



CITY OF KIRKLAND
Department of Finance & Administration
123 Fifth Avenue, Kirkland, WA 98033 425.587.3100
www.kirklandwa.gov

MEMORANDUM

To: Kurt Triplett, City Manager

From: Michael Olson, Director of Finance & Administration
Chip Corder, Temporary Deputy Director-Budget
Robby Perkins-High, Senior Financial Analyst
Kevin Lowe Pelstring, Budget Analyst

Date: July 23, 2020

Subject: June 2020 Sales Tax Revenue

Summary

The Financial Planning Division prepares a monthly sales tax revenue memo analyzing monthly and year-to-date activity by business sector, forecasting sales tax revenue in the current year, and tracking key national and regional economic indicators to provide additional context for the state of the economy. The general retail sales tax is the City's largest single revenue source, accounting for 19 percent of total budgeted revenues in the General Fund and funding, along with property tax and utility taxes, public safety and other general government (i.e., non-utility) services. It is also more sensitive to economic cycles than other tax revenues. Accordingly, it is monitored closely by staff—even more so given the economic disruption and the uncertainty, in terms of a return to normalcy, caused by COVID-19.

There is a two-month lag between when sales tax is generated and when it is distributed to the City by the Washington State Department of Revenue (DOR). Accordingly, June sales tax revenue relates to April retail activity in Kirkland. The negative economic impacts of COVID-19 are evident in various business sectors, with April representing the first full month under the Governor's stay-at-home order, which took effect on March 23. **Comparing June 2020 to June 2019, sales tax revenue is down \$566,167 (29.2 percent).** However, this includes a \$499,925 negative adjustment by the Washington State Department of Revenue (DOR) for taxpayer remittance errors, which overstated retail activity in January and March (resulting in higher distributions to the City in March and May). **Excluding this correction, sales tax revenue is down only \$66,241 (3.4 percent) in June. Comparing the first half of 2020 to the first half of 2019, year-to-date sales tax revenue is down \$669,540 (5.3 percent),** with the following business sectors (constituting 82.2% of the sales tax revenue budget in 2020) being most noteworthy:

Business Sector	% of Total Sales Tax Revenue Budget (2020)	% Change: First Half 2020 vs. First Half 2019
Contracting	26.2%	+3.3%
Auto/Gas Retail	16.6%	-20.5%
Services	14.4%	+8.4%
Other Retail	13.6%	+7.2%
Retail Eating/Drinking	6.1%	-16.4%
Miscellaneous	5.3%	-35.5%

June 2020 vs. June 2019

Two tables are provided, one including the \$499,925 correction noted above and the other excluding it.

June Sales Tax Receipts including \$499,925 Correction

Business Sector Group	June		Dollar Change	Percent Change	Percent of Total	
	2019	2020			2019	2020
Services	255,316	(222,786)	(478,102)	-187.3%	13.2%	-16.2%
Contracting	540,633	490,854	(49,779)	-9.2%	27.9%	35.8%
Communications	46,728	32,346	(14,382)	-30.8%	2.4%	2.4%
Retail:						
Auto/Gas Retail	283,227	352,166	68,939	24.3%	14.6%	25.7%
Gen Merch/Misc Retail	208,604	196,418	(12,186)	-5.8%	10.8%	14.3%
Retail Eating/Drinking	144,040	113,253	(30,787)	-21.4%	7.4%	8.3%
Other Retail	238,209	240,863	2,654	1.1%	12.3%	17.5%
Wholesale	106,877	70,053	(36,824)	-34.5%	5.5%	5.1%
Miscellaneous	115,236	99,536	(15,700)	-13.6%	5.9%	7.3%
Total	1,938,870	1,372,703	(566,167)	-29.2%	100%	100%

Note: June 2020 revenue includes a \$499,925 correction to the Services business sector for taxpayer remittance errors, which overstated retail activity in January and March (resulting in higher distributions to the City in March and May).

