



CITY OF KIRKLAND
Department of Finance & Administration
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MEMORANDUM

To: Kurt Triplett, City Manager

From: Michael Olson, Director of Finance and Administration
Sri Krishnan, Deputy Director of Finance and Administration
Chip Corder, Temporary 2021-2022 Budget Development Staff

Date: October 1, 2020

Subject: 2020-2026 General Fund Financial Forecast Update &
2021-2022 General Fund Budget Balancing

RECOMMENDATION:

City Council receive the updated 2020-2026 General Fund forecast and a preview of the 2021-2022 General Fund Budget balancing and themes.

BACKGROUND:

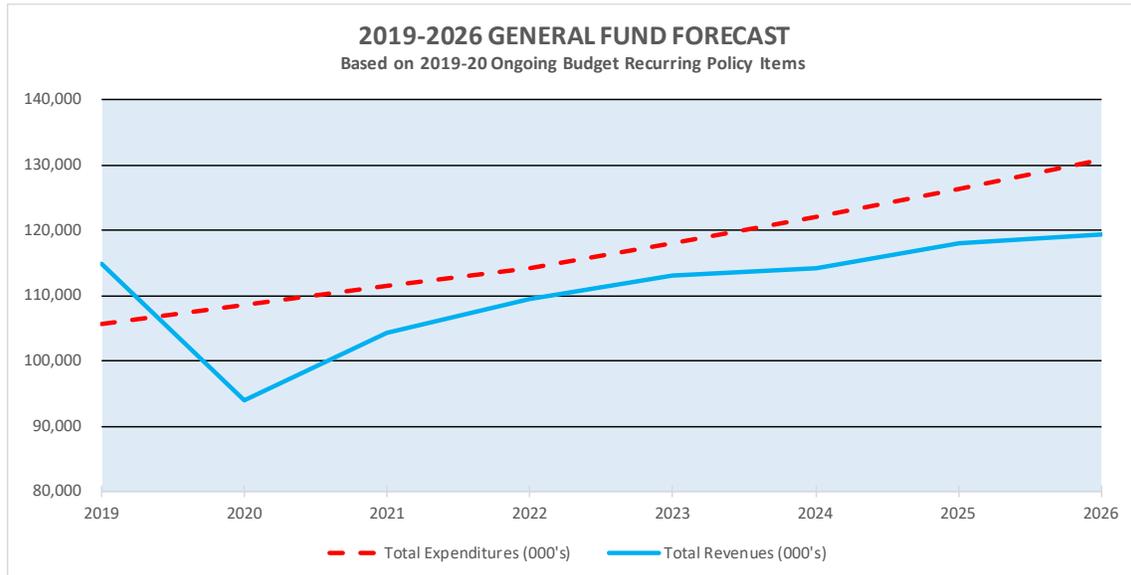
May 2020 General Fund Forecast

At the May 29, 2020 Council Finance Retreat staff presented two General Fund forecast scenarios, reflecting the estimated financial impact of COVID-19 on the City's revenues in 2020-2026: 1) V-Shaped Recovery, and 2) Big-V Recovery. The scenarios were based on guidance from the Government Finance Officers Association (GFOA) and similar to the forecasts provided by the King County Office of Economic and Financial Analysis.

As noted in the September 15, 2020 Revenue Public Hearing, in May 2020, the City had very little actual data on which to base its COVID-19 related forecasts. Fortunately, actual revenues over the past 3-4 months have been much better than projected back in May 2020, when the level of economic uncertainty was extremely high. The City's updated General Fund revenue forecast incorporates actual sales tax revenue through August 2020 and actual property tax, utility taxes, development fees, and other revenues through July 2020.

