



CITY OF KIRKLAND
Department of Finance & Administration
123 Fifth Avenue, Kirkland, WA 98033 425.587.3100
www.ci.kirkland.wa.us

MEMORANDUM

To: David Ramsay, City Manager
From: Tracey Dunlap, Director of Finance and Administration
Date: May 7, 2009
Subject: Budget Update

The City Council requested a budget update in advance of the mid-year budget process which will begin in June. This report recaps the status information that has been provided to the City Council and Finance Subcommittee since the City Council Retreat in late March, describes the upcoming process, and frames some of the initial policy issues.

Budget Update

Attachment A contains the March Dashboard of financial indicators that was reviewed with the Finance Subcommittee at their April 28, 2009 meeting. In brief, General Fund expenditures continue to track to budget expectations. Revenues continue to fall short, especially in the areas of sales tax and development fee receipts. We are continuing to monitor all revenue sources and are analyzing the level of business license fees and expect to make recommendations regarding collections as part of the mid-year budget process.

Attachment B is the April sales tax report. As detailed in the report, April sales tax was down 20.1% compared to April 2008, with year-to-date revenues down 19.4% (or almost a million dollars behind last year's results). All business sectors continue to experience negative performance, especially major sectors like auto/gas retail and contracting.

In preparation for the Mid-Year Budget Update, we are providing a recap of the sales tax projections and related forecast scenarios that were discussed at the City Council Retreat. That discussion focused on two main scenarios:

- Scenario 3: Adopted Budget with 20% decrease in sales tax in 2009 and no growth in 2010, representing a relatively pessimistic scenario where 2009 sales tax continues at the levels experienced in January and February and there is no recovery in 2010;
- Scenario 5: Adopted Budget with 2009-2010 sales tax per the State Economic and Revenue Forecast Council projection, which represents a relatively optimistic scenario, with sales tax beginning to recover in the second half of 2009 and resuming a growth rate in 2010 that is more in line with long-term trends.

The forecasted General Fund shortfalls from the 2009-2010 adopted budget that were presented at the Retreat range from \$2.7 million to \$8.0 million for the biennium, as summarized below.

Recommended General Fund Shortfall Scenario

Dollars in thousands

	Annual Change		Biennial Change	No Voted Tax in 2010	Range of Shortfall
	2009	2010			
Scenario 3 - 20% Decrease & Flat Sales Tax	(2,772)	(3,055)	(5,827)	(2,240)	(8,067)
Scenario 5 - State Forecast Sales Tax Assumptions	(514)	69	(445)	(2,240)	(2,685)
Average of Scenarios 3 & 5 Sales Tax Decline	(1,643)	(1,493)	(3,136)	(2,240)	(5,376)

At the Retreat, we recommended that the budget reduction strategy focus on the "Average of Scenarios 3 & 5" sales tax assumptions. During the mid-year budget update, we will be presenting options to address the potential shortfalls in the recommended scenario. However, given that the sales tax receipts year-to-date have declined over 19%, we will also be evaluating additional options for addressing the more pessimistic scenario (Scenario 3).

To further expand on the sales tax assumptions, sales tax is budgeted in two places in the City's budget: the General Fund and the Capital Improvement Program. The assumptions related to the General Fund are generally the focus of discussion (as in the preceding paragraphs), but the monthly sales tax report includes the total general sales tax revenues. The **total** sales tax percentage changes in the scenarios are:

Total Sales Tax Assumptions by Scenario	2009 Change over 2008	2010 Change over 2009
Adopted Budget	-2.20%	-2.06%
Scenario 3 - 20% Decrease & Flat Sales Tax	-20.64%	-5.11%
Scenario 5 - State Forecast Sales Tax Assumptions	-5.62%	1.98%
Average of Scenarios 3 & 5 Sales Tax Decline	-13.13%	-1.13%

We hope that this additional information helps when reviewing the monthly sales tax report.

Mid-Year Budget Update/Adjustments

There are three scheduled Council discussions planned for the mid-year budget adjustments, as summarized below, with an initial listing of planned topics.

