

August 15, 2022

## MEMORANDUM

**To:** Finance & Housing Committee  
**From:** Tom Mikesell, Analyst  
**Subject:** General Fund Financial Plan Update

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On August 17, 2022, the Finance & Housing Committee (Committee) will receive a briefing on key updates to the General Fund (GF) financial status. Starting from information presented at the May 4, 2022, meeting of the Committee, this presentation will update the GF financial planning projections with new information, including:

- Updated GF revenue projections for 2022 through 2026 based on the August 8, 2022, revenue forecast presented by the Office of Economic and Revenue Forecasts (OERF) and the City Budget Office (CBO) to the Forecast Council;
- Updated expenditure projections based on approved legislation, 2023 and 2024 baseline budget projections and revised growth assumptions provided by CBO; and,
- CBO's updated estimates of non-appropriated 'planning reserves' in 2022 that are not factored into growth estimates.

Based on this update, revised estimates of the projected annual funding gap and unreserved ending fund balance will be provided, as context ahead of the Mayor's Proposed 2023-2024 Budget submittal on September 27, 2022.

### Caveats:

It is important to note that the underlying assumptions, baseline data, and methodologies used for the figures in this memorandum are consistent with the approach developed by CBO. Put another way, these plans are not engineered by Central Staff using independent methods and research, but rather represent a recasting and transparent discussion of work that is already performed by CBO. Further, all elements of the GF budget are subject to review and revision by the City Council. The portrayal of these plans as 'baseline' is not intended to indicate that the underlying budget decisions embedded within cannot be changed during the budget process, but rather that the projections are estimates of the future cost of continuing ongoing 2022 adopted budget programs into the future.

The updated financial plan described in this memo is the starting point from which the Mayor must prepare a proposed balanced budget for the 2023-2024 biennium. These numbers do not include items that were explicitly added as one-time in the 2022 Adopted Budget, nor do they include any proposals to cut and/or enhance services in the future, or any assumptions about 2022 underspend (that is, actual spending coming in below budget) or revenue collections above forecast. It is anticipated that the proposed budget will include some of those changes that the executive is still considering (e.g., reductions to baseline expenditures to free up resources for other priorities to meet the needs of the community) and may include other

proposed legislation to modify existing City policies to reprioritize use of other city resources (e.g., changing permitted uses of revenues deposited into GF adjacent funds, such as the Short-term Rental Fund or the JumpStart Fund). That proposal will then serve as the starting point for the Council as they prepare to adopt a balanced budget.

### Recap of May 4<sup>th</sup> GF Baseline Financial Plan

As noted, at its May 4, 2022, meeting the Committee received an introduction and overview of the GF financial plan, which projected the financial status of the GF based on the April revenue forecasts from OERF and CBO, and estimates of GF expenditures through 2026. Table 1 shows the May 4<sup>th</sup> plan based on those data sources and assumptions made at that time.

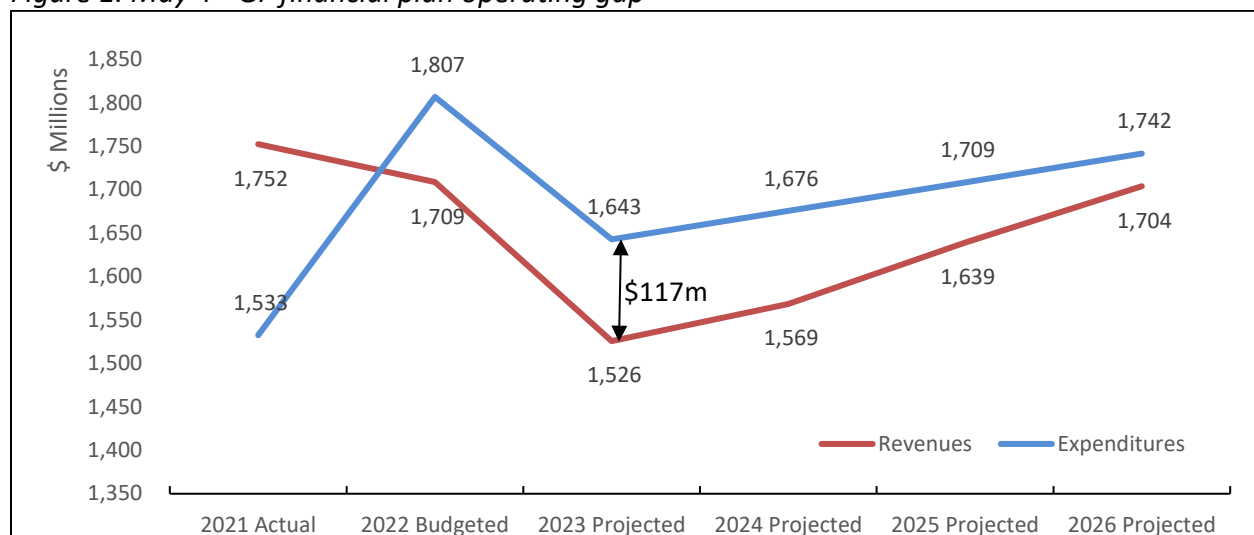
Table 1. 2022 Revised GF Budget Financial Plan – May 4<sup>th</sup> presentation