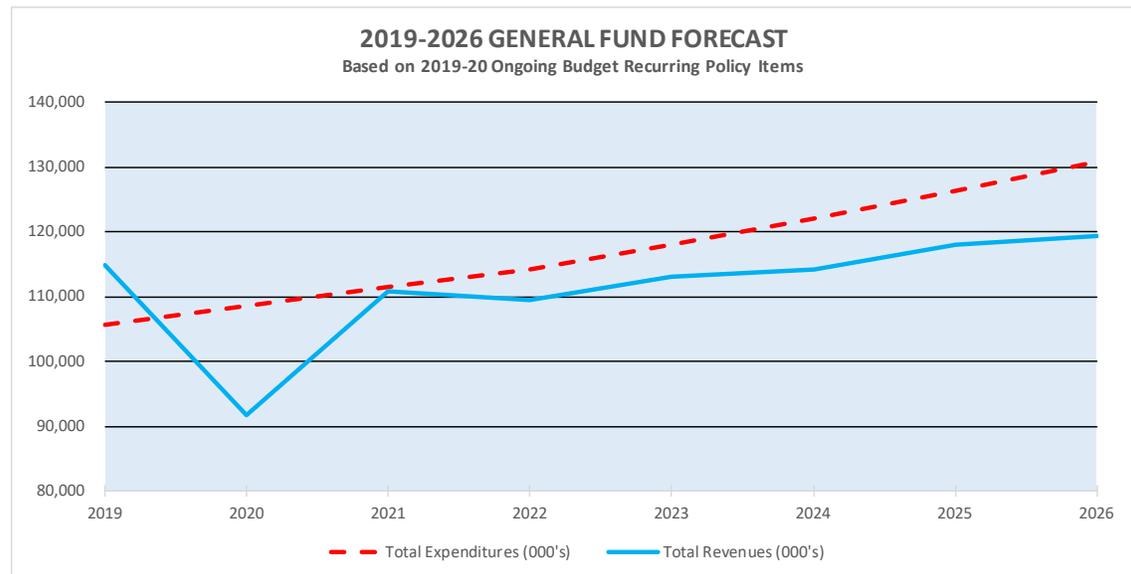
For purposes of this discussion, the two forecasts provided in May are presented below. These are followed by the August 2020 General Fund Forecast and a discussion of the reasons for the changes.

Long-Term Forecast V-Shaped Recovery



	2019	2020	2021	2022	2023	2024	2025	2026
Total Expenditures (000's)	105,619	108,698	111,528	114,140	118,004	122,012	126,372	130,918
Total Revenues (000's)	114,774	94,086	104,379	109,489	112,991	114,261	118,067	119,421
Net Change (000's)	9,155	(14,612)	(7,149)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
Net Less Additions to Reserves	4,619	(14,612)	(7,149)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
Biennium Net Resources (000's)		(9,994)		(11,800)		(12,764)		(19,802)