June 2 Study Session

- First quarter Financial Management Report (FMR)
- Results of CIP Review (preview at 5/26 Finance Subcommittee Meeting)
- Present information developed on the 7 budget-balancing strategies
- Discuss potential reductions necessary without voted private utility tax increase
- Layout the process timeline to place the utility tax question on the ballot
- Introduce specific issues to be addressed at the Mid-Year Budget Review study session

July 7 Mid-Year Budget Review Study Session

- Resources Forward adjustments
- Transfer from development services reserve
- Proposed adjustments to revenues/expenditures
- Internal rate changes

- Any mid-year reductions recommended
- Summary of the 7 budget-balancing strategies and related recommendations
- Utility tax ballot title and related information

July 21 Regular Meeting

- Adoption of mid-year adjustments
- Public hearing/potential action placing utility tax question on the ballot

We are providing some additional information on two mid-year policy issues for Council consideration. Ideally, staff would like to receive preliminary direction on May 19 regarding funding for:

Outside Agencies Funding for 2010

The 2009 Budget includes an appropriation of \$13,020 for Community Grants and \$15,000 for July 4th Fireworks. The Community Grants and Fireworks are one component of the outside agency funding package which is reviewed and appropriated annually by the City Council. They are funded using one-time resources. Due to funding limitations for 2009, this funding within the General Fund was reduced from \$66,375 (2008 approved) to \$28,020 (2009 approved). As a result, grant applicants were funded at about one half of the amount received in previous years. The following table shows the requested and approved amounts for the 2009 Community Grants and July 4th Fireworks.

Organization & Event	2008 Approved	2009 Requested	2009 Approved
Bridle Trails Park Foundation –Banner for Picnic	325	500	150
Celebrate Kirkland – July 4 th Parade	4,500	6,000	2,100
Celebrate Kirkland – July 4 th Picnic	4,500	4,500	2,100
Concours d' Elegance – Police Support & Banners	2,500	4,525	1,170
Eastside Heritage Center –City Hall Displays	1,250	4,500	585
Interlaken Trailblazers –Volkssporting 2009	300	300	140
Junior Softball World Series – Event Support*	5,000	10,000	-
Kirkland Arts Center –Free/Subsidized Classes	4,000	4,000	1,870
Kirkland Downtown Association –Classic Car Show*	3,500	4,500	-
Kirkland Heritage Society -Cataloging	2,000	2,000	935
Kirkland Interfaith Transitions in Housing -7 Hills of Kirkland	7,000	7,000	3,270
Kirkland Wednesday Market -Conference	-	3,000	-
Transportation Choices Coalition –Dues	<u>1,500</u>	<u>1,500</u>	<u>700</u>
Subtotal Community Grants	<u>36,375</u>	<u>52,325</u>	<u>13,020</u>
July 4 th Fireworks (Coordinated through Celebrate Kirkland)	<u>30,000</u>	<u>30,000</u>	<u>15,000</u>
Subtotal Fireworks	<u>30,000</u>	<u>30,000</u>	<u>15,000</u>
Total General Fund – One-Time	<u>66,375</u>	<u>82,325</u>	<u>28,020</u>

*Funded from Lodging Tax Fund

Staff generally begins the application process in June so that requests can be reviewed and a recommendation for Council prepared for the budget process. Given the financial challenges facing the City for 2009 and 2010, staff would like direction from Council for Community Grants and July 4th Fireworks. Options include:

May 7, 2009

Page 4

- Forego funding for one year
- Fund the program from one-time sources (cash or Council Contingency) at the same level
- Fund the program at a different level from one-time sources

Flexpass

The current King County Flexpass cards issued to City employees expire at the end of August 2009. During the 2009-2010 budget process, a service package to continue the program was submitted but was not approved, as the total cost had increased from \$42,630 in 2007-2008 to \$98,522 for 2009-2010. Staff is considering other options to the program and it would be useful to receive some guidance as to how much funding, if any, the City Council would be interested in putting toward an alternative program. Further information on possible options will be discussed as part of the mid-year budget adjustments.