Amounts in \$1,000s	2022 Revised <sup>1/</sup>	2023 Projected	2024 Projected	2025 Projected	2026 Projected
Starting Budgetary Balance	\$273,327	\$175,116	\$57,889	(\$49,230)	(\$118,495)
Revenues	\$1,708,670	\$1,525,719	\$1,568,507	\$1,639,317	\$1,703,982
Expenditures	\$1,806,881	\$1,642,946	\$1,675,626	\$1,708,582	\$1,741,695
<b>Operating Surplus (Deficit)</b>	<b>(\$98,211)</b>	<b>(\$117,227)</b>	<b>(\$107,119)</b>	<b>(\$69,266)</b>	<b>(\$37,713)</b>
Ending Budgetary Fund Balance	\$175,116	\$57,889	(\$49,230)	(\$118,495)	(\$156,208)
Planning Reserves	(\$93,043)	(\$93,043)	(\$93,043)	(\$93,043)	(\$93,043)
Ending Unreserved Fund Balance	\$82,074	(\$35,154)	(\$142,272)	(\$211,538)	(\$249,251)

<sup>1/</sup> 2022 Revised Expenditures include \$221 m of one-time carryforward and reserve replenishments items added through proposed supplementals. These are fully funded through carryforward 2021 fund balance and \$37 m of anticipated grants.

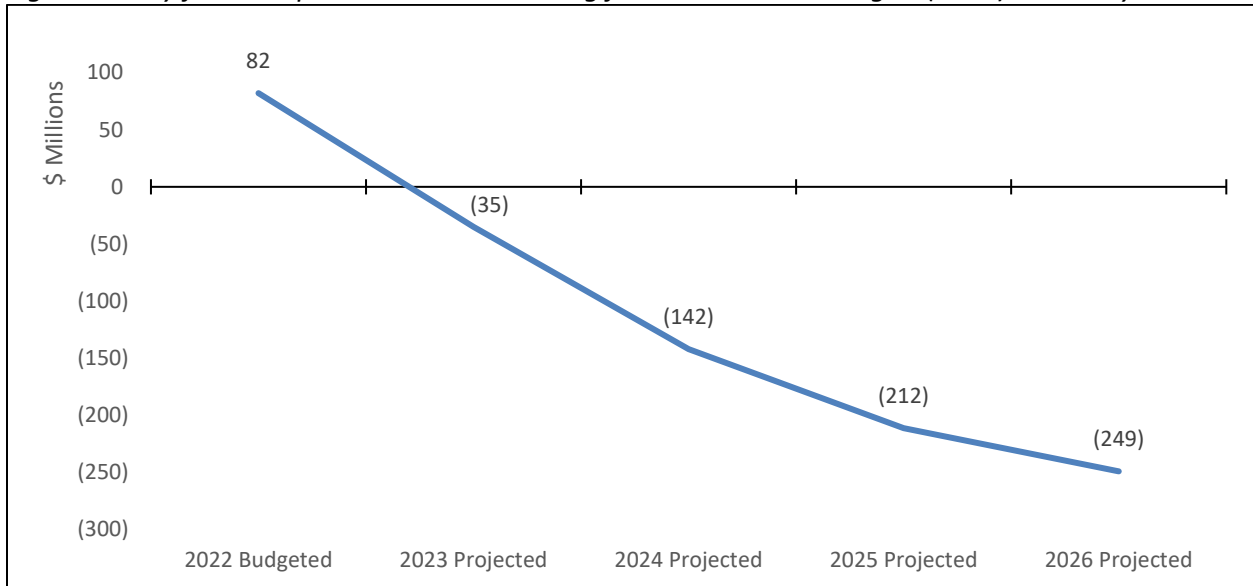
As shown in the Operating *Surplus (Deficit)* row of Table 1, the May plan demonstrated a projected \$117 million GF operating gap between revenues and expenditures in 2023, though the deficit decreased in future years of the forecast, as shown visually in Figure 1.

