fire Department.) Woodinville Fire & Life Safety District (WFLSD) serves its portion of the annexation area through a crew located in Fire Station 34, in the Kingsgate neighborhood. At the conclusion of Phase I, the post-annexation disposition of Fire Station 34 was uncertain. Woodinville Fire & Life Safety had not established a definitive position on whether or not they would continue to staff the Fire Station after annexation.

New Information: WFLSD has now indicated that, in the event that Kingsgate is annexed, they will relocate Fire Station 34 out of the Kingsgate area to an area east of the PAA. Under this scenario, the Kirkland Fire Department will have to expand the Totem Lake Fire Station and add an engine company to serve the area. It will likely take 4-6 years for Woodinville Fire & Life Safety to relocate Fire Station 34, after which time the City would incur the one-time and on-going costs related to staffing this area. It is estimated that the annual cost of additional engine company staffing is $1.5 million in 2007 dollars and the one-time cost of renovating the Totem Lake Station is estimated at $3.5 million.

Finn Hill Park District

Issue: The Finn Hill Park District was authorized on November 5, 2002, when nearly 70 percent of Finn Hill residents voted in favor of the creation of a local Park and Recreation District with an accompanying tax levy. The Finn Hill Park District (FHPD) maintains O.O. Denny Park, a 40-acre park within the Finn Hill area. Helen Denny, the widow of O.O. Denny, willed the park land to the City of Seattle with a stipulation that it was to be operated and maintained as a park in perpetuity. In the event that it failed to be operated as a park space, O.O. Denny Park would revert to Children's Home Society, which could keep or sell the land for development.

During Phase I, the City identified three potential scenarios for the future of the FHPD after annexation:
(1) the District keeps the District levy in place and remains responsible for the maintenance of the park;
(2) the District keeps the District levy in place and the District contracts with the City (i.e. in effect, turns over the levy to Kirkland) to provide park maintenance provided by City employees; or,
(3) the District dissolves, the District's levy goes away, and Kirkland must use general fund dollars to operate the District's properties.

New Information: The Finn Hill Park District recently advised the City that their intention would be to dissolve after annexation with the understanding that Kirkland would take over responsibility for the maintenance of O.O. Denny Park. Under this scenario, there would likely be a transition period to allow for a smooth changeover in the operation of the park. At the conclusion of the transition period, the City would assume the costs of park maintenance. At current Kirkland service levels, this cost is estimated at $205,000 annually in 2007 dollars.

Capital Needs in the Annexation Area

Issue: This September, the Public Works and Parks Departments completed assessments of the condition of parks, roads, and stormwater facilities in the annexation area. Water and wastewater services will remain under the jurisdiction of the Northshore Utility District (NUD) and the Woodinville Water District for the foreseeable future, and thus were not addressed in this assessment. The purpose of the assessment was to analyze the capital needs in the annexation area to determine whether they were similar in scope to the needs faced by the current City of Kirkland, or whether there were extraordinary infrastructure deficiencies that would require a disproportionate investment to bring up to Kirkland standards.

New Information: The infrastructure assessment identified specific transportation, stormwater, and parks capital improvements that are needed in the annexation area. The complete assessment was presented at the October 2, 2007 Study Session. The overall conclusion of the assessment was that the identified needs in the annexation area were roughly comparable in scope to the capital needs that the City currently faces. The capital financing summary below

shows that the level of funded infrastructure needs in the PAA is comparable but slightly greater than the funded programs in the existing City.

The capital revenues generated by the PAA were calculated in the Fiscal Analysis and include Real Estate Excise Tax (REET), gas tax, and a portion of sales tax with financing policies applied similar to those applied in the City of Kirkland CIP. In addition, those capital projects identified as "funded" in the King County capital plan are assumed to be completed by the County or the funding will be made available for the City to complete the projects. Those projects designated as "unfunded" in the King County plan are shown as unfunded in the City projections as well. The projected capital funding sources in the PAA for the next six years are summarized in the table below.

