Council Budget Workshop

April 26, 2010

Revenues

Policy Issues:

1. Recognizing that some revenue sources are more stable than others, what is the optimal mix and level of revenues to maintain services and fund capital needs through economic cycles?
2. What is the appropriate mix and level of revenues to remain economically competitive?

Current Policy:

- *The City must be sensitive to the balance between the need for services and the City's ability to raise fees, charges, and taxes to support those services.*
- *The City will strive to keep a total revenue mix that encourages growth and keeps Bellevue economically competitive and a City of choice for people to live and do business.*

Existing Guiding Principles:

1. Provide financial sustainability.
2. Maintain a mix of revenue that encourages growth and keeps Bellevue economically competitive.

Revenues

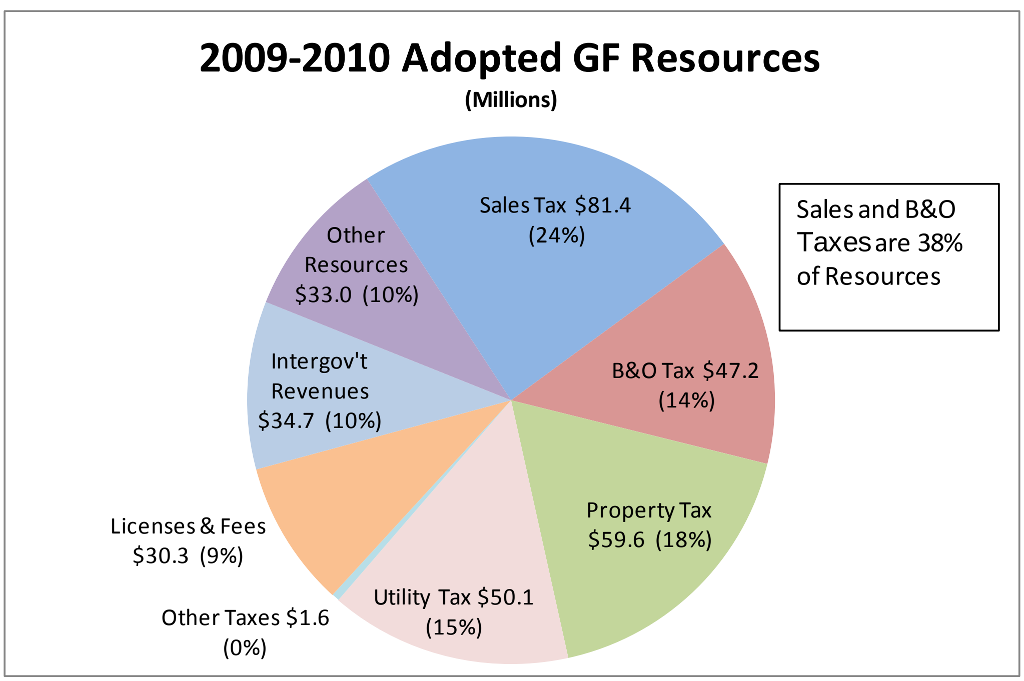
Policy Issue #1

Recognizing that some revenue sources are more stable than others, what is the optimal mix and level of revenues to maintain services and fund capital needs through economic cycles?

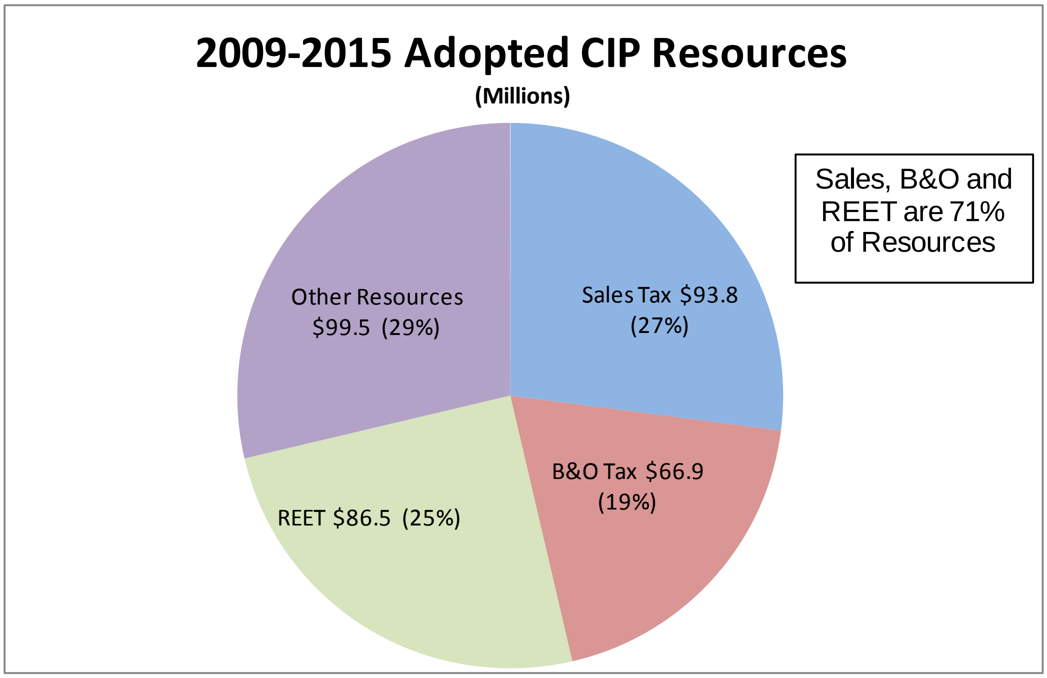
Background:

As with a personal investment portfolio, having a diversified mix of revenues is important in minimizing risk. Bellevue has historically had a diversified revenue mix which has helped the City remain economically viable and able to provide needed services to its citizens even during economic downturns. A good mix of revenues includes different types of revenues, including some sources that are stable (i.e., reliable in providing funding for essential services even during economic downturns) and some that are more economically sensitive.