March 2009 Financial Dashboard Highlights

April 24, 2009

- The March 2009 actual revenues and expenditures summarized in the dashboard represent the first quarter of 2009. In general terms, we continue to be concerned with the sales tax and development fee receipts, and we are monitoring closely the business license fee collections.
- Total General Fund revenues are below expectations due to the following:
 - 14.2% decline in sales tax revenues from March 2008, resulting in year-to-date revenues down 19.2%, or \$750,000 from last year.
 - Business License revenues are still lagging year-to-date due to a number of factors including:
 - IBM consolidated facilities at Carillon Point in January. The Carillon Point location renews in November and should reflect the combined FTEs from both locations, but the closed location (133 FTEs) would have renewed in February if it had remained.
 - We are in the process of reviewing delinquencies and will be discussing our collections process with the Finance Committee at the April meeting.
 - Development revenues are down dramatically for Planning and Public Works activities, but Building-related permit fees have improved from the February results. Further discussion of the March development activity follows the dashboard.
 - Selected large General Fund revenues are received in periodic increments including property tax (mostly received in April/May and October/November) and Fire District 41 and King County EMS payments (quarterly or semi-annually - no payments have been received through March).
- Total General Fund expenditures are within expectations. We are monitoring fire overtime, although the results through March are consistent with the estimate provided by Deputy Chief Henderson in January's report. The overtime is expected to be further reduced when the additional positions added as part of the 2009-2010 budget are on-duty beginning in April 2009.

Attachments: March Dashboard
Development Services Highlights

City of Kirkland Budget Dashboard

Annual Budget Status as of **3/31/2009** (Note 1)Percent of Year Complete **25.00%**

	2009 Budget	Year-to-Date Actual	% Received/ % Expended	Status		Notes
				Current Month	Last Month	
General Fund						
Total Revenues	58,081,118	10,290,749	17.7%			Prop. tax/FD41/EMS spike in 2Q
Total Expenditures	61,552,551	14,762,544	24.0%			
Key Indicators (All Funds)						
<i>Revenues</i>						
Sales Tax	14,700,801	3,173,579	21.6%			Prior YTD = \$3,927,052; Jan-Mar were 26% in 2008
Utility Taxes	11,586,963	2,854,392	24.6%			
Business License Fees	3,077,720	642,818	20.9%			Closely monitoring delinquency levels
Development Fees	3,373,273	528,722	15.7%			Continue to be down dramatically
Gas Tax	1,133,278	240,230	21.2%			
<i>Expenditures</i>						
GF Salaries/Benefits	42,618,606	10,100,519	23.7%			Excludes Fire Suppression Overtime
Fire Suppression Overtime	677,267	243,012	35.9%			New positions will not be on-duty until 4/1/09
Contract Jail Costs	899,680	249,663	27.8%			
Fuel Costs	558,310	57,453	10.3%			Cost/gallon running at about half budgeted rate

Status Key

Revenue is higher than expected or expenditure is lower than expected

Revenue/expenditure is within expected range

WATCH - Revenue/expenditure outside expected range



Note 1 - Report shows annual values during the first year of the biennium (2009).

na - not applicable

Development Services Report – March 2009

A review of the March 2009 permit data allows us to offer the following:

- The March 2009 statistics continue to follow the trend that we witnessed in the second half of 2008. New SFR permits applications remain low (1 application received compared to 16 last year) while commercial (tenant improvements) remain relatively healthy in numbers (8 applications compared to 4 last year). In the past when we have seen a downturn in new development permits, we have seen an increase in commercial tenant improvement permits and single-family remodel permits but that is not the case so far this year (14 applications compared to 29 last year). At this point it is too early to tell if that trend will repeat itself during this downturn.
- The total number of permits received in March 2009 (84) is lower than the monthly average for 2008 (222), and lower than March 2008 (113).
- Building Department revenue for March 2009 was \$243,491, well above our projected monthly revenue average of \$200,292 for 2009. However, year to date revenue falls short of the monthly average (for 3 months) by \$177,368.
- We still expect to issue Lake Washington High School in April (\$295,375) and Merrill Gardens II in May (\$78,947). We expect the Kirkland Transit Center, Totem Lake Apartments and the Northwest University (Seahawks) remodel to be issued later this year. The McLeod project is being redesigned by the applicant.
- Touchstone has begun the design review process for the redevelopment of Park Place. The Conceptual Design conference was held in January. At the meeting the DRB identified key issues and discussed the process for review. The first Design Response Conference will be held in April. The DRB will hold a series of additional meetings as they work their way through the development and give their approval by end summer.