6-Year Total Revenue					
Dedicated Revenue	**Transportation**	**Surface Water**	**Parks**	**Totem Lake Fire Station Expansion**	**Total**
Gas Tax	1,637,000				**1,637,000**
Sales Tax	104,000				**104,000**
Utility Rates		5,920,000			**5,920,000**
REET 1	3,400,000		175,000	3,500,000	**7,075,000**
REET 2	7,075,000				**7,075,000**
Impact Fees*					**TBD**
6-Year Funding	**12,216,000**	**5,920,000**	**175,000**	**3,500,000**	**21,811,000**

* To be determined

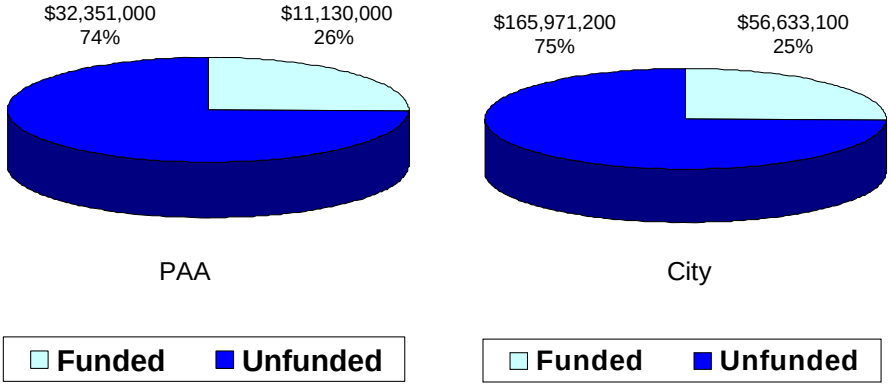
The infrastructure needs assessment for the PAA identified immediate and known needs. Until more comprehensive planning efforts are undertaken, a complete list of capital needs cannot be developed. Based on needs identified at this time, compared to the capital revenue available over the next six years, the following costs were identified:

6-Year Total Project Costs			
	Funded CIP	**Unfunded CIP**	**Total CIP**
Transportation	11,130,000	32,351,000	**43,481,000**
Surface Water	5,920,000		**5,920,000**
Parks[1]	175,000		**175,000**
Expand TL Fire St.	3,500,000		**3,500,000**
Total	**20,725,000**	**32,351,000**	**53,076,000**

[1] Parks amount includes funding for immediate needs and a master plan for Edith Moulton Park only.

These costs include transportation projects identified by staff and/or included in King County's capital improvement program and immediate needs in the parks and storm drainage systems. In addition, the cost of renovating the Totem Lake Fire Station to serve the Kingsgate area is included. Note that the costs of facilities (public safety building, City Hall, and Maintenance Center) are being addressed in a separate report described later in this memo.

To evaluate the PAA transportation capital needs in relation to the existing City transportation needs, we compared the level of funded and unfunded capital projects (as identified at this time) as summarized in the pie chart below.



Based on the Phase 2 results, the level of funded infrastructure needs in the PAA is comparable to the funded programs in the existing City.

King County Annexation Funding

Issue: As part of King County's Annexation Initiative, the County has allocated one-time funding to encourage cities to annex the remaining unincorporated urban areas. The County has budgeted a total of $10 million to be allocated among annexing cities.

New Information: The City has submitted a request for $18.0 million in one-time funding from the County. At the time of the writing of this memo, we had not yet received the County's response to our request. It is likely that the County's financial offer will be in the range of $2 - 4 million, which is comparable to the funding that it has offered other annexing cities. This funding would be a one-time payment, so it would not address annual, ongoing needs.

State Sales Tax Credit Rules

Issue: In 2006, Governor Gregoire signed Substitute Senate Bill 6686 into law. With the exception of the City of Seattle, this law establishes a state sales tax credit incentive program for any city in King, Pierce or Snohomish counties that commences annexations of 10,000 or more people by Jan. 1, 2010. The wording of the law that states, *"All revenues collected under this section shall be used solely to provide, maintain, and operate municipal services for the annexation area,"* can be interpreted differently by different parties. Recognizing this, Kirkland has worked with a group comprised of finance, planning, and inter-governmental relations representatives from the King County cities most likely to commence these annexations to develop a common template for eligible and non-eligible expenses.

New Information: In October, the City convened a meeting of representatives from affected King County cities, the State Department of Revenue, the Attorney General's Office and the State Auditor's Office to resolve some of the questions raised by the language of the law. While the State is working through the issues associated with the implementation of SB 6686, they are not in a position to commit to a firm set of rules regarding its application. It is likely that guidance will come from the experience of cities such as Auburn and Renton that have recently had successful annexation elections that meet the population threshold requirements for the sales tax credit. Kirkland is now seeking initial advice from bond counsel on the relative risks of reliance on the state sales tax credit to pay for the facilities costs associated with annexation. The fiscal analysis continues to assume that we will qualify for the maximum contribution (0.2% of taxable retail sales).