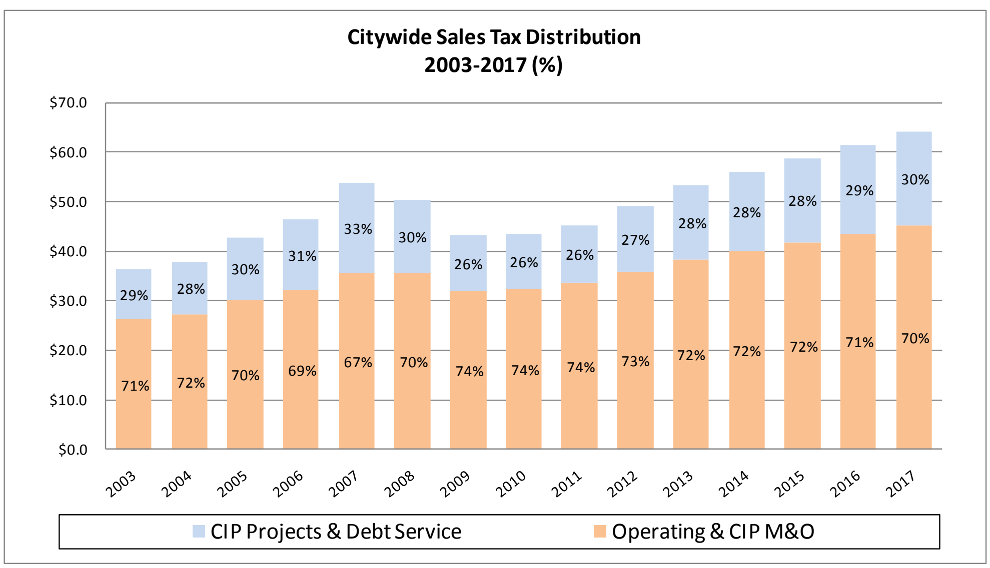
Property and utility taxes are the most stable of the City's major taxes. Sales, business and occupation (B&O), and real estate excise taxes are the most sensitive to economic changes of the City's major taxes. The mix of resources in the City's General Fund is illustrated in the following chart.

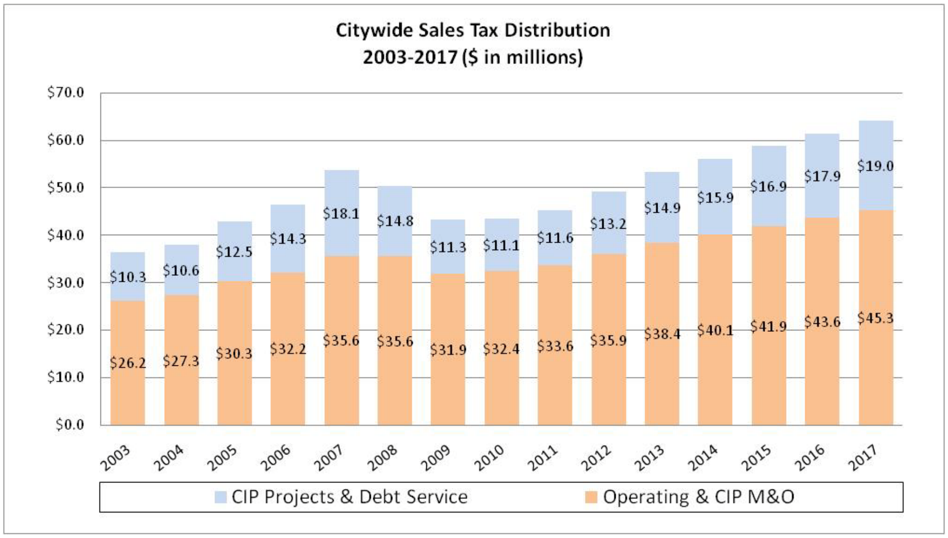


The mix of revenues in the City's General CIP is illustrated by the following chart.



The following graphs show the distribution of the City's historical and forecasted sales tax revenues between the General Fund (tan) and the CIP (blue). As the chart below illustrates, the percentage split of sales tax between operating and capital has ranged from 26-33% for operating and from 67-74% for capital.





Stability is important to examine when pledging a revenue stream to fund a core service such as fire protection or human services programs. The types of revenues sought for these ongoing services should continue indefinitely and, ideally, should grow at a rate faster than the anticipated growth in program expenditures. In addition, one-time revenue sources, such as grants, should supplement rather than supplant long-term revenues. The charts below show which General Fund and General CIP revenues are stable and which are economically sensitive.