Figure 1. May 4<sup>th</sup> GF financial plan operating gap



After accounting for \$93 million in planning reserves, which represent unbudgeted GF resources assigned by the Executive for estimated current expenditures, and beginning 2022 fund balances of \$273 million, which represent one-time cash balances in the fund at the beginning of the year, the operating gap projected in May would have reduced the projected unreserved fund balance (the figure that ultimately determines whether the budget is balanced) to (\$249) million by 2026, as shown in Figure 2.

Figure 2. May financial plan: Unreserved ending fund balance declining to (\$249) million by 2026.



### August 17<sup>th</sup> GF Baseline Financial Plan Update

Since the May 4<sup>th</sup> meeting, CBO and OERF presented revised revenue forecasts, and CBO provided new baseline expenditure and unappropriated planning reserve estimates. Further, new inflation estimates for 2025 and 2026 are included in the OERF Regional Economic Forecast presented to the Forecast Council on August 8. This new information is used to prepare an updated GF financial plan, including revised estimates of the operating gap and estimated unreserved ending fund balance.

#### August Revenue forecast update

At the August 8<sup>th</sup> meeting of the Forecast Council, staff from OERF and CBO [updated their GF revenue projections](#) for 2022 through 2024 and provided to staff a longer-term projection through 2026. The forecasts, built largely upon the baseline (50 percent probability) economic scenario provided by [IHS Markit](#), support a \$37 million increase in 2022 GF revenues, the net result of \$42 million of late payments of 2021 payroll expense tax liabilities, which are credited to the GF, being offset by reductions across several other revenue categories. As shown in Table 2, for 2023 and future years, due largely to deterioration in future economic projections, the GF forecast was downgraded, with a \$7 million reduction in 2023 building to a \$22 million reduction by 2026.

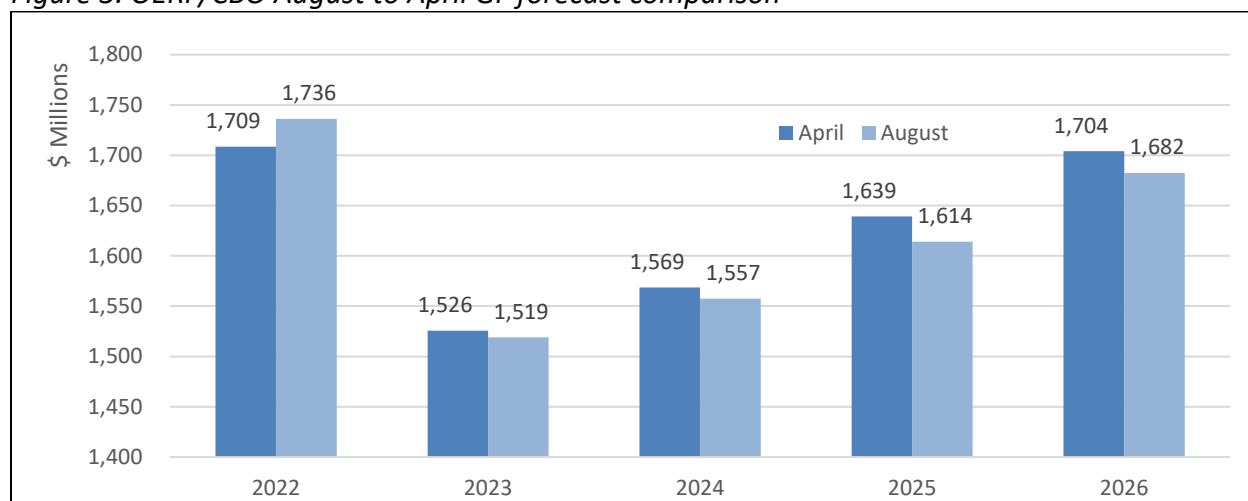
Table 2. August to April GF revenue comparisons.