Public Safety Building Feasibility Analysis and Public Facilities Financing

Issue: The Phase 1 financial model evaluated the cost of expansion of City facilities to meet identified needs with and without annexation and the impacts were incorporated into the operating portion of the fiscal analysis. A component of this analysis included the annexation area's share of a $44 million public safety facility that would be housed in a separate, stand-alone building. The $44 million cost estimate is derived from a 2003 study of public safety facility needs.

New Information: The City is currently completing a public safety building feasibility analysis that updates the assumptions and cost estimates from the original 2003 public safety building study. This new feasibility study will also provide cost estimates for a range of public safety facility options, including: building a new facility; retrofitting an existing facility; or expanding on the current court facility as part of a public safety campus. These updated cost estimates will likely impact the facility-related operating cost assumptions that are in the current fiscal analysis. The feasibility study is scheduled for completion by the end of November.

Review of Capital Financing for Facilities

The costs in the current projections reflect the same assumptions as Phase 1, pending completion of the public safety facility feasibility analysis. The assumed costs for expanding City facilities are summarized in the table below.

Needs	No Annexation	With Annexation	Incremental Cost
City Hall Expansion (incl. public safety)	25,000,000	N/A	
Public Safety/Jail Facilities	N/A	44,000,000	
City Hall Space Needs	N/A	28,900,000	
Maintenance Center Space Needs	4,564,000	7,763,000	
TOTAL	**$ 29,564,000**	**$ 80,663,000**	**$ 51,099,000**

Note that the "no annexation" scenario assumes that the City's public safety needs will be met by expanding on the current City Hall site, rather than with a separate public safety facility, which is assumed only under the annexation scenario.

Based on these facilities needs, the costs with annexation were allocated between those that should be attributed to the impact of annexation alone and those costs that should be borne by the entire City (existing Kirkland and the PAA). This allocation takes the incremental cost and adjusts it to recognize two factors in allocating those costs to the PAA:

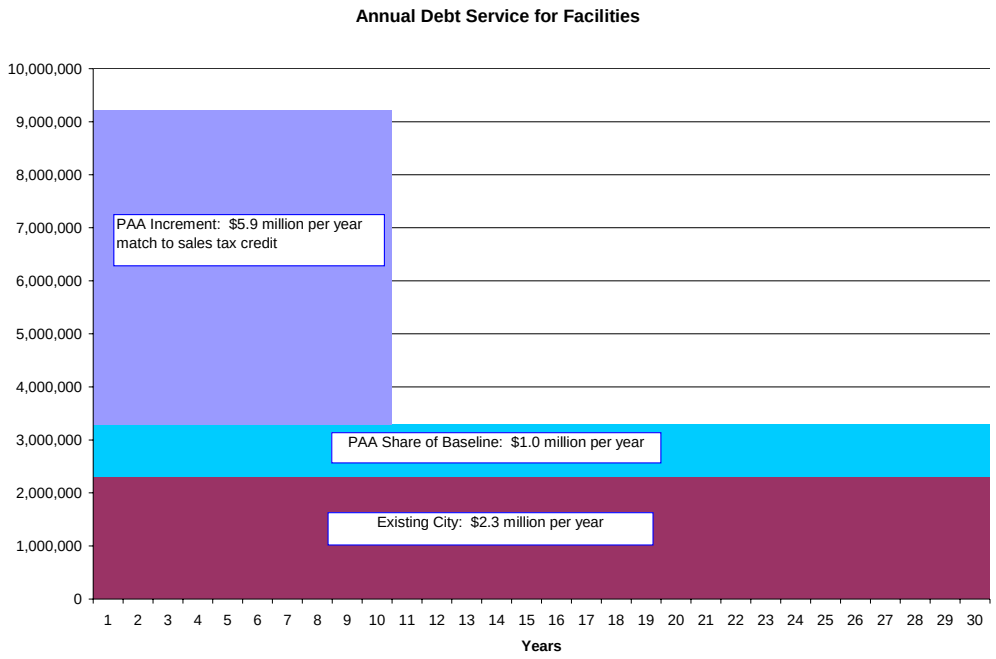
- Under annexation, both the City's tax base and its facility needs will increase. Adjusting the cost of the baseline needs ($29.6 million) for the larger tax base of a City of 80,000 rather than the existing City of 47,000, means that the PAA would contribute an additional $10.6 million ($30 million need for 47,000 people is "equivalent" to a $40.6 million need for 80,000 people) toward the incremental costs of annexation, and
- When the PAA residents assume a share of the City's current voted debt, existing citizens' tax burden would be reduced by an amount with a present value of $2.2 million.