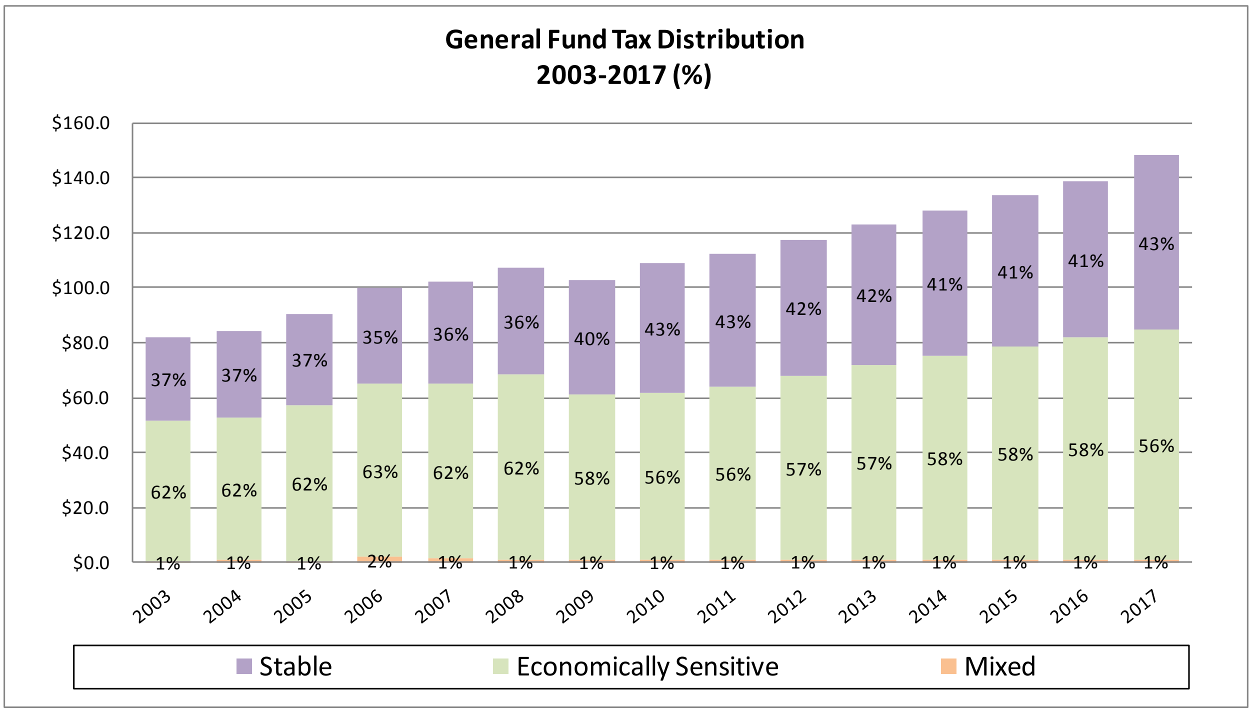
General Fund –Sources of Revenue

Source	Percent of Total Revenue	Stable or Economically Sensitive
Property Tax	18%	Stable
Sales Tax	24%	Economically sensitive
B&O Tax	14%	Economically sensitive
Utility Taxes	15%	Some utility taxes are stable, with the exception of rate modification; some are more economically sensitive, such as cellular telephone tax
Other	29%	Mixed

General CIP – Sources of Revenue

Source	Percent of Total Revenue	Stable or Economically Sensitive
Sales Tax	27%	Economically sensitive
B&O Tax	19%	Economically sensitive
Real Estate Excise Tax	25%	Economically sensitive
Grants & other	29%	Stable, when available

The following chart shows the break-down of General Fund taxes by groupings of stable, economically sensitive, and mixed.



Stable – Property, Electric Utility, Gas Utility, Garbage Utility, Water Utility, Sewer Utility, and Storm Drainage Utility Taxes.

Economically Sensitive – Sales, B&O, Telephone Utility, Cellular Phone, and Criminal Justice Sales Tax.

Mixed – Other Taxes (Admission, Leasehold Excise, and Other Taxes).

Options:
Council can choose to maintain the current mix (type and level) of revenues or choose to change the mix to increase or decrease sensitivity to economic changes.

Recommendations:
Maintain current policy until implications can be evaluated in the context of budget proposals.

Policy Issue #2

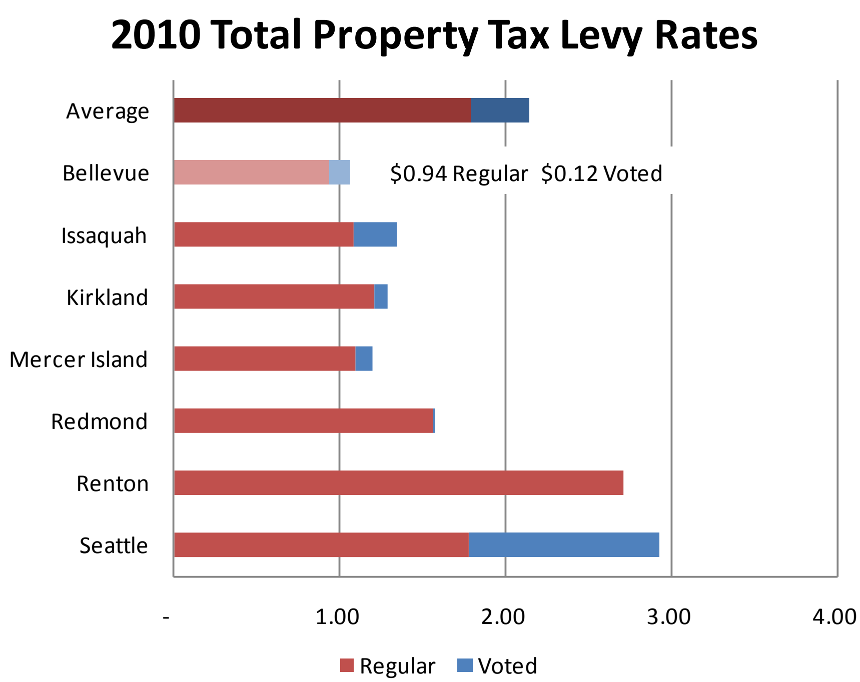
What is the appropriate mix and level of revenues to remain economically competitive?

Background:

Another important aspect of revenue policy is to identify a mix of revenues that keeps the City economically competitive.

The City has maintained property tax rates lower than most jurisdictions and is the lowest among neighboring cities.

Council asked what the property tax rate is.



Compared to other cities, Bellevue residents pay less in total dollars for the average value home in their community, as illustrated below.

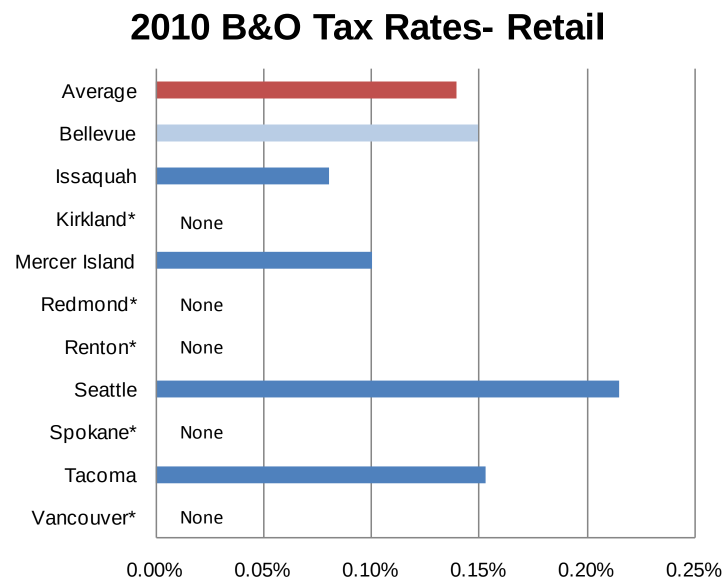
Comparisons of 2010 Property Tax Rates
Selected Washington Cities