Amounts in \$1,000,000	2022 Revised Budget <sup>1/</sup>	2023 Projected	2024 Projected	2025 Projected	2026 Projected
August	\$1,736	\$1,519	\$1,557	\$1,614	\$1,682
May	\$1,709	\$1,526	\$1,569	\$1,639	\$1,704
<b>Change</b>	\$37	(\$7)	(\$12)	(\$25)	(\$22)

<sup>1/</sup> May value excludes approximately \$3 million of grant revenue that was included as April forecasted revenue in the CBO/OERF August presentation but was not included in the May financial plan, as it relates to grant revenues that had not yet been accepted through ordinance until July.

Figure 3 provides a visual comparison of the April and August forecasts.

Figure 3. OERF/CBO August to April GF forecast comparison



### Baseline Expenditures Update

The May 4<sup>th</sup> GF financial plan presentation did not include data from the Executive’s baseline budget<sup>1</sup> process, which was underway at the time. Lacking the actual baseline data, as described in the [staff memorandum](#), inflation estimates were applied to certain cost categories as a proxy estimate of future cost growth. Since May 4<sup>th</sup>, CBO has updated financial projections to include baseline cost information submitted by departments. Using this new data to update the plan, GF expenditures are now projected to be higher in each year compared to the May 4<sup>th</sup> financial plan, as shown in Table 3.

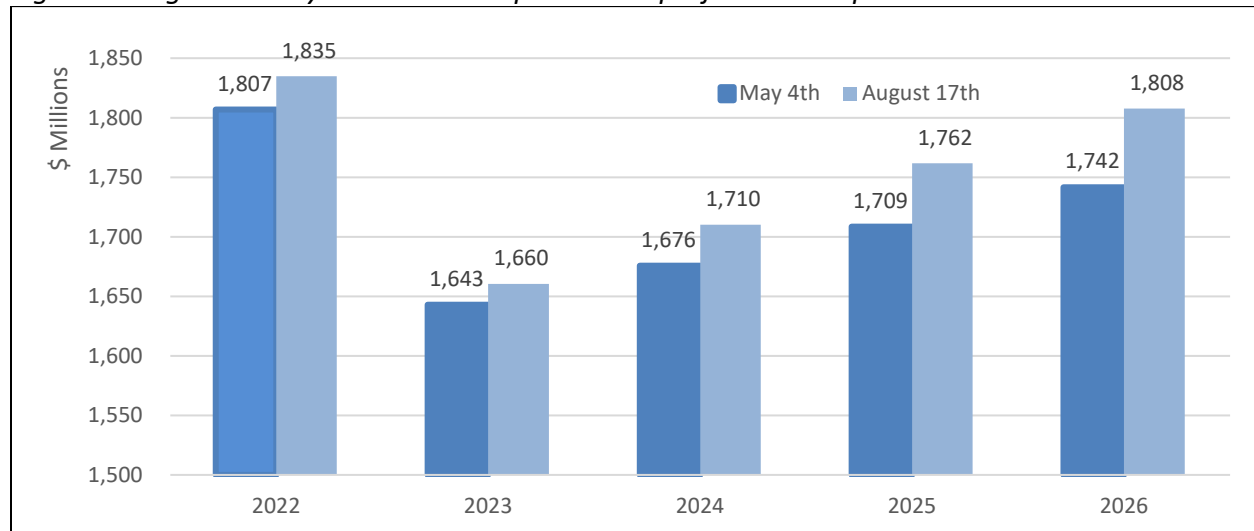
Table 3. CBO August to May change in projected GF baseline expenditures

Amounts in \$1,000,000	2022 Revised Budget	2023 Projected	2024 Projected	2025 Projected	2026 Projected
August	\$1,835	\$1,660	\$1,710	\$1,762	\$1,808
May	\$1,807	\$1,643	\$1,676	\$1,709	\$1,742
<b>Change</b>	\$28	\$17	\$35	\$53	\$66

<sup>1</sup> As a refresher, the baseline budget is intended to show the future cost of providing services considered ongoing in the 2022 Adopted Budget.