The applicant has indicated a desire to apply for the first permits (demolition and grading) possibly by the end of 2009. Permits for buildings will be phased, probably beginning in 2010. Meanwhile Development Review Services is in preliminary discussions with the Park Place design team to provide review services during the design process. This approach has the potential of generating substantial fees prior to the actual submittal of their permit applications and a shorter review period once they submit.

- On April 1st, a Public Works Office Specialist position (in the Development Division) was vacated. Due to the decrease in permit activity, Public Works has chosen to not backfill this position at this time. This decision coupled with the Development Engineering staff working for Surface Water Group (discussed in last month's report) result in an approximate savings of 2 additional FTE costs to the General Fund in 2009/2010 if it continues throughout the biennium.



CITY OF KIRKLAND

Department of Finance & Administration

123 Fifth Avenue, Kirkland, WA 98033 425.587.3100

www.ci.kirkland.wa.us

MEMORANDUM

To: Dave Ramsay, City Manager

From: Tracey Dunlap, Director of Finance & Administration
Neil Kruse, Budget Analyst

Date: April 28, 2009

Subject: April Sales Tax Revenue Analysis – READING FILE

April is **down 20.1 percent** compared to April 2008. This is in line with January and February, which were down 19.0 percent and 22.8 percent respectively, and in contrast to March which was down only 14.2 percent compared to the same months of the prior year. **Year-to-date** sales tax revenue is **down 19.4 percent** compared to the same period in 2008, which translates to almost one million dollars less revenue compared to the same period in 2008. Sales tax revenue received this month is for activity in February.

All business sectors continue to experience negative performance compared to the same period last year. The primary sectors causing the downward swing in April are automobile/ gas retail (down 32.3 percent or about \$85,000 compared to April 2008) and contracting (down 36.6 percent or about \$67,000 compared to April 2008).

Business sector review:

- The **contracting** sector performance had stabilized over the latter half of 2008 compared to earlier in the year. But, the sector has performed weakly so far in 2009, **down 28.3 percent** compared to the same period last year. Severe weather may have played a role in this sector's steep decline earlier in the year; however receipts this month (reflecting February activity) are down significantly from last April, as mentioned earlier. This decline most likely reflects a response to the economic conditions more than weather. This sector could start improving once some of the large planned projects commence, such as the replacement of Lake Washington High School. Other potential future projects include the Bank of America project and a major renovation of the Totem Lake Fred Meyer store.
- Overall, the **retail** sectors performance remains negative, **down 16.6 percent** collectively compared to the same period in 2008 due to negative performance across the board.
 - The **auto/gas retail** sector is **down 22 percent** compared to the same period last year due to disappointing sales experienced by several major dealerships. This month was especially poor, down 36.6 percent compared to last April and may be in part due to the sales tax exemption granted to hybrid vehicle purchases as of January 1st. The impact of the temporary closure of one of the major dealerships last month due to financing problems will not show up until next month. The positive news is the Hyundai franchise, which also closed recently, has been picked up by another dealership in Kirkland.
 - The **retail eating/drinking** sector, which was relatively stable throughout 2008, is **down 14.6 percent** compared to last year due to negative performance experienced by most major businesses, as well as a closure of one restaurant in Totem Lake. This sector is also heavily influenced by reduced discretionary consumer spending.
 - The **general merchandise/miscellaneous retail** sector continues in the negative, **down 12.2 percent** compared to the same period last year due to disappointing performance by key retailers. However, this sector has improved slightly over the first two months of the year, which were down 13.8 percent and 15.7 percent respectively year-to-date. This sector may be impacted by the streamlined sales tax sourcing rule change.