After scaling the base City needs to reflect the larger City and giving PAA taxpayers credit for their contribution to existing City voted debt, there is still a significant incremental facility costs associated with annexation. The net cost after these adjustments is calculated at $38.3 million and is the share of the overall facility costs that should be borne by the PAA alone, with the remainder of the cost ($42.3 million) funded by the entire (larger) City, as shown below.

Category	Amount
Incremental Costs	51,099,000
PAA contribution to "baseline need" (1)	(10,600,000)
PAA contribution to existing GO debt (2)	(2,177,000)
Total facilities cost allocable to PAA Only	**$ 38,322,000**
Total baseline facilities costs	29,564,000
Net incremental facilities cost allocable to the Entire City	12,777,000
Total facilities costs allocable to Entire City	**$ 42,341,000**
Grand Total Facilities Cost	**$ 80,663,000**

(1) PAA contribution toward base facility cost (City w/o annexation $29.6M)
(2) Present value of PAA contributions to existing City GO debt

This distinction is important because it is one of the key factors in addressing the short-term nature of the 10-year state sales tax credit. The facility costs attributed to the PAA alone are assumed to be financed over 10 years, so that the true incremental costs of annexation are matched up with the period of state support for annexation deficits. Also, after the sales tax credit expires, the City's costs will be appropriately reduced to the baseline ongoing service and facility needs for the larger City. The remaining costs are financed over 30 years with both the existing City and the PAA bearing their proportionate share. The graph on the following page illustrates this dynamic.



The debt service costs associated with facilities are incorporated as part of the operating projections. It is important to note that both costs of facilities and potential financing strategies are currently being evaluated and update assumptions will be incorporated into the analysis once the information is available.

Impacts on Financial Projections

Operating Cost Projection

The fiscal model was updated as part of Phase 2 to incorporate the following major items:

- Update the existing City projections to reflect the 2007/08 adopted budget for new positions and refined revenue and expenditure estimates. These changes had an impact on both the PAA and the existing City portions of the budget.
- Validate the PAA projections based on additional data received since Phase 1,
- Add the incremental PAA costs identified as part of Phase 2:
    - The assumption of Fire District 41 debt and related land lease costs associated with the consolidated fire station ($290,000 in 2007 dollars),
    - Maintaining O.O. Denny Park to Kirkland level of service standards assuming that the Finn Hill Parks District will discontinue operations ($205,000 in 2007 dollars),
    - Adding an engine company to the Totem Lake Station to provide service to the Kingsgate area, assuming that the Woodinville Fire and Life Safety District will move its station out of the area in 2015 ($1.5 million in 2007 dollars, escalating to $1.9 million by 2015).

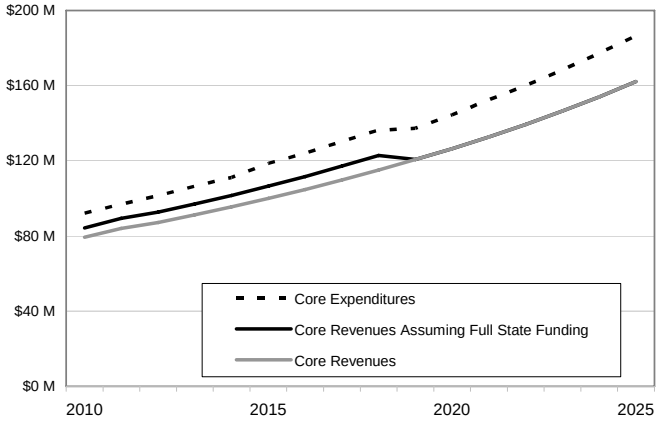
The updated existing costs and base PAA assumptions resulted in an increase in the projected shortfalls in the City and the PAA, however, the logic that the actions taken to close the gap in the existing City worked as well to close the gap in the PAA continued to hold true. However, the addition of new costs to the PAA projection results in a proportionately larger gap in the PAA than in the existing City. As a result, the actions required to close the City gap do not work as well to close the new gap in the PAA.

