Seattle
City Budget Office

Date: **November 2, 2021**

To: **City Councilmembers**

From: **Ben Noble, City Budget Office, Director**

RE: **November update of revenue forecast**

Dear Councilmembers,

Attached please find the update to the City of Seattle's August General Fund forecast and notable non-General Fund revenues. The August forecast is the basis for the Mayor's 2022 Proposed Budget. This memorandum begins with a brief summary of the overall forecast changes, and then provides detailed explanations regarding modifications to specific revenue sources.

Summary

This update provides a 4.7% decrease in 2021 General Fund revenues of $80.7 million and a 3.9% increase in 2022 General Fund revenues of $61.6 million. These adjustments bring total General Fund revenues to $1.642 billion in 2021 and $1.638 billion in 2022, from $1.72 billion and $1.57 billion respectively. Importantly, these large changes include the movement of $66.5 million in General Fund property sale proceeds from the Mercer Megablock project from 2021 to 2022, due to a minor delay in the closing date of this transaction. Without the net neutral movement across the years of the Megablock proceeds, total remaining General Fund reductions in 2021 are -$14.2 million and -$4.9 million in 2022.

A key driver for these changes is the delay in workers returning to downtown core and other employment centers due to the pandemic. The largest impact of this delay is on the Payroll Expense Tax (PET). In particular, the forecast for PET revenues is decreased by $17.6 million in 2021. This directly reflects the specific announcements from major employers delaying "return to the office". At present, we have not reduced the formal forecast for 2022 PET revenues to reflect continued delay, but this represents a very tangible and specific risk to the current forecast. The current forecast assumes a hybrid working model beginning in January. A more cautious view would be to acknowledge that current practices will continue through the first quarter of 2022, although this has not been formally announced by most employers. The potential loss to PET from an additional quarter of delay in 2022 is approximately $17.6 million, consistent with the adjustment now being made for the 4th quarter of 2021.

In addition to PET, there are also changes to several dedicated taxing sources, including the admission tax, sweetened beverage tax, commercial parking tax, and school zone camera fees. On net these changes further reduce available revenues by $5. 8 million in 2021, and $550,000 in 2022. There is however some good news, with the combined 2021-2022 forecasts for REET revenues increasing by just over $26 million. The uses of these revenue are restricted so they cannot directly offset reductions in General Fund and other resources, but could help address some City funding priorities.

Forecast Detail

Unfortunately, some of the pandemic-related risks we discussed in August are appearing in the data underlying this November update. Although generally holding to the baseline forecast scenario, revenue from various taxes and fees continues to be affected by constrained consumer behavior in response to the surge in COVID-19 cases beginning in July and August. Our national and regional economic forecasts, while showing continued recovery, have indeed indicated slower growth in GDP, employment and personal income than the July forecasts, even as retail sales remain relatively strong. Inflation from supply chain disruptions, labor market shortages, and increased energy costs and rising borrowing rates are expected to affect growth into 2022.

The largest influence on this update is a behavioral, rather than economic driven response to the pandemic. In particular, the lack of workers and visitors in the downtown core is affecting revenues such as the Payroll Expense Tax (PET), the Commercial Parking Tax (CPT) and other revenues dependent on workplace activity and/or visitors.

Specifically, recent announcements by Amazon, Google, Microsoft, Facebook, Apple and other major employers in the City of Seattle, have moved the likely dates of when workers would return to office back to January 2022 at the earliest. In Amazon's case, it has announced that the decision to return would be made by each work group according to their needs, thus extending the effects of any return to office movements indefinitely into 2022 and potentially beyond. These announcements ensure relatively few employees will return to Seattle offices in the 4th quarter of 2021 relative to prior forecast, slowing down the recovery of the leisure and hospitality sector and negatively affecting the sales tax and PET forecasts. In July, corporate intentions and our forecast assumed more comprehensive movement by employers to return to office in the fourth quarter 2021, even if only a partial 2 or 3 days per week.

The effect of these changes in return policy has led to the $17.6 million reduction in the 2021 PET forecast. The forecast continues to include the affected payroll for those living and working in Seattle, but has reduced the number of employees who would be subject to the tax, because they will continue to work from homes outside of Seattle. As for 2022, the previous forecast assumed workers would work in the office an annual average of 3 days per week in 2022. To date, announcements of delayed return indicate that such a hybrid model, starting on January 1, is still the goal of many employers. However, as noted above, there is reason to doubt whether that will be achieved, and the prospect of further delay is very real. For context, decisions to postpone the return by an additional quarter would reduce the revenue estimate for 2022 by a similar amount as for the fourth quarter of 2021, $17.6 million. Alternatively, if the workers were to return to the office but for 2 days on average instead of 3 over the course of the year, the revenue estimate for 2022 would be $18.3 million lower. These are behavioral decisions, being driven by health concerns and not directly economics, and are thus difficult to forecast. To date, we have developed estimates based on the stated intentions of the major affected employers and are now adjusting forecasts as those statements have changed. However, as highlighted here, additional behavioral changes could have significant impact on revenues and represent very tangible risks.

Beyond PET, there is also a significant reduction in parking fines in both 2021 and 2022. This decrease is due to lower than projected collections on written citations as the City continues its suspension of penalties and collections as part of the Court's COVID response. High unfilled vacancies among the Parking Enforcement Officers, contributes to a falloff in citation volumes from the June/July period. On the positive side, larger than projected non-current, one-time B&O revenue payments (approximately $7 million of adjusted payments) combined with stronger than projected performance in year-to-date 2021 receipts have led to an increase in 2021 of $11.8 million. The remainder of the changes are smaller adjustments that reflect actual 2021 year-to-date receipts and expectations. Reductions in sales tax, water utilities tax, and a variety of service fees are augmented in 2021 by modest increases in sewer utilities tax and a one-time $3 million distribution of state money for law enforcement and criminal justice purposes. In 2022, increases above prior forecast are expected in property taxes due to increased new construction, and on-street parking meter revenues due to increased rates to be implemented in December 2021.

As we have all learned, the pandemic and our response to it affects different sectors and revenue streams differently. Non-General Fund revenue adjustments forecast by the City Budget Office include 2021 and 2022 decreases to Commercial Parking Tax revenues, which are directly affected by the changed commute, tourist and retail shopping behavior related to COVID-19 concerns. Similarly decreases to the Sweetened Beverage Tax are likely related to reduced sales of fountain and other sweetened beverages by daily commuters and other visitors to Seattle as return to office has been pushed back. This update also increases School Zone Camera fine revenues in 2021 based on actual performance year-to-date and in 2022 to reflect the addition of 6 new speed enforcement cameras effective January 2022.

Finally, Real Estate Excise Tax revenues, driven by increased commercial and single-family prices and sales are increased $18.6 million in 2021 to $101.5 million total, and $7.5 million in 2022 to $88.0 million. The large increase in 2021 is the result of several large commercial transactions on top of generally strong residential sales prices and quantities.

Should you have questions or inquiries about these revenue changes or other revenue matters, please let me know or contact Dave Hennes.

Sincerely,

Ben Noble
City Budget Director

Attachment

Cc:
Mayor Jenny A. Durkan
Esther Handy, Director, Council Central Staff
Dan Eder, Council Central Staff
Aly Pennucci, Council Central Staff
Tom Mikesell, Council Central Staff