City	Property Tax Levy Rate	2010 Avg. Home Value	Total Levy Cost
Bellevue	**$1.06**	**$579,400**	**$614**
Issaquah	1.35	493,200	664
Kirkland	1.29	511,800	661
Mercer Island	1.20	1,057,500	1,270
Redmond	1.58	444,600	702
Renton	2.71	293,500	796
Seattle	2.92	448,500	1,312
Average	**$1.73**	**$546,929**	**$860**

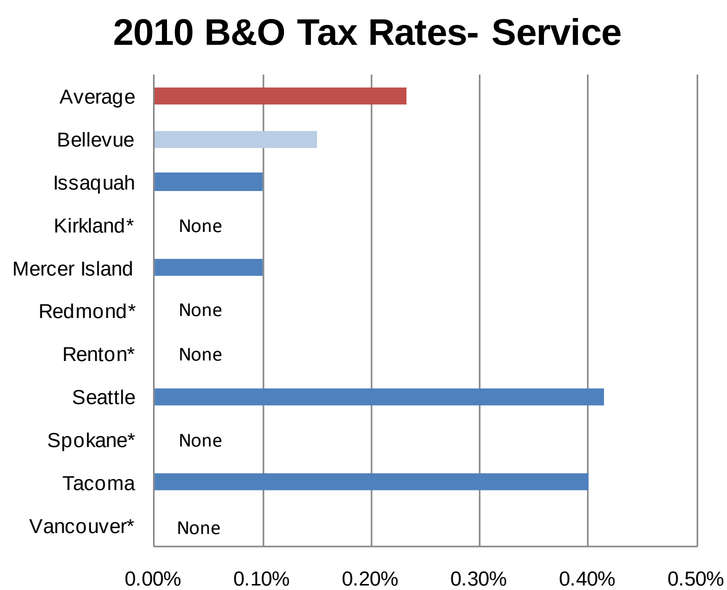
The City of Bellevue tends to be about average for cities that have a B&O tax. The City's current B&O tax rate is 0.1496%.

Council asked what the B&O tax rate is.

Revenues



*Variable license fee based on employee hours/FTEs



*Variable license fee based on employee hours/FTEs

While Kirkland, Redmond, Renton, Spokane, and Vancouver do not have a “B&O” tax, it should be noted that they do assess other business taxes.

A comparison of the amount of business tax that would be paid by a small, medium, and large business in Bellevue versus the other communities is shown below.

Comparisons of 2010 Business Tax Rates
Selected Washington Cities

City	Small Business	Medium Business	Large Business
Bellevue	**$1,050**	**$89,760**	**$121,180**
Issaquah	560	48,000	81,000
Kirkland	500	30,100	75,100
Mercer Island	700	60,000	81,000
Redmond	360	27,000	67,500
Renton	220	16,500	41,250
Seattle	1,510	129,000	336,150

Business Assumptions

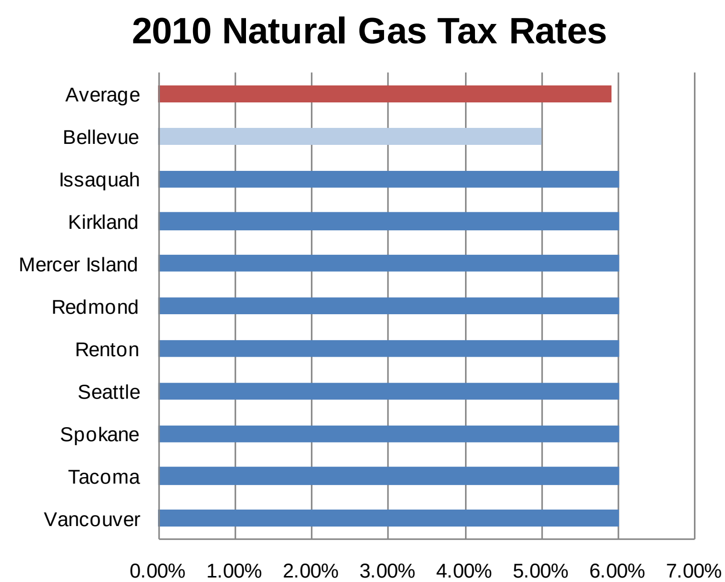
Small- $700,000 in gross receipts, 4 employees

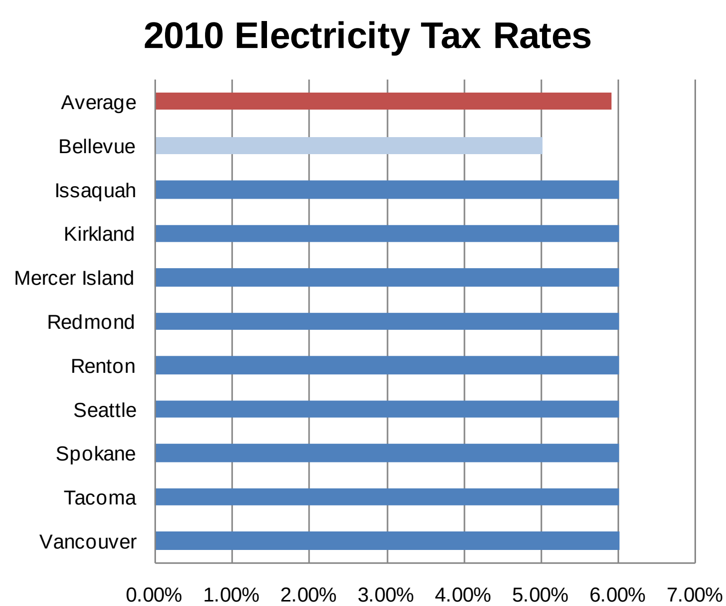
Medium- $60 million in gross receipts, 300 employees