June Sales Tax Receipts excluding \$499,925 Correction

Business Sector Group	June		Dollar Change	Percent Change	Percent of Total	
	2019	2020			2019	2020
Services	255,316	277,140	21,824	8.5%	13.2%	20.2%
Contracting	540,633	490,854	(49,779)	-9.2%	27.9%	35.8%
Communications	46,728	32,346	(14,382)	-30.8%	2.4%	2.4%
Retail:						
Auto/Gas Retail	283,227	352,166	68,939	24.3%	14.6%	25.7%
Gen Merch/Misc Retail	208,604	196,418	(12,186)	-5.8%	10.8%	14.3%
Retail Eating/Drinking	144,040	113,253	(30,787)	-21.4%	7.4%	8.3%
Other Retail	238,209	240,863	2,654	1.1%	12.3%	17.5%
Wholesale	106,877	70,053	(36,824)	-34.5%	5.5%	5.1%
Miscellaneous	115,236	99,536	(15,700)	-13.6%	5.9%	-29.2%
Total	1,938,870	1,872,629	(66,241)	-3.4%	100%	100%

Including the \$499,925 correction, which impacted the Services business sector, **sales tax revenue is down \$566,167 (29.2 percent) in June**. However, this correction should be excluded from the comparison, since it ties back to the March and May sales tax distributions to the City. Thus, **sales tax revenue is down only \$66,241 (3.4 percent) in June, ignoring the correction**.

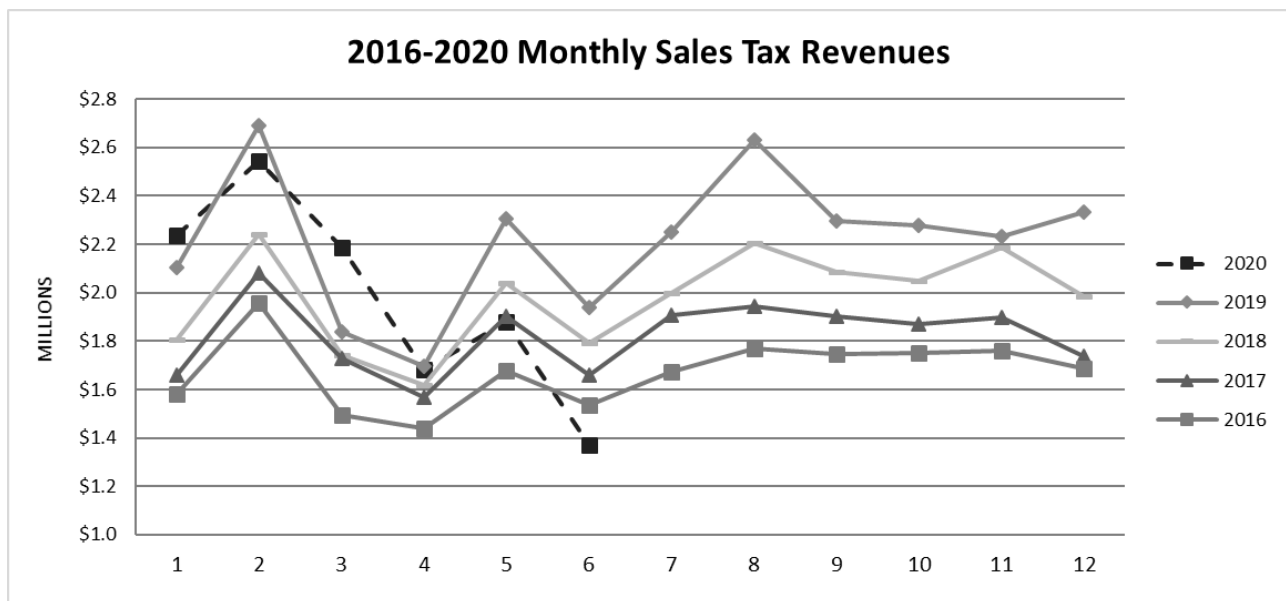
Looking at business sectors, the most significant growth occurred in **Auto/Gas Retail (up \$68,939, or 24.3 percent) and Services (up \$21,824, or 8.5 percent)**. Noteworthy declines occurred in **Contracting (down \$49,779, or 9.2 percent), Wholesale (down \$36,824, or 34.5 percent), and Retail Eating/Drinking (down \$30,787, or 21.4 percent)**. There were significant percentage declines in Communications (down 30.8 percent) and Miscellaneous (down 13.6 percent) as well, but both were under \$16,000 each, which is less consequential.