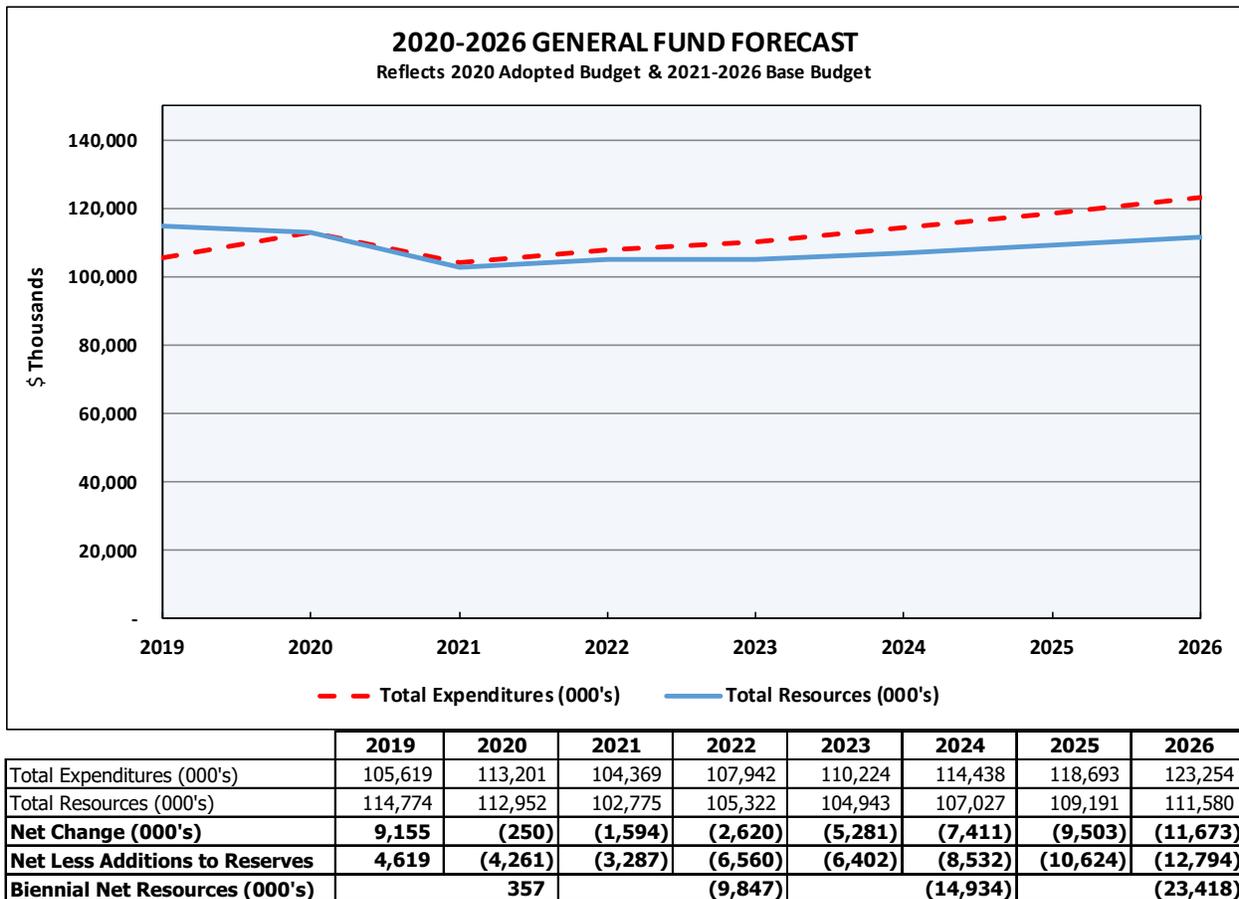
Long-Term Forecast Big-V Recovery



	2019	2020	2021	2022	2023	2024	2025	2026
Total Expenditures (000's)	105,619	108,698	111,528	114,140	118,004	122,012	126,372	130,918
Total Revenues (000's)	114,774	91,721	110,794	109,489	112,991	114,261	118,067	119,421
Net Change (000's)	9,155	(16,978)	(734)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
Net Less Additions to Reserves	4,619	(16,978)	(734)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
Biennium Net Resources (000's)		(12,359)		(5,385)		(12,764)		(19,802)

August 2020 General Fund Forecast

The 2020-2026 General Fund forecast was updated in late August 2020 based on actual revenues and expenditures through July 2020, with the exception of sales tax, which is through August.



Because of much better than projected economic performance since the two forecasts were presented to the Council at its May 29, 2020 retreat, the August 2020 forecast projects much smaller deficits in 2020-2021. The three forecasts are compared below and numbers in parentheses mean deficits. All numbers are in thousands.

General Fund Forecast	2020	2021	2022	2023	2024	2025	2026
May 2020 V-Shaped Recovery	(14,612)	(7,149)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
May 2020 Big-V Recovery	(16,978)	(734)	(4,651)	(5,013)	(7,751)	(8,305)	(11,497)
August 2020	(4,261)	(3,287)	(6,560)	(6,402)	(8,532)	(10,624)	(12,794)

Focusing on 2020, the dramatic swing from significant deficits in the two May 2020 forecasts to smaller deficits in the August 2020 forecast is primarily due to the following:

- **Sales tax** through August 2020 is down only 4.7 percent compared to the same period in 2019. Given the continuing high level of economic uncertainty through the balance of

the year, especially with temporary federal assistance ending in July, staff assumed a 10 percent decline in sales tax in 2020 relative to 2019 (which is \$802,394, or 3.5 percent, more than the amount budgeted in 2020). The August 2020 sales tax forecast is compared to both May 2020 sales tax forecasts in the following two tables.

Aug 2020 vs. V-Shaped Recovery Forecast	2020
August 2020 forecast (10% < 2019 actual)	\$23,932,560
May 2020 V-Shaped Recovery forecast (36.1% < 2019 actual)	\$16,997,492
Increase over V-Shaped Recovery forecast	\$6,935,068

Aug 2020 vs. Big-V Recovery Forecast	2020
August 2020 forecast (10% < 2019 actual)	\$23,932,560
May 2020 Big-V Recovery forecast (41.5% < 2019 actual)	\$15,559,881
Increase over Big-V Recovery forecast	\$8,372,679

- **Development fees** are projected to be \$854,191, or 8.1 percent, more than what is budgeted in 2020.
- **Business fees**, which encompass revenue generating regulatory license fees, business license fees, and franchise fees, are projected to be \$311,267, or 4.2 percent, more than what is budgeted in 2020.
- **CARES Act grants** of \$4.0 million have been awarded to the City in 2020. Of this amount, an estimated \$1.2 million represents a reimbursement of budgeted personnel costs that were re-directed to the City's pandemic response and to employee leave related to COVID-19. This number will be further refined in October and November as CARES Act monies are fully spent and the full benefit to the General Fund is known.
- **Investment interest** is projected to be \$1.49 million, or 184.2 percent, more than what is budgeted in 2020.