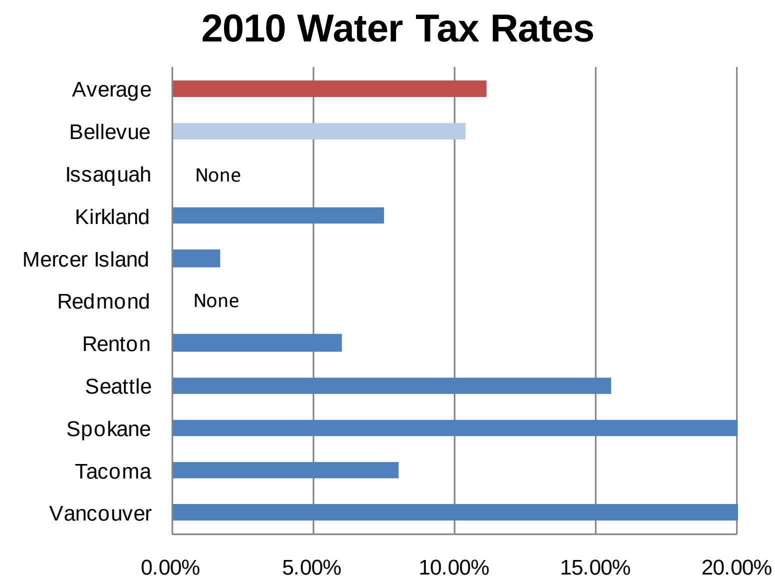
Large- $135 million in gross receipts, 750 employees

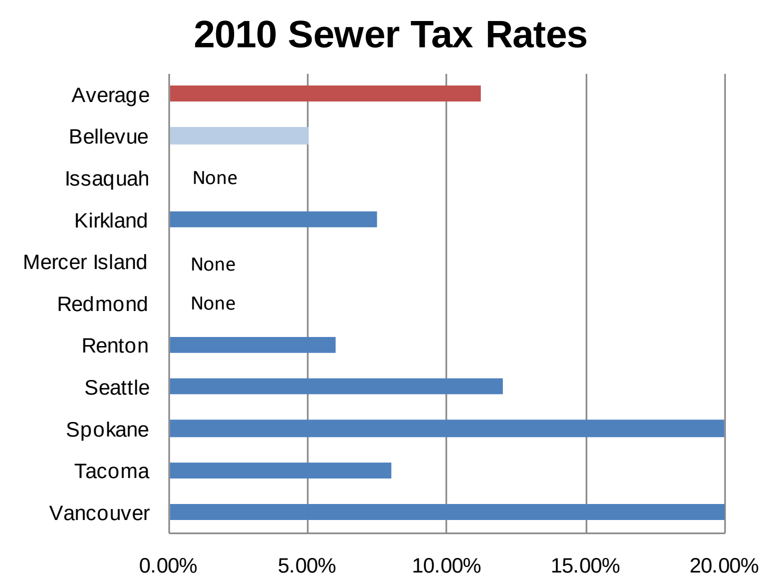
As this chart shows, Bellevue is second to Seattle in terms of business taxes and higher than most other small cities on the Eastside. Business taxes are difficult to compare, because cities tax businesses in different ways. Seattle and Bellevue, along with 36 other cities in Washington, levy a gross receipts tax. As noted previously, the smaller cities use combinations of head taxes, license fees, and square footage to tax businesses. Bellevue's gross receipts tax supports the infrastructure and community attributes that make Bellevue an attractive place for businesses to operate.

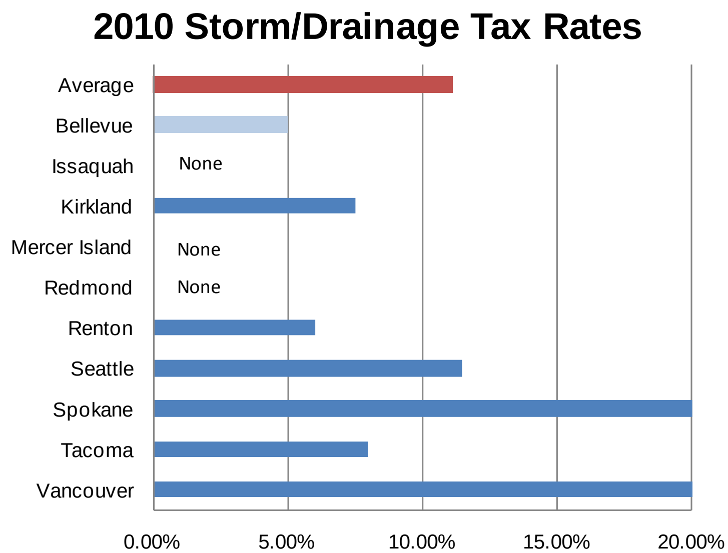
Bellevue compares favorably in terms of utility tax rates on gas, electric, water, sewer, storm drainage, and garbage, with rates below average for all of these services.