January-June 2020 vs. January-June 2019

Business Sector Group	YTD		Dollar Change	Percent Change	Percent of Total	
	2019	2020			2019	2020
Services	1,578,112	1,710,975	132,863	8.4%	12.5%	14.4%
Contracting	3,013,931	3,114,032	100,101	3.3%	24.0%	26.2%
Communications	263,182	250,009	(13,173)	-5.0%	2.1%	2.1%
Retail:						
Auto/Gas Retail	2,491,536	1,981,290	(510,246)	-20.5%	19.8%	16.6%
Gen Merch/Misc Retail	1,305,838	1,364,305	58,467	4.5%	10.4%	11.5%
Retail Eating/Drinking	867,418	725,114	(142,305)	-16.4%	6.9%	6.1%
Other Retail	1,505,794	1,614,937	109,143	7.2%	12.0%	13.6%
Wholesale	568,516	512,581	(55,935)	-9.8%	4.5%	4.3%
Miscellaneous	981,546	633,090	(348,456)	-35.5%	7.8%	5.3%
Total	12,575,873	11,906,333	(669,540)	-5.3%	100%	100%

Sales tax revenue is down \$669,540 (5.3 percent) in the first half of 2020. In terms of business sectors, the most significant growth occurred in **Services (up \$132,863, or 8.4 percent), Other Retail (up \$109,143, or 7.2 percent), and Contracting (up \$100,101, or 3.3 percent)**. Within Services, the growth has been concentrated in the Administration & Support and Publishing Services sub-sectors. Other Retail’s growth has been led by the Electronics and Health & Personal sub-sectors. Noteworthy declines occurred in **Auto/Gas Retail (down \$510,246, or 20.5 percent), Miscellaneous (down \$348,456, or 35.5 percent), and Retail Eating/Drinking (down \$142,305, or 16.4 percent)**. The dramatic drop in Auto/Gas Retail is primarily due to a \$410,305 (83.5 percent) decline in May sales tax revenue (for March retail activity). The significant decrease in Miscellaneous relates to a large payment in back taxes by a business in 2019 (roughly \$248,522) distorting the year-over-year comparison, so **without this adjustment the Miscellaneous sector would only be down 13.6 percent from 2019 and total sales tax revenues would be down roughly 3.4 percent.**

The chart below shows Kirkland’s monthly sales tax revenue through June 2020 compared to the four prior years.



“What If” Forecast Scenarios (2020 Only)

Given current COVID-19 data trends in King County and the high level of economic uncertainty that accompanies it, four “what if” forecast scenarios are provided for 2020 sales tax revenue.

“What If” Scenario	2020 Forecast	2020 Budget	Surplus (Deficit)	Staff Forecast Assessment
2020 forecast is 5% below 2019 actual*	\$25,262,146	\$23,130,166	\$2,131,980	Optimistic
2020 forecast is 10% below 2019 actual*	\$23,932,560	\$23,130,166	\$802,394	Somewhat likely
2020 forecast is 15% below 2019 actual*	\$22,602,973	\$23,130,166	(\$527,193)	Likely
2020 forecast is 20% below 2019 actual*	\$21,273,386	\$23,130,166	(\$1,856,780)	Somewhat pessimistic

*2019 actual sales tax revenue = \$26,591,733.

As previously noted, sales tax revenue for the first half of 2020 is down only 5.3 percent relative to the same period in 2019. However, this is not expected to hold for the second half of 2020. **The most recent King County Forecast Model, which was released in July 2020 by the Office of Economic and Financial Analysis, projects a 15.7 percent decline in taxable retail sales in 2020 relative to the prior year.** Previously, the King County Economic and Revenue Forecast, which was released in June 2020 by the same Office, projected a 30.0 percent decline in taxable retail sales in 2020. Such a dramatic swing in projected taxable retail sales captures how difficult the current forecasting environment is. With only two months of sales tax revenue data available since COVID-19 took root, the next two monthly sales tax distributions from DOR in July (for May retail activity) and August (for June retail activity) are critical to developing a more informed forecast for 2020 and the coming biennium.

There are two key “takeaways” from these “what if” forecast scenarios. **First, 2020 budgeted sales tax revenue is 13 percent below 2019 actual sales tax revenue.** That provides a significant “cushion” in 2020, reducing the financial impact of the two deficit scenarios accordingly. For example, under the 20 percent reduction scenario, the \$1,856,780 budget shortfall in sales tax revenue represents only a 7 percent reduction. **Second, if 2020 sales tax revenue declined 20 percent, the City could cover the \$1,856,780 budget shortfall with General Fund surplus cash at the end of 2019.**

To help frame staff’s assessment of the last two “what if” forecast scenarios, the following two tables identify how much sales tax revenue in the second half of 2020 would have to decline relative to the second half of 2019 to end the year 15 percent and 20 percent below 2019 actual sales tax revenue.