Looking at 2021-2022, the reduced deficits in the August 2020 forecast can be attributed primarily to the following:

- The **annexation sales tax credit reserve**, which will have a \$2.16 million balance by June 30, 2021, is assumed to be fully spent in 2022.

Unlike other King County cities, Kirkland has been insulated, in part, from the economic downturn in 2020 by the following:

- The City's **modified two-year sales tax lag policy** has provided a significant "buffer," with 2020 budgeted sales tax revenue being 13 percent below 2019 actual sales tax revenue. This budget policy sets Kirkland apart from most, if not all, cities in King County.

- The City is continuing to experience a **high level of development activity**, though the Governor’s “stay-at-home” order had a temporary, negative economic impact.
- The **available General Fund surplus** at the end of 2019, discussed below, provides an additional one-time “buffer.”

As a result, City staff have been able to continue monitoring the economic impact of the pandemic and to thoughtfully propose a balanced 2021-2022 Preliminary Budget that fully funds previous one-time service packages as well as new staffing and programs responsive to Resolution R-5434.

Available General Fund Cash and Reserves in 2020

Available General Fund Cash

At the May 29, 2020 Council Retreat, staff indicated that the early estimate of the available cash in the General Fund from 2019 was approximately \$9.0 million. Since then, staff completed the year-end financial statements and the annual audit at the end of July. The cash reconciliation, which was part of the financial statement process, identified an additional \$9.09 million in available cash from 2018. The result is that there is now \$18.09 million in available cash in the General Fund from 2019.

Reasons for change from \$9.0 million to \$18.09 million:

1. **Timing** – The early estimate of the available cash in the General Fund of approximately \$9.0 million was based on *estimated* 2019 General Fund revenues and expenses. At the end of May 2020, staff had not completed the 2019 financial statements and could not provide the actual available General Fund cash balance at the May 29, 2020 Council Retreat. That number became available in July after the Accounting group had completed their review, reconciliations, and necessary adjustments.
2. **Financial System Change** – The City transitioned from the prior financial system (IFAS) to a new financial system, Munis, in late 2018 and developed the 2019-2020 Budget using data in both financial systems. This resulted in staff focusing on ensuring that the 2019-2020 Budget was accurate and balanced based on *estimated* year-end General Fund cash in 2018. Although it is common to use the estimated year-end cash amount as the next biennial budget is developed, the estimate itself was very conservative (low), because the change in financial systems also included a change in reporting from a cash-basis in IFAS to an accrual-basis in Munis.

2018 turned out to be a year of extraordinary economic growth and revenues came in much higher than estimates. At the same time the city had significantly more 2018 under-expenditures than estimated, due in large part to extended vacancies in 2018 that took longer to fill in the full employment economy. Staff were aware that there could potentially be more *actual* cash available at the end of 2018, but they would have to complete the implementation and then revisit this issue as part of a future cash reconciliation. This reconciliation, which was completed as part of the 2019 financial statement preparation process, resulted in the recognition of \$9.1 million in addition to the \$9.0 million of available General Fund cash that was identified in May 2020.

The table below summarizes the difference between actuals and budget in 2018 that results in the \$9.1 million of cash from 2018.

Item	Amount
Revenues over budget in 2018	\$ 5,979,563
Expenditures under budget in 2018	\$ 3,032,998
	\$ 9,012,561

The table below summarizes the change in the amount of available General Fund cash as of the end of 2019.

Item	Amount
May 2020 Estimate of 2019 Year-End Available General Fund Cash	\$ 9,075,775
Available General Fund Cash identified following May Retreat	\$ 9,012,561
Revised Available General Fund Cash	\$ 18,088,336

The Council 2020 approved uses and the City Managers preliminary 2021-2022 budget uses of the available General Fund cash are presented below.