- **Other retail is down 14.2 percent** largely due to generally negative performance in most retail sectors included in this group, especially building materials and electronic equipment. This sector is another that may be impacted by the streamlined sales tax sourcing rule change.
- The **miscellaneous** sector is **down 19.7 percent** compared to the same period last year primarily due to the slumping finance/insurance and real estate sectors.
- The **services** sector is **down 11.1 percent** compared to the same period last year largely due to declines in software and car/equipment leasing. The accommodations sector continued negative performance for the fourth month in a row, down 11.2 percent compared to the same period last year after normalizing for a one-time event in 2008.
- The **communications** sector is **down 17.7 percent** compared to last year due to changes in levels of development-related activity.
- **Wholesale** is **down 36.4 percent** compared to last year, primarily due to the difference in development-related purchases compared to last year and also due to changes in sourcing rules from streamlined sales tax.

City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January-April		Dollar Change	Percent Change	Percent of Total	
	2008	2009			2008	2009
Services	546,879	486,195	(60,684)	-11.1%	10.9%	12.0%
Contracting	826,679	592,942	(233,737)	-28.3%	16.5%	14.7%
Communications	193,606	159,340	(34,266)	-17.7%	3.9%	3.9%
Auto/Gas Retail	1,051,037	819,342	(231,695)	-22.0%	21.0%	20.3%
Gen Merch/Misc Retail	799,926	702,507	(97,419)	-12.2%	16.0%	17.4%
Retail Eating/Drinking	418,699	357,711	(60,988)	-14.6%	8.4%	8.9%
Other Retail	584,511	501,601	(82,910)	-14.2%	11.7%	12.4%
Wholesale	317,859	202,066	(115,793)	-36.4%	6.3%	5.0%
Miscellaneous	273,595	219,595	(54,000)	-19.7%	5.3%	5.4%
Total	5,012,791	4,041,299	(971,492)	-19.4%	100.0%	100.0%

Streamlined Sales Tax

The City received a mitigation payment of \$77,000 last month for activity in the last quarter of 2008. This follows a payment of almost \$75,000 received in December 2008. As noted before, this contradicts earlier projections by the Department of Revenue (DOR) that Kirkland would experience a slight positive impact from sourcing rule changes. The number of wholesale deliveries by businesses located in Kirkland appears to be higher than originally calculated. If we add these two payments to sales tax revenue in 2009, total sales tax would be down 16.3 percent over 2008 year to date. Based on Council direction at the retreat, the mitigation payments will be treated as revenues to the General Fund rather than placing them in the Revenue Stabilization Reserve. The next payment will be received in June for the first quarter of 2009 activity.

Conclusion

April sales tax performance illustrates the continuing economic recession experienced both locally and globally. Local consumer spending reflects the same trend seen nationally in reduced discretionary purchases in retail sectors, especially automobiles and dining out. Declining development activity as a result of both economic uncertainty and credit availability impacts sales tax revenue not only in the contracting sector, but also wholesale, services, and communications sectors.

Nationally, consumer spending is expected to increase at an annual rate of 1.5 percent for first quarter 2009, which is its best showing since 2007 according to Forbes.com. This is partially due to lower fuel prices,

which provided relief to consumer budgets. Since consumer spending accounts for 70 percent of the gross domestic product (GDP), personal consumption will contribute 1.1 point to real GDP growth. But, the improvement in consumer spending will be more than offset by contraction in business and government spending. However, business spending should start turning around in response to increased consumer spending.

The Conference Board Consumer Confidence Index improved in April to 39.2 after sinking to 25 in February and posting 26.9 in March. The reading is the highest it's been since last November; however it is still far below the March 2008 index of 65.9. Improved consumer confidence along with the report of slower declines in single-family home prices also helped lift the stock market according to the New York Times.

Members of the "Group of 7" industrialized nations met last week and stated that there were signs of stabilization in the global economic crisis. "There are signs that the pace of deterioration in economic activity and trade flows has eased," said U.S. Treasury Secretary Timothy Geitner in the New York Times. He also stated that while encouraging, "it's too early to say that the risks have receded."