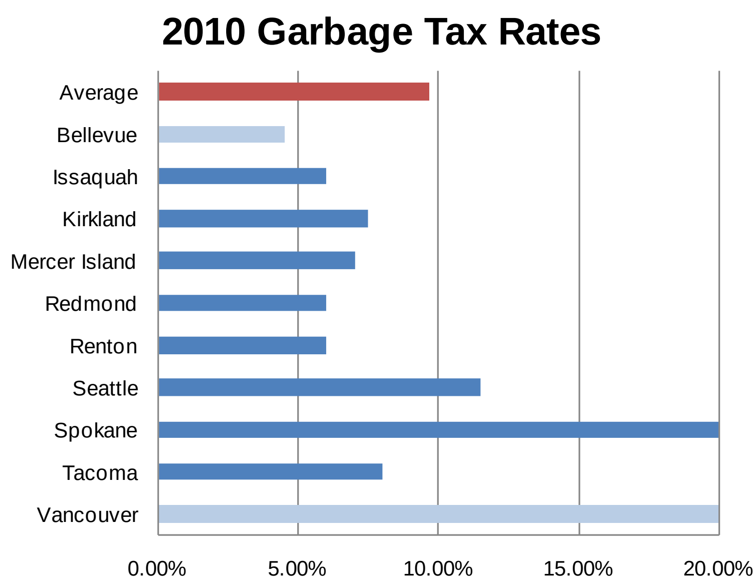




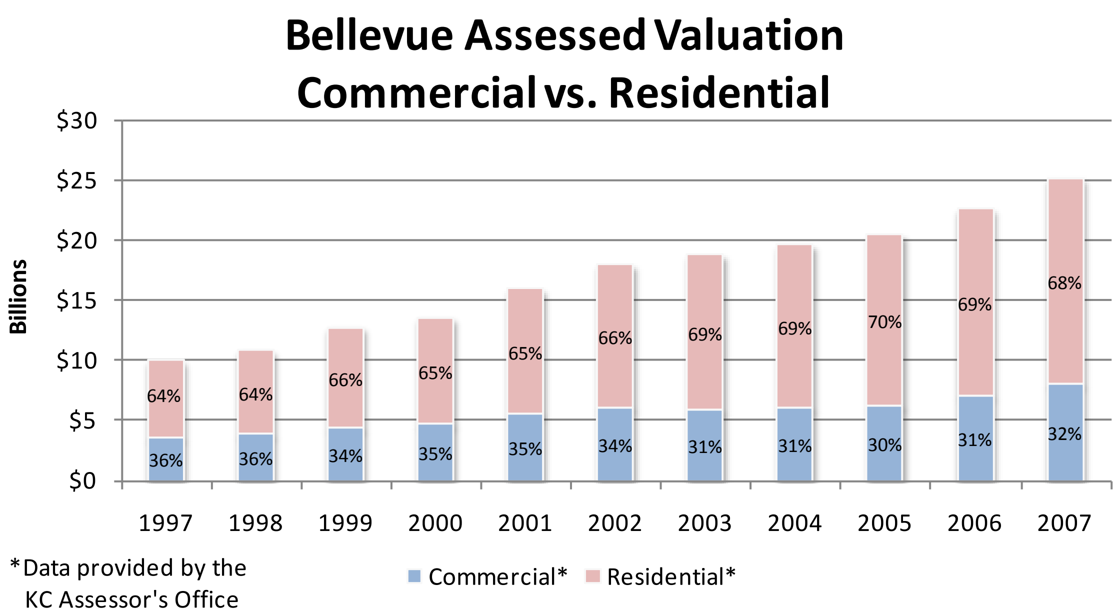

2010 Water Tax Rates
Average
Bellevue
Issaquah
Kirkland
Mercer Island
Redmond
Renton
Seattle
Spokane
Tacoma
Vancouver
None
None
0.00%
5.00%
10.00%
15.00%
20.00%


2010 Sewer Tax Rates
Average
Bellevue
Issaquah
Kirkland
Mercer Island
Redmond
Renton
Seattle
Spokane
Tacoma
Vancouver
None
None
None
0.00%
5.00%
10.00%
15.00%
20.00%


2010 Storm/Drainage Tax Rates
Average
Bellevue
Issaquah
None
Kirkland
Mercer Island
None
Redmond
None
Renton
Seattle
Spokane
Tacoma
Vancouver
0.00%
5.00%
10.00%
15.00%
20.00%


2010 Garbage Tax Rates
Average
Bellevue
Issaquah
Kirkland
Mercer Island
Redmond
Renton
Seattle
Spokane
Tacoma
Vancouver
0.00%
5.00%
10.00%
15.00%
20.00%

Another important aspect in terms of economic competitiveness is the balance between residential and commercial taxpayers. Bellevue's assessed valuation is comprised of approximately 33% for commercial properties and 67% for residential properties. This split is illustrated in the chart below.



Options:
Council can maintain the current revenue policy or change the mix (type and level) to increase or decrease the tax burden for either businesses or residents.

Recommendation:
Continue with current mix and evaluate potential changes in the context of budget proposals.

Council Budget Workshop

April 26, 2010

Reserves

Policy Issues:

1. What are the appropriate targets for various types of reserves?
2. Should some or all of the reserves be considered in aggregate for setting targets?
3. When should reserves be used and, if used, should there be a timeframe for restoring target levels?

Current Policy:

- *Maintain adequate reserves to be used in the event of a natural catastrophe, counter-cyclical revenue growth, to support cash flow during normal business cycles, future obligations, mandated requirements, and to fund replacement of major assets.*

Existing Guiding Principles:

1. Maintain AAA bond rating.
2. Provide financial sustainability.
3. Use expert/actuarial recommendations when available.
4. Use best practice of reserving for repair and/or replacement of major assets.

Reserves

Policy Issue #1

What are the appropriate targets for various types of reserves?

Background:
Fund reserves are a critical component of a strong financial management system and long-range financial plan. The creation of fiscally sound reserve policies is fundamental to the financial health of the City. Risk tolerance is a primary driver of the City's reserve policies and targets. Each fund's reserve policies are designed to address the risk exposure of the activity. The level of reserves, or target, is balanced between the need to provide adequate resources for cash flow and contingency purposes at a reasonable cost. The City's policies and practices for reserves are intended to provide sufficient funds:

- in the event of a natural catastrophe or counter-cyclical revenue growth;
- to support normal business cycle cash flow needs;
- for future obligations;
- to meet mandated requirements; and
- to fund replacement of major assets.

Determining the appropriate level of reserves should be evaluated within the specific context of the reserves functional purpose and level of risk.

For discussion purposes, the City's operating and capital reserves have been classified into four groups.

1. ***Council Directed*** – Reserve policies adopted by Council through an ordinance or resolution.

2. ***Best Practices*** – Reserve policies based on best practices established by expert opinions and organizations recognized for excellence and sound business practices.

