



CITY OF KIRKLAND
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MEMORANDUM

To: Kurt Triplett, City Manager

From: Michael Olson, Director of Finance & Administration
 Chip Corder, Temporary 2021-2022 Budget Development Staff
 Robby Perkins-High, Senior Financial Analyst
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Date: October 16, 2020

Subject: September 2020 Sales Tax Revenue

Background

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 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 18 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 uncertainty 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, September sales tax revenue relates to July retail activity in Kirkland.

September 2020 vs. September 2019

Business Sector Group	September		Dollar Change	Percent Change	Percent of Total	
	2019	2020			2019	2020
Services	314,096	272,922	(41,174)	-13.1%	13.7%	12.2%
Contracting	520,549	500,326	(20,223)	-3.9%	22.6%	22.4%
Communications	39,100	35,670	(3,430)	-8.8%	1.7%	1.6%
Retail:						
Auto/Gas Retail	492,815	436,855	(55,960)	-11.4%	21.4%	19.5%
Gen Merch/Misc Retail	284,322	308,220	23,898	8.4%	12.4%	13.8%
Retail Eating/Drinking	164,099	129,141	(34,958)	-21.3%	7.1%	5.8%
Other Retail	264,691	307,718	43,027	16.3%	11.5%	13.8%
Wholesale	94,174	111,479	17,305	18.4%	4.1%	5.0%
Miscellaneous	124,551	134,210	9,659	7.8%	5.4%	6.0%
Total	2,298,397	2,236,541	(61,856)	-2.7%	100%	100%

Comparing September 2020 to September 2019, **sales tax revenue is down \$61,856, or 2.7 percent.**

Looking at business sectors, the most significant growth occurred in Other Retail (up \$43,027, or 16.3 percent), General Merchandise/Miscellaneous Retail (up \$23,898, or 8.4 percent), and Wholesale (up \$17,305, or 18.4 percent).

Noteworthy declines occurred in Auto/Gas Retail (down \$55,960, or 11.4 percent), Services (down \$41,174, or 13.1 percent), Retail Eating/Drinking (down \$34,958, or 21.3 percent), and Contracting (down \$20,223, or 3.9 percent). The 13.1 percent decline in Services is driven by the Accommodation, Art/Entertainment and Healthcare subsectors.

YTD 2020 vs. YTD 2019

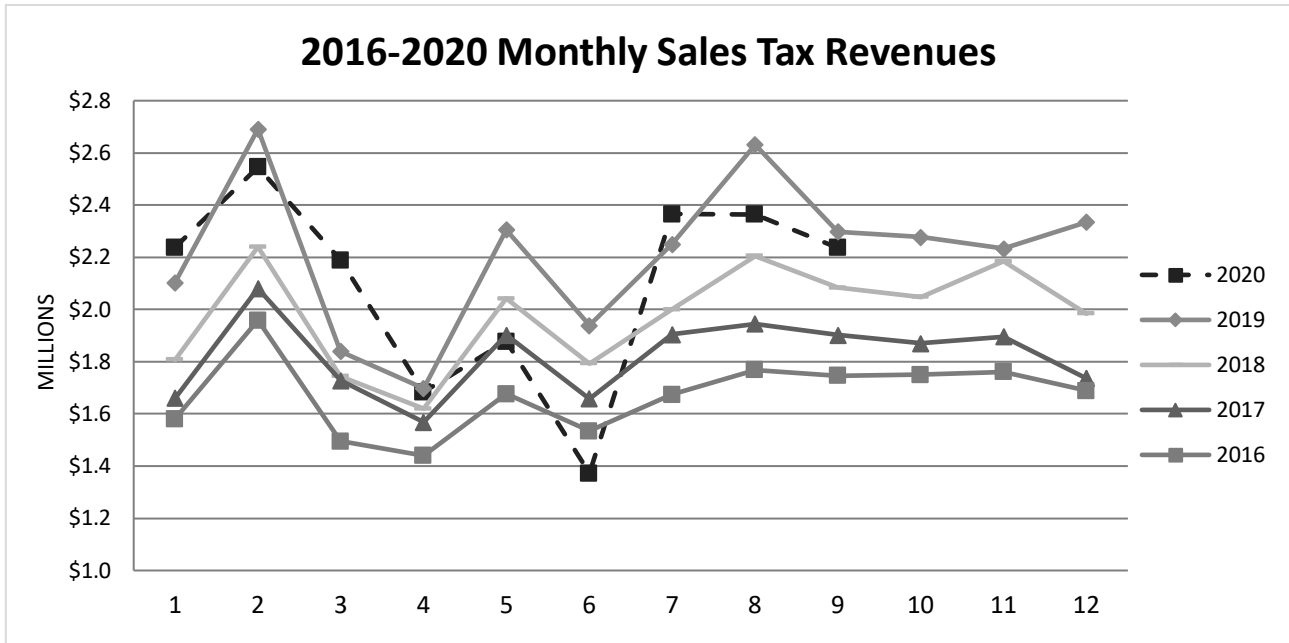
Business Sector Group	YTD		Dollar Change	Percent Change	Percent of Total	
	2019	2020			2019	2020
Services	2,528,145	2,642,000	113,854	4.5%	12.8%	14.0%
Contracting	4,772,783	4,895,187	122,404	2.6%	24.2%	25.9%
Communications	586,277	360,476	(225,801)	-38.5%	3.0%	1.9%
Retail:						
Auto/Gas Retail	3,927,029	3,352,496	(574,533)	-14.6%	19.9%	17.8%
Gen Merch/Misc Retail	2,032,612	2,159,966	127,354	6.3%	10.3%	11.4%
Retail Eating/Drinking	1,375,546	1,102,743	(272,804)	-19.8%	7.0%	5.8%
Other Retail	2,307,430	2,499,575	192,144	8.3%	11.7%	13.2%
Wholesale	862,943	858,472	(4,471)	-0.5%	4.4%	4.5%
Miscellaneous	1,364,043	1,001,321	(362,722)	-26.6%	6.9%	5.3%
Total	19,756,808	18,872,235	(884,574)	-4.5%	100%	100%