Figure 4 provides a visual comparison of the May and August financial plan expenditures.

*Figure 4. August to May GF baseline expenditures projection comparison*



The \$27.9 million increase in 2022 represents appropriation increases approved in supplemental budget legislation, as discussed in the staff memorandum covering [Ordinance 126641](#), the midyear supplemental appropriations, including:

- [Ordinance 126582](#): \$15.6 million for 2022 Annual Wage Increases and new City holidays;
- [Ordinance 126641](#): \$12.3 million for several changes, including \$5.9 million for frontline worker’s pay, \$2.5 million for parking fine repayments, and \$3.9 million for grant funded programs. It is worth noting that this ordinance also included \$40.3 million to fully replenish the Revenue Stabilization Fund; that change was already incorporated in the May baseline numbers.

Except for the \$3.9 million increase for grant-funded programs, these items were funded with resources from the 2022 planning reserves.

#### Baseline Expenditures 2023 -2026 Update

As mentioned, in the financial plan presented on May 4<sup>th</sup>, to account for the impact of inflation on projected costs, staff applied inflation assumptions to an array of costs categories consistent with CBO’s practice. In addition, to account for high levels of current year inflation, Central Staff applied an additional inflation estimate to 2023 costs.

In large part, when compared to the baseline expenditure data, these adjustments provided for an adequate projection of future costs, with a notable exception: Human Services Provider contract costs, which due to inflation provisions in [Seattle Municipal Code \(SMC\) § 3.20.060](#), would increase in 2023 and 2024 by \$10 million, and \$18 million over 2022, respectively. The May 4<sup>th</sup> financial plan update did not include any assumed growth in these contracts. Furthermore, it does not seem that financial plans developed since 2019, when this

requirement was codified, have accounted for these inflationary increases. Adding this inflation assumption, as codified in SMC §3.20.060, more accurately projects future cost growth.

The impact of including this expected growth is most notable in future years of the plan, as demonstrated by the widening difference between the May and August expenditure projections in Figure 4. On balance, including these projected increases have the largest expenditure impact on the growing operating gap. The remaining impact can largely be attributed to changes in other non-inflation planning assumptions made by the Executive, that are reflected as updates to the future (2023 to 2026) planning reserves in the Executive's planning process but are built into expenditures for the purpose of identifying the GF baseline operating gap between ongoing revenues and expenditures.

#### 2022 Planning Reserves Update

In addition to updated projections for future costs, CBO also provided updated projections to 2022 planning reserves. As discussed at the May 4<sup>th</sup> meeting, these amounts represent unappropriated balances that are held outside the budget to accommodate estimated current years costs of labor agreements that are under negotiation, and potential legal and other obligations that may become expenditures. As mentioned, changes to planning reserves in 2023 through 2026 are included as part of the baseline expenditure projections discussed above; to ensure that the financial plan projections discussed in this memorandum maintain a direct nexus to the 2022 Revised Budget, the 2022 portion of planning reserves is maintained as a separate line in the projections.

Since the May discussion, the total amount of 2022 planning reserves has decreased by \$32.7 million, from \$93 million in May, to \$60.3 million in the August plan. A large share of this reduction is due to the appropriation changes described above. After accounting for these Council-approved appropriations, the net reduction in unappropriated 2022 planning reserves in GF fund balance is \$8.7 million.

## August 17th GF Baseline Financial Plan

Incorporating the revenue, expenditure and reserve changes described above, Table 4 shows the revised baseline GF financial plan.