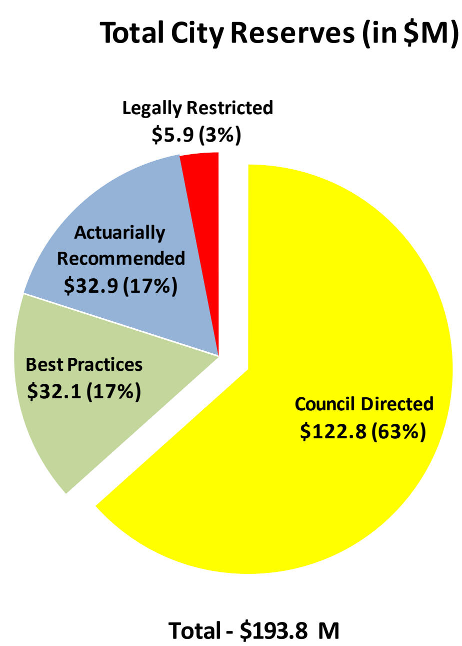
3. ***Actuarially/Administrator Recommended*** – Reserve policies are based on actuarial or third-party administrator's reviews and recommendation.

4. ***Legally Restricted*** – Reserve policies governed by legal mandates or codes.

Reserves

While many of these reserves fit into more than one category, for discussion purposes we have grouped them into categories according to the primary basis for the specific policy. The following chart displays the City's total reserves by group at year-end 2009.

Council asked staff to provide more information on fund reserves.



Council Directed -	Reserve policies adopted by Council through an ordinance or resolution.
Best Practices -	Reserve policies based on best practices established by expert opinions and organizations recognized for excellence and sound business practices.
Actuarilally Recommended -	Reserve policies are based on actuarial or third-party administrator's reviews and recommendation.
Legally Restricted -	Reserve policies governed by legal mandates or codes.

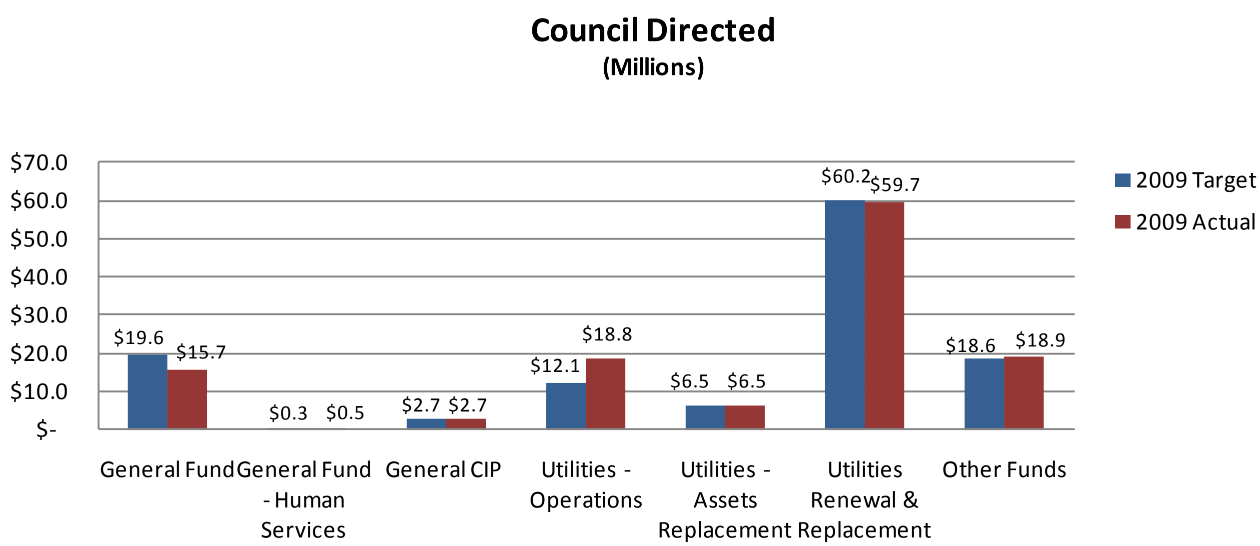
Reserves

The City Council has discretion regarding many reserve policies and reserve funding levels. Following past practices, a summary of the different reserves in each category are presented for Council's review. Updates to reserve policies and levels are made each biennium during the budget process.

Council Directed
(Reserve policies adopted by Council through an ordinance or resolution)

The City Council has adopted reserve policies that provide for funding during an economic downturn or other emergency to meet cash flow needs, and to fund known future expenditures (that is, asset replacement reserves). Council has the option to adjust these reserve targets as determined prudent.

The following chart displays the target and actual Council-directed fund reserves as of December 31, 2009. With the exception of the General Fund and the Utilities R&R Fund, all funds meet or exceed the targeted amounts.



Reserves

The following table provides the 2009 actual and target reserve levels for Council-directed polices.

Reserves by Group	2009 Actual Reserve EFB	Actual % (if Applicable)	2009 Target Reserve EFB	Surplus (Deficit)
Council Directed				
General Fund	$15.7	10.0%	$19.6	($3.9)
General Fund - Human Services	$0.5		$0.3	$0.2
General CIP	$2.7		$2.7	$0.0
General	**$18.9**		**$22.5**	**($3.7)**
Water Utility - Operations	$7.8		$7.9	($0.1)
Sewer Utility - Operations	$7.6		$3.1	$4.5
Storm & Surface Water Utility - Operations	$3.4		$1.1	$2.3
Utilities - Operations	**$18.8**		**$12.1**	**$6.8**
Water Utility - Asset Replacement	$2.7		$2.7	$0.0
Sewer Utility - Asset Replacement	$1.1		$1.1	$0.0
Storm & Surface Water Utility - Asset Replacement	$2.7		$2.7	$0.0
Utilities - Asset Replacement	**$6.5**		**$6.5**	**$0.0**
Water Utility R&R	$22.0		$21.8	$0.2
Sewer Utility R&R	$29.0		$28.1	$0.9
Storm Utility R&R	$8.7		$10.4	($1.7)
Utilities Renewal & Replacement	**$59.7**		**$60.2**	**($0.5)**
Development Services - Operations & Asset Replacement	$10.1		$10.1	$0.0
Parks M&O Reserve	$3.3		$2.7	$0.6
Marina	$0.5		$0.8	($0.3)
Housing Fund	$5.0		$5.0	$0.0
Other Funds	**$18.9**		**$18.6**	**$0.3**
Total Council Directed	**$122.8**		**$120.0**	**$2.9**

Individual Council Directed Fund Policies:

General Fund – In the 2009-2010 Budget, Council adopted a General Fund reserve policy to assure that Bellevue will be in a position to weather economic tides or to respond to natural disasters. The policy set the target at 15% of annual General Fund revenues and transferred the existing Rainy Day Reserves balance ($5.3 M) into the General Fund. The General Fund reserve was at about $15.7 million or 10% of the target at the end of 2009.