Comparing 2020 to 2019, year-to-date (YTD) sales tax revenue is **down \$884,574, or 4.5 percent**. However, 2019 includes two large back tax payments totaling \$458,733 from the Communications and Miscellaneous business sectors. **Factoring out these one-time payments**, YTD sales tax revenue is **down 2.2 percent** relative to the same period in 2019.

Looking at business sectors, the most significant growth occurred in Other Retail (up \$192,144, or 8.3 percent), General Merchandise/Miscellaneous Retail (up \$127,354, or 6.3 percent), Contracting (up \$122,404, or 2.6 percent), and Services (up \$113,854, or 4.5 percent). The growth in Other Retail has been led by the Electronics, Health & Personal Care, and Sporting Goods sub-sectors. Within Services, the growth has been concentrated in the Administration & Support, Professional Scientific, and Publishing Services sub-sectors.

Noteworthy declines occurred in Auto/Gas Retail (down \$574,533, or 14.6 percent), Miscellaneous (down \$362,722, or 26.6 percent), Retail Eating/Drinking (down \$272,804, or 19.8 percent), and Communications (down \$225,801 or 38.5 percent). Most of the drop in Auto/Gas Retail is primarily due to a \$410,305 (83.5 percent) decline in May 2020 (for March retail activity) versus May 2019. The significant decreases in Miscellaneous and Communications respectively relate to back tax payments of \$248,522, which was received in February 2019, and \$210,211, which was received in July 2019. Retail Eating/Drinking is down due to the Governor's stay-at-home order, which was in effect from March 25th to May 31st, and social distancing requirements, which limit the number of customers that can be served.

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



“What If” Forecast Scenarios (2020 Only)

Given the high level of economic uncertainty for the balance of the year, three “what if” forecast scenarios are provided in the following table for 2020 sales tax revenue. Note that the 2020 budget of \$23,130,166 reflects the City’s modified two-year sales tax lag policy (2020 budget = 2018 estimate).

“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	Likely
2020 forecast is 10% below 2019 actual*	\$23,932,560	\$23,130,166	\$802,394	Pessimistic
2020 forecast is 15% below 2019 actual*	\$22,602,973	\$23,130,166	(\$527,193)	Very pessimistic

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

As previously noted, sales tax revenue through September 2020 is down 4.5 percent relative to the same period in 2019. This is significantly better than the following two September 2020 forecasts of annual taxable retail sales growth in King County in 2020:

- King County Office of Economic and Financial Analysis: **11.6 percent decline** in 2020
- Puget Sound Economic Forecaster: **8.7 percent decline** in 2020

The key **“takeaway”** from these “what if” forecast scenarios is that **2020 budgeted sales tax revenue is 13 percent below 2019 actual sales tax revenue**. That provides a significant “buffer” in 2020, reducing the financial impact of the three scenarios accordingly.