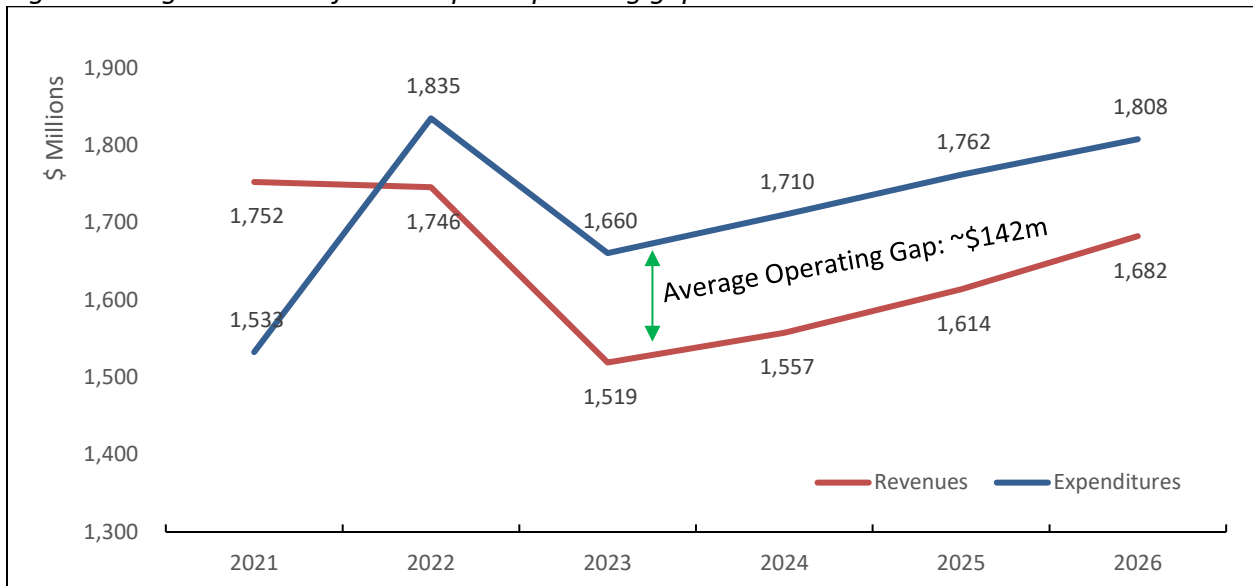
Table 4. 2022 Revised baseline GF financial plan – August update

Amounts in \$1,000s	2022 Revised <sup>1/</sup>	2023 Projected	2024 Projected	2025 Projected	2026 Projected
Starting Budgetary Balance	\$273,327	\$184,197	\$42,933	(\$109,982)	(\$257,830)
Revenues	\$1,745,610	\$1,519,120	\$1,557,310	\$1,613,970	\$1,682,370
Expenditures	\$1,834,740	\$1,660,385	\$1,710,224	\$1,761,818	\$1,807,663
<b>Operating Surplus (Deficit)</b>	<b>(\$89,129)</b>	<b>(\$141,265)</b>	<b>(\$152,914)</b>	<b>(\$147,848)</b>	<b>(\$125,293)</b>
Ending Budgetary Fund Balance	\$184,197	\$42,933	(\$109,982)	(\$257,30)	(\$383,123)
Planning Reserves	(\$60,383)	(\$60,383)	(\$60,383)	(\$60,383)	(\$60,383)
Ending Unreserved Fund Balance	\$123,814	(\$17,450)	(\$170,365)	(\$318,212)	(\$443,505)

<sup>1/</sup> 2022 Revised Expenditures include \$249 m of one-time carryforward and other items added through supplemental budget adjustments. These are fully funded through carryforward 2021 fund balance and anticipated grant revenues.