- Council 2020 Approved Uses totaling \$595,681:
 - **Human Services Grants** – On March 31, 2020, in response to the impact of COVID-19 on the community, Council approved the use of \$265,000 in 2019 sales tax revenue that came in above the budgeted amount to stabilize Human Services grantees.
 - **Resolution R-5434** – On September 1, 2020, Council approved expenditure budgets proposed in Resolution R-5434. The expenditures included:
 - 1) Extending 1.0 Temporary Management Analyst through 12/31/2021 (\$160,000);
 - 2) Temporary Special Projects Coordinator for 6 months through approximately 3/31/2021 depending on start date (\$70,000);
 - 3) Professional Services Funding for equity/racial justice consultants and related costs (\$150,000). Total cost of additions was \$380,000. Of this amount, \$246,839 was from 2019 sales tax revenues above budget.
 - **General Fund Working Capital** – The total purchase price of the property at 13213 100th Place NE was \$583,842 in project PSC3002000. A developer settlement of \$500,000 for the benefit of affordable housing was received in 2019 and recognized in the General Fund as part of the 12/10/2019 budget adjustments, while the remaining cost of \$83,842 was paid by a transfer of General Fund Working Capital.

The balance of General Fund cash available after accounting for the uses listed above is \$17,492,655.

- City Manager Preliminary 2021-2022 Budget Proposed Uses:
 - **2020 General Fund Gap** – As of this writing, the estimated General Fund gap between revenues (excluding reserved revenues) and expenditures is \$1.33 million. As discussed at the May 29, 2020 Council Retreat, staff recommended the use of 2019 year-end available cash in the General Fund to bridge this gap.
 - **2021 General Fund Gap** – The estimated General Fund gap between revenues (excluding reserved revenues) and expenditures is \$787,480.

- **2022 General Fund Gap** – The estimated General Fund gap between revenues (excluding reserved revenues) and expenditures is \$4.06 million.
- **Continuation of 2019-2020 Service Packages and Community Safety Initiative Service Package** – One-time funding of \$7.59 million is needed for service packages recommended by the City Manager in 2021 (\$4.16 million) and 2022 (\$3.43 million). The \$7.59 million set aside represents the amount needed after accounting for expenditure savings, new revenues, and the use of reserves.
- **General Fund Carryovers** – As part of the 2021-2022 Budget development process, Financial Planning staff are evaluating the amount of the 2019-2020 General Fund Budget that will need to be carried over to the next biennium. Historically, General Fund Carryovers have been about \$1.0 million. Based on the latest estimates, staff recommends setting aside \$1,231,970.
- **The Village at Totem Lake Infrastructure Development Contribution** – The General Fund portion of the \$7.5 million City contribution to The Village at Totem Lake development is \$1,703,744. The recommendation is to use REET funds for the remainder. Using available cash eliminates the need to issue debt and decreases annual debt service by \$466,000 in the General Fund. This action is necessary to fully fund the service packages recommended by the City Manager.
- **General Capital Reserve** – Over this biennium, Council has approved various uses of the General Capital Reserve totaling \$3,505,286. One of the uses was in the amount of \$1,755,836 for the purchase of property (Office Max building) for the new Parks Maintenance Center. This action included a plan to replenish the reserve with ten (10) annual contributions from available year-end cash in the General Fund. The forecast includes reimbursing the General Capital Reserve \$350,000 per year beginning in 2021 and 2022.

The estimated gaps and service package costs reflect the best information at the time of this writing. It is likely that some of these numbers might change because staff continue to review and update them as part of developing the Preliminary 2021-2022 Budget.

The following table summarizes the Council approved and City Manager proposed uses of the available cash in the General Fund at the end of 2022. Note there is still net available General Fund cash of \$798,627. Staff has reserved this for Council directed uses not accounted for above or to mitigate any potential impact from a further or second economic downturn as a result of the pandemic. Staff will seek final direction on the uses of the \$798,627 during the Council's review of the 2021-2022 Preliminary Budget.

Item	Amount
Available General Fund Cash as of 12/31/2019	\$ 18,088,336
<i>Council Approved Uses</i>	
Human Services Grants	265,000
Resolution R-5434	246,839
FS24/ARCH -- Land Purchase	83,842
<i>Subtotal Council Approved Uses</i>	<i>\$ 595,681</i>
Balance of General Fund Cash after Council Approved Uses	\$ 17,492,655
<i>Potential and Planned Uses</i>	
Estimated 2020 General Fund gap	1,325,410
Estimated 2021 General Fund gap (base budget)	787,480
Estimated 2022 General Fund gap (base budget)	4,059,541
2021 Service Packages	4,160,651
2022 Service Packages	3,425,232
Estimated General Fund Carryovers	1,231,970
The Village at Totem Lake Infrastructure Development Contribution	1,703,744
<i>Subtotal Potential and Planned Uses</i>	<i>\$ 16,694,028</i>
Net Available General Fund Cash	\$ 798,627

