

June 1, 2021



FIRST QUARTER 2021 FINANCIAL OVERVIEW

This reporting provides an overview of the financial results for the City of Bothell for the quarter ended March 31, 2021 and includes: a listing of financial highlights for the quarter; financial challenges and concerns for the quarter; notable subsequent events; and, a brief look at predictions for the mid biennial budget update.

While we are technically still in the pandemic, the first quarter financial results continue the several quarters-long trend of a return to stability and the move to what appears to be a more normal economic cycle. Revenues in all funds are in line with forecasted values and, in a couple cases, slightly better. Expenditures are also in line with budgeted values; a couple line items are exceeding their budgeted values and are likely to exceed budgeted values by the end of the calendar year/biennium. Overall the first quarter financial results are consistent with expectations and the Adopted Budget, which is encouraging given the recent uncertainty and volatility.

Despite solid financial performance in the first quarter, a new concern is emerging, inflation. Conditions appear ripe for rising inflation in the very near future and previous statements from the Federal Reserve's Federal Open Market Committee (FOMC) raise questions about how much the FOMC will attempt to control inflation with policy. Inflation is especially concerning to local governments due to its effects on consumer confidence/spending and the inability of local government revenue to keep up with inflation above one-percent due to the annual one-percent property tax cap.

Below are first quarter highlights, followed by: challenges and concerns, subsequent events, and preliminary expectations for the mid-biennial budget update.

FIRST QUARTER 2021 FINANCIAL HIGHLIGHTS

- ❖ Sales tax collections have stabilized and are trending above the forecasted values.
- ❖ Utility tax collections are generally in line with expectations and unremarkable.
- ❖ Development revenues are ahead of the forecast signaling optimism among property owners and developers.
- ❖ Typical Real Estate Excise Tax collections are strong, despite limited property inventory, and total collections are trending significantly above the forecast thanks to individually significant property transactions.
- ❖ Departments continue to exercise good budget discipline and first quarter spending is consistent with the 2021-2022 spending plan.
- ❖ CONCLUSION: The revenue disruptions caused by the global pandemic appear to be behind us and we appear to be settling into a more normal economic cycle. We have seen recent growth in sales tax collections, but it is difficult to conclude whether this is a temporary condition resulting from more people working and schooling from home or whether it is a sign of high consumer confidence and likely to continue. Spending in the first quarter was consistent with the spending plan (the Adopted Budget). Overall the first quarter results are positive and are meeting or beating financial performance expectations.

CHALLENGES AND CONCERNS

- ❖ Inflation is becoming a hot topic increasing concern associated with the structural deficit.
- ❖ Sales tax leakage may increase back to pre-pandemic levels resulted in reduced sales tax collections post-pandemic.¹
- ❖ Expenditure savings resulting from operational disruptions caused by the pandemic are likely to end as operations return to normal in the coming months.

SUBSEQUENT EVENTS

- ❖ Moody's annual issuer update concluded in May and the recently upgraded Aa1 credit rating was sustained.
- ❖ General Fund ending fund balance grew in 2020; preliminary results suggest that the ending fund balance nearly met the new minimum fund balance target of ninety days of operating reserve.

¹ "Sales tax leakage" is the sales tax paid by Bothell residents to other local jurisdiction when Bothellites travel outside of Bothell to purchase goods and taxable services.

- ❖ Lot A is scheduled to close in the very near future; the expected \$750k proceeds of sale are currently unbudgeted.
- ❖ American Rescue Plan funding may change compared to earlier estimates.

EXPECTATIONS FOR THE MID-BIENNIAL UPDATE

A mid-biennial budget review is required by Statute for local governments that adopt a biennial budget. Under more normal economic times, the review is an opportunity to reconcile actual financial performance with the forecast used to develop the budget. During development of the 2021-2022 budget, staff highlighted unusual difficulty in forecasting revenues due to the unprecedented economic uncertainty and warned of the possibility of a significant mid-biennial update and adjustment to realign the budget for the second year of the biennium (2022). Staff will kick off the mid-biennial budget update in the fall; the following are some early observations that are likely to affect the mid-biennial budget update.

- ❖ Two city owned surplus properties are likely to sell before the mid-biennial budget update. The proceeds of any such sales are currently unbudgeted and will be included in the mid-biennial budget update.
- ❖ Based on early results we may have the opportunity to increase operating or other reserves during the mid-biennial budget update. Reserve examples include a rainy-day fund, budget stabilization fund, strategic opportunity fund, and council contingency fund.
- ❖ Sales tax is trending above the budgeted value. If the trend continues, then the forecast is likely to be adjusted upward during the mid-biennial update.
- ❖ Development services revenues are trending above the budgeted value. If the trend continues, then the forecast is likely to be adjusted upward during the mid-biennial budget update.
- ❖ Some expenditure budgets will require an increase due to emergent operating needs. Adjustments are likely to be needed in the Community Development, Legal, and Police Department.
- ❖ Some expenditure budgets are likely to require an upward adjustment to account for inflation related increases.
- ❖ Additional funding should be considered for asset replacements.