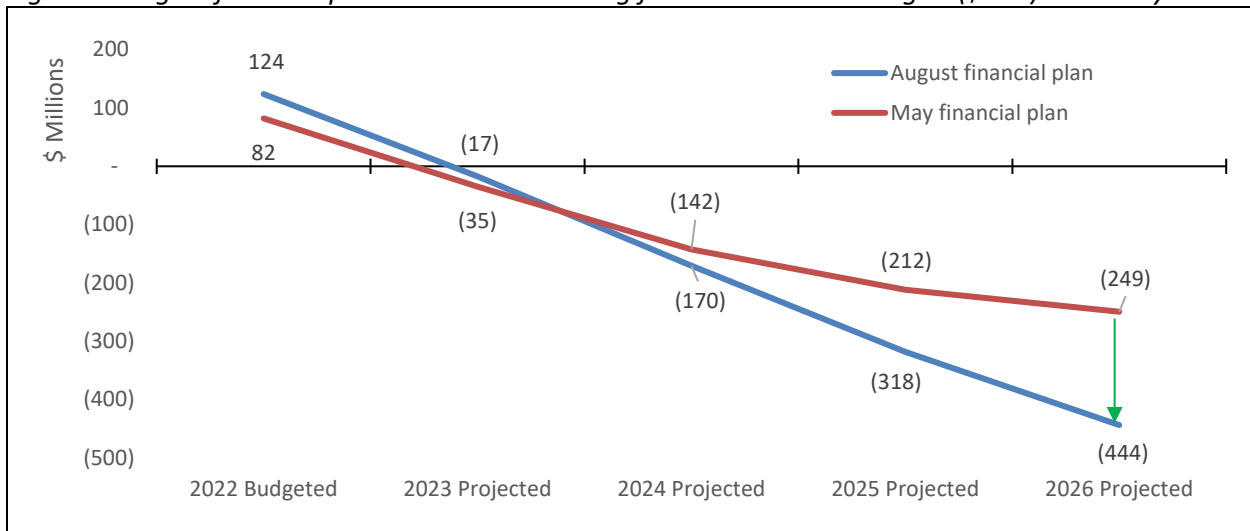
As show in Table 4, the projected operating deficits are \$141 million and \$152 million in 2023 and 2024, respectively. Furthermore, as shown in Figure 5, due to the forecast decreases in 2025 and 2026, coupled with the new inflation estimates applied to human services contracts, the projected deficit in 2025 and 2026 has widened compared to the May financial plan, leading to an average operating gap of approximately \$142 million through 2026.

Figure 4. August 17th GF financial plan operating gap



For 2023, the ending unreserved fund balance (the figure that ultimately determines whether the budget is balanced) improved from **(\$35)** million in May, to **(\$17.5)** million in the August financial plan. This improvement is due entirely to a larger 2023 beginning fund balance caused by the 2022 revenue forecast and planning reserves change discussed in this memo. In future years, the projected ending unreserved balances are lower compared with the May financial plan, due to the overall lower revenue forecast and higher expenditure projections described. Figure 5 show the changes in the projected ending unreserved fund balance from 2022 through 2026.

*Figure 5. August financial plan: Unreserved ending fund balance declining to (\$444) million by 2026.*



### Balancing Considerations

The May General Fund Financial planning staff memo included a set of approaches that could be employed to balance the GF budget. Though the magnitude of the challenge has increased over the long-term, the general approaches offered, including new revenues, reducing and right sizing of expenditures, and changes to restricted fund policies, over both a long-term and temporary basis, would still apply.

As described on page one of the memo, there are several decisions still to be made by the executive prior to transmittal of a proposed balanced budget that will likely result in changes to the financial plan (an updated plan will be transmitted with the proposed budget). Both the Mayor and the Council are faced with preparing a balanced budget at a time when there is a projected long-term operating deficit in the GF, increasing costs to maintain core city services, increasing risk of future forecasts projecting further declines in city revenues, as well as responding to the city’s growing population and increasing needs in the community. If the Council wants to provide additional input that CBO and the Mayor and his team could consider as they finalize their proposed budget, including proposals to modify existing policies related to other funds, the time is now. As stated previously, once it is transmitted, the Council then can accept, reject, or modify any component of that proposal.



## **Next Steps**

The Mayor will transmit his Proposed 2023-2034 Budget on September 27, 2022. That proposal will then serve as the starting point for Council's consideration as they prepare to adopt a balanced budget. This is the final review of the GF financial plan before the budget transmittal. The final revenue update will be provided during the Council's budget deliberations, which will establish the final fiscal parameters for the 2023-2024 Budget. Using the GF financial planning framework continued with this memorandum, Central Staff will provide updates at each stage in the process.

cc: Esther Handy, Director  
Aly Pennucci, Deputy Director