To help frame staff's assessment of the three "what if" forecast scenarios, the following three tables identify how much sales tax revenue would have to decline in the last three months of 2020 relative to the last three months of 2019 to end the year 5 percent, 10 percent, and 15 percent below 2019 actual sales tax revenue.

2020 Forecast is 5% below 2019 Actual (Staff Forecast Assessment: Likely)

Sales Tax Revenue	2019	2020	\$ Change	% Change
January-September (actual)	\$19,756,808	\$18,872,235	(\$884,574)	-4.5%
October-December (2019 actual & 2020 forecast)	\$6,834,925	\$6,389,911	(\$445,013)	-6.5%
Total	\$26,591,733	\$25,262,146	(\$1,329,587)	-5.0%

2020 Forecast is 10% below 2019 Actual (Staff Forecast Assessment: Pessimistic)

Sales Tax Revenue	2019	2020	\$ Change	% Change
January-September (actual)	\$19,756,808	\$18,872,235	(\$884,573)	-4.5%
October-December (2019 actual & 2020 forecast)	\$6,834,925	\$5,060,325	(\$1,774,600)	-26.0%
Total	\$26,591,733	\$23,932,560	(\$2,659,173)	-10.0%

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

Sales Tax Revenue	2019	2020	\$ Change	% Change
January-September (actual)	\$19,756,808	\$18,872,235	(\$884,573)	-4.5%
October-December (2019 actual & 2020 forecast)	\$6,834,925	\$3,730,738	(\$3,104,187)	-45.4%
Total	\$26,591,733	\$22,602,973	(\$3,988,760)	-15.0%

Sales tax revenue would have to decline 6.5 percent, 26.0 percent, and 45.4 percent respectively in October-December 2020 to end the year 5 percent, 10 percent, and 15 percent below 2019 actual sales tax revenue. The latter two reduction scenarios are very unlikely provided that a second "stay at home" order is not issued between now and the end of the year.

For the **2021-2022 Preliminary Budget**, staff is **conservatively forecasting a 10 percent decline in 2020**, which is still \$802,394 greater than the 2020 budget, and no growth in 2021 and 2022, consistent with the City's modified two-year lag policy. However, the 2020-2022 sales tax forecast will be subject to change based on the monthly sales tax distribution at the end of October 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 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	September	Index	86.3	101.8	15.5	128.1	103.5
Unemployment Rate							
National	September	%	8.4	7.9	(0.5)	3.7	8.6
Washington State	July	%	9.9	10.0	0.1	4.5	9.3
King County	July	%	9.6	8.3	(1.3)	3.0	8.3
Kirkland	July	%	7.5	6.6	(0.9)	2.9	7.0
Housing							
New House Permits (WA)	August	Thousands	41.0	39.2	(1.8)	48.7	43.8
Case-Shiller Seattle Area Home Prices	July	Index	272.3	273.9	1.6	252.2	267.1
Inflation (CPI-W)							
National	September	% Change	1.4	1.5	0.1	1.7	1.2
Seattle	August	% Change	1.0	2.4	1.4	2.1	1.9
Car Sales							
New Vehicle Registrations	September	Thousands	20.8	21.7	0.9	23.7	18.5

The **Consumer Confidence Index** increased from 86.3 in August to 101.8 in September. The 2020 average is 24.6 points below the 2019 average.

The national **Unemployment Rate** dropped from 8.4 percent in August to 7.9 percent in September, while the Washington State unemployment rate was flat in July (10.0 percent) compared to June (9.9 percent), after hitting a high of 16.1 percent in April. King County's unemployment rate dropped from 9.6 percent in June to 8.3 percent in July, and Kirkland's unemployment rate fell from 7.5 percent in June to 6.6 percent in July.

New Housing Permits in Washington State have steadied from a volatile spring, falling slightly from 41,000 in July to 39,200 in August, while the 2020 average sits 4,900 below the 2019 average. The **Case-Shiller Home Price Index** saw an increase of 1.6 points in July, and the 2020 average is 14.9 points above the 2019 average, reflecting a strong housing market despite the pandemic.

Inflation for Seattle-Tacoma-Bellevue, as measured by the CPI-W, increased from 1.0 percent in June to 2.4 percent in August. On the national level, inflation inched up slightly from 1.4 percent in August to 1.5 percent in September, after going negative in May.

New Vehicle Registrations increased by 900 from August to September, but the 2020 average is 5,200 below the 2019 average.