2020 Forecast is 15% below 2019 Actual (Staff Forecast Assessment: Likely)

Sales Tax Revenue	2019	2020	\$ Change	% Change
First half of year (actual)	\$12,575,873	\$11,906,332	(\$669,541)	-5.3%
Second half of year (2019 actual & 2020 forecast)	\$14,015,860	\$10,696,641	(\$3,319,219)	-23.7%
Total	\$26,591,733	\$22,602,973	(\$3,988,760)	-15.0%

2020 Forecast is 20% below 2019 Actual (Staff Forecast Assessment: Somewhat Pessimistic)

Sales Tax Revenue	2019	2020	\$ Change	% Change
First half of year (actual)	\$12,575,873	\$11,906,332	(\$669,541)	-5.3%
Second half of year (2019 actual & 2020 forecast)	\$14,015,860	\$9,367,054	(\$4,648,806)	-33.2%
Total	\$26,591,733	\$21,273,386	(\$5,318,347)	-20.0%

In the 15 percent and 20 percent reduction scenarios, sales tax revenue in the second half of 2020 would have to decline 23.7 percent and 33.2 percent respectively compared to the second half of 2019.

Staff will finalize its 2020-2022 sales tax forecast at the end of August for the 2021-2022

Preliminary Budget. However, it will be subject to change based on the monthly sales tax distributions in September, October, and November as well as other relevant economic data. If necessary, the 2020-2022 sales tax forecast can be adjusted as late as December, when the 2021-2022 Final Budget is adopted by the Council.

Key National and Regional Economic Indicators

Information about wider trends in the economy provides a mechanism to help understand current results in Kirkland and to predict future performance. The combination of consumer confidence, unemployment levels, housing data, inflation, and auto sales provides a broader economic context for key factors in sales tax revenues. Since the sales tax figures reported above are from two months prior, some of the figures in the table below can function as leading indicators for where sales taxes may go in future reports.

Indicator	Most Recent Month of Data	Unit	Month			Yearly Average	
			Previous	Current	Change	2019	2020
Consumer Confidence							
Consumer Confidence Index	June	Index	85.9	98.1	12.2	128.1	108.6
Unemployment Rate							
National	June	%	13.3	11.1	(2.2)	3.7	8.4
Washington State	May	%	16.1	14.8	(1.3)	4.5	9.1
King County	April	%	5.6	14.9	9.3	3.0	8.0
Kirkland	April	%	5.3	13.0	7.7	2.9	7.0
Housing							
New House Permits	May	Thousands	28.6	56.6	28.0	48.7	46.9
Case-Shiller Seattle Area Home Prices	April	Index	266.2	270.0	3.8	252.2	263.0
Inflation (CPI-W)							
National	June	% Change	(0.1)	0.5	0.6	1.7	1.1
Seattle	June	% Change	1.5	1.0	(0.5)	2.1	1.7
Car Sales							
New Vehicle Registrations	June	Thousands	9.4	16.6	7.2	23.7	17.2

The Conference Board **Consumer Confidence Index** increased modestly in June at 98.1, after a sharp decline in April. The 2020 average thus far sits 19.5 points below the 2019 average.

The national **Unemployment Rate** dropped from 13.3 percent in May to 11.1 percent in June, while the Washington State unemployment rate dropped from 16.1 percent in April to 14.8 percent in May. King County and Kirkland’s unemployment rates increased dramatically from March to April, with the County going from 5.6 percent to 14.9 percent and Kirkland going from 5.3 to 13.0 percent. Preliminary data (not included in the above table) indicates that unemployment rates will likely fall in June for Washington State (possibly below 10.0 percent) and in May for King County and Kirkland.

New Housing Permits rebounded significantly from April, increasing by 28,000 in May. The **Case-Shiller Home Price Index** saw an increase of 3.8 points, and currently sits 10.8 points above the 2019 average.

Inflation for Seattle-Tacoma-Bellevue, as measured by the CPI-W, fell from 1.5 percent to 1.0 percent between April and June. On the national level, inflation turned moderately positive, increasing from -0.1 percent in May to 0.5 percent in June.

New Vehicle Registrations decreased by 7,200 from May to June, continuing to decline since the COVID-19 crisis began.