Reserves

It should be noted that certain revenues in 2020 (i.e., Ground Emergency Medical Transportation grant, \$1.0 million of the annexation sales tax credit, and net development fees) have been backed out and reserved according to budget policy. As part of the 2021-2022 Budget development process, all General Fund and Contingency reserves will be reviewed and the estimated ending balances as of December 31, 2022 will be established. These revised reserve balances will be reviewed as part of the 2021-2022 Preliminary Budget discussion.

2021-2022 General Fund Budget Preview

The Preliminary 2021-2022 Budget reflects the following specific strategies from the City Manager's proposed budget framework presented at the May 29 retreat and approved by Council to guide the organization through 2020 and the next biennium.

- **2020 "COVID-19 Budget"**
 - Use one-time strategies (i.e., reduce planned expenditures and use available General Fund cash balance at the end of 2019) to bridge the revenue shortfall.
 - Do not use reserves.
- **2021 "Bridge Budget"**
 - Prepare a base budget (no service packages unless the costs are fully offset).
 - Use available General Fund cash balance at the end of 2019 and then reserves, if needed, to bridge programs and maintain current service levels.
- **2022 "Recovery Budget"**
 - Prepare base budget + targeted service packages.
 - Use available General Fund cash balance at the end of 2019, if any, and then reserves to sustain programs and maintain current service levels.
 - Implement new revenues as necessary to balance the budget.

Working within this budget framework, the Preliminary 2021-2022 Budget maintains current service levels in all Departments, although some existing positions are reprioritized. The preliminary budget also fully funds the continuation of most 2019-2020 one-time service packages. Finally, the preliminary budget funds a new "Community Safety Initiative" to invest in a more equitable, safe, and resilient Kirkland. The Community Safety Initiative provides funding to implement staffing and actions called for in Resolution R-5434 to respect the safety and dignity of Black people and help end structural racism. Much more detail on the Community Safety Initiative will be presented during the October 27, 2020 special Council meeting.

These investments require the use of the one-time General Fund available cash of \$18.09 million and the Annexation Sales Tax Credit reserve, estimated to be \$2,160,494. The current forecast reflects a preliminary budget that strives to balance the current economic uncertainties and need for social change, while meeting the service expectations of the community as Kirkland grows and thrives.

The table below summarizes the use of available General Fund cash to address the gap in 2020 and balance the budget in 2021 and 2022.

2020-2022 General Fund Balancing
Updated 9/30/20

	2020	2021	2022	2021-2022
Resources forward:				
Available cash, 12/31/19	17,492,655	13,231,530	8,283,399	13,231,530
Reserve funding used for Urban Forester, Development Fee Study, and Parking Collection Machines service packages		54,333	488,778	543,111
Annexation sales tax credit reserve balance, 12/31/21			2,160,494	2,160,494
Plus total revenues (base budget only in 2021-2022)	112,951,844	102,774,721	103,161,788	205,936,509
Plus new revenues for 2021-2022 service packages		971,974	1,087,025	2,058,999
Less reserved revenues:				
Annexation sales tax credit	(1,000,000)	(500,000)	-	(500,000)
Medicare/Medicaid emergency medical transport	(1,494,803)	(1,121,102)	(1,121,102)	(2,242,204)
Net development revenues to be reserved	(1,246,545)	-	(1,755,696)	(1,755,696)
Net school zone penalties to be reserved	(270,168)	(72,110)	(1,063,168)	(1,135,278)
Less total expenditures	(110,265,739)	(100,727,611)	(103,416,619)	(204,144,230)
Less Totem Lake development contribution (General Fund portion)	(1,703,744)			
Repay General Capital Reserve (10 annual payments)		(350,000)	(350,000)	(700,000)
Less carryovers ^[1]	(1,231,970)			
Less contract reserve in 2021 (2%) & 2022 (2%)	-	(791,378)	(1,675,238)	(2,466,616)
Less service packages in 2021 & 2022 (excluding development & CIP) ^[2]	-	(5,186,958)	(5,001,035)	(10,187,993)
Surplus/(Deficit)	13,231,530	8,283,399	798,626	798,627

Notes:

[1] Current estimate

[2] Net of expenditure savings