Note that relocation of the Kingsgate station was recognized in the Phase 1 analysis as a significant risk factor, because it increased the deficit in the PAA to such a degree that the actions necessary to close the gap in the existing City no longer worked as efficiently in the PAA. The addition of the other two elements exacerbates the problem. The revised baseline projection, with annexation, is summarized in the graph and tables below.

Scenario: Baseline With Annexation

Including the Following Impacts:

OO Denny Park Maintenance (2010):	$224,049
FD 41 Debt/Lease (2010):	$290,000
Kingsgate Engine Crew (2015):	$1,990,179



Current Kirkland	2010	2015	2020	2025
Core Expenditures (000's)	64,672	83,353	107,003	137,610
Facility Debt Service (000's)	2,295	2,303	2,288	2,254
Subtotal Expenditures	**66,967**	**85,655**	**109,291**	**139,864**
Core Resources (000's)	62,741	78,551	97,907	122,627
State Sales Tax Credit ('000's)	0	0	0	0
Subtotal Revenues	**62,741**	**78,551**	**97,907**	**122,627**
Net Resources (000's)	**(4,226)**	**(7,104)**	**(11,384)**	**(17,238)**
Deficit as % of Expenditures	**-7%**	**-9%**	**-11%**	**-13%**

Increment from PAAs	2010	2015	2020	2025
Core Expenditures (000's)	18,282	26,084	34,181	45,636
Facility Debt Service (000's)	6,919	6,911	993	1,027
Subtotal Expenditures	**25,202**	**32,995**	**35,174**	**46,662**
Core Resources (000's)	16,646	21,468	28,594	39,486
State Sales Tax Credit ('000's)	4,929	6,527	0	0
Subtotal Revenues	**21,576**	**27,995**	**28,594**	**39,486**
Net Resources (000's)	**(3,626)**	**(5,001)**	**(6,580)**	**(7,176)**
Deficit as % of Expenditures	**-20%**	**-19%**	**-19%**	**-16%**

Entire City	2010	2015	2020	2025
Core Expenditures (000's)	82,954	109,437	141,184	183,246
Facility Debt Service (000's)	9,214	9,214	3,281	3,281
Subtotal Expenditures	**92,169**	**118,651**	**144,465**	**186,527**
Core Resources (000's)	79,388	100,019	126,502	162,113
State Sales Tax Credit ('000's)	4,929	6,527	0	0
Subtotal Revenues	**84,317**	**106,546**	**126,502**	**162,113**
Net Resources (000's)	**(7,851)**	**(12,105)**	**(17,963)**	**(24,414)**
Deficit as % of Core Expenditures	**-9%**	**-11%**	**-13%**	**-13%**

Note that the updated fiscal model has been provided in response to a public disclosure request and is available for City Council review.

Conclusion

As a result of this new information, the policy guidance and actions to close the revised gap need to be revisited to arrive at a financially feasible scenario. In order to make the annexation scenario work financially, the City will have to consider modifications to the initial assumptions and policy direction related to annexation.

These initial assumptions include:

- Providing the same level of service in the PAA as in the existing City; and
- Allowing no material decrease in the level of service provided to the existing City residents.

The initial policy direction includes:

- Continuation of the ban on card rooms;
- Annexation of the entire PAA all at one time;
- Assumption of the Fire District 41 debt; and,
- Assumption of responsibility for the maintenance of O.O. Denny Park.

In re-examining these assumptions and policy options, there is no one obvious policy choice that would resolve the revised gap. For example, the annexation area boundary could be changed so that the boundary coincided with the boundaries of Fire District 41 and the Redmond Fire District, eliminating the costs associated with additional Fire staffing to serve the portion of annexation area currently served by Woodinville Fire & Life Safety. However, this smaller annexation area would have a proportionate reduction in revenue and the costs to serve the area would likely be disproportionately higher because the City would not likely realize staffing economies of scale. Because of the complexity of such issues, it will likely take a combination of strategies and difficult choices to develop an annexation scenario that is financially prudent for the City overall. Further direction is needed by Council about the types of strategies they are interested in pursuing at this time.