Human Services – Council has directed that the Human Services Fund establish a reserve target equal to total unpaid contracts and some additional funds to meet cash flow needs.

Utilities Operations - The Council establishes updated criteria for the Utility Department's operating and asset replacement policies each budget cycle.

Development Services Operations and Asset Replacement - Council adopted reserve policies when the fund was created. Reserves are maintained to cover prepaid services, core staffing needs during cyclical downturns, and for support of the Permit Center.

Parks M&O – The Parks Maintenance & Operations reserve funds from the 1988 Levy Lid lift and 2008 Park's Voter initiative are restricted for parks maintenance and operating costs. A target of $2.7 million provides interest earnings that subsidize the Bellevue Aquatics Center.

Parks Marina – Parks Marina's reserve policy was set in the 1998 Marina Financial Plan which establishes a reserve target of 10% of annual net revenues and an additional amount for capital repair and replacement (maximum $800,000 for both).

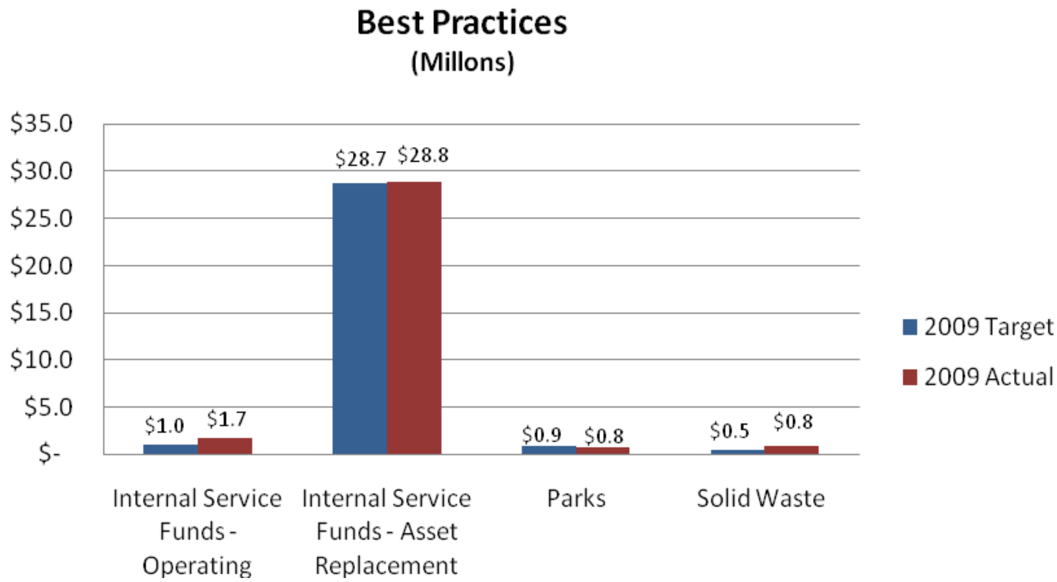
Housing Fund – The Housing Fund reserve is based on direction from the City Council for funding allocated to affordable housing projects recommended by the ARCH Board.

Best Practices
(Reserve policies based on best practices established by expert opinions and organizations recognized for excellence and sound business practices)

In addition to Council directed policies, the City has internally established reserve policies for internal services and other special activities that provide funding during an economic downturn or other emergency, to meet cash flow needs, and to fund known future expenditures (that is, asset replacement reserves). The Council has the option to make adjustments to these "best practice" policies.

Reserves

The following chart displays the target and actual best practice fund reserves as of December 31, 2009.



The following table displays 2009 year-end actual reserve and target reserve levels for the best practice category of reserves. In all cases, except the Parks Enterprise Fund, there are sufficient funds to meet the funds' targets.

Best Practice Reserves	2009 Actual Reserve EFB	2009 Target Reserve EFB	Surplus (Deficit)
Equipment Rental Fund - Operations	$0.6	$0.4	$0.2
Information Technology - Operations	$1.1	$0.6	$0.5
Internal Service Funds - Operating	**$1.7**	**$1.0**	**$0.7**
Equipment Rental Fund - Asset Replacement	$23.1	$23.0	$0.1
Facilities Services (Operations)	$1.3	$1.3	$0.0
Information Technology - Asset Replacement	$4.4	$4.4	$0.0
Internal Service Funds - Replacement	**$28.8**	**$28.7**	**$0.1**
Parks Enterprise	$0.8	$0.9	($0.1)
Parks	**$0.8**	**$0.9**	**($0.1)**
Solid Waste	$0.8	$0.5	$0.4
Solid Waste	**$0.8**	**$0.5**	**$0.4**
Total Best Practices	**$32.1**	**$31.0**	**$1.1**

Individual Best Practice Fund Policies:

Equipment Rental Fund (ERF) – ERF's reserve policy for operations is set at 5% of budgeted operating expenses to provide funding during an economic downturn. The asset replacement reserve policy targets a reserve level of 20%-40% of the total value of ERF-owned capital equipment and is examined each biennium to ensure target levels are maintained throughout the forecast period.

Information Technology (IT) – IT's reserve policy for operations is set at 2.5%-7.5% of budgeted operating expenses to provide funding during an economic downturn. Asset replacement reserve policy targets a reserve level of 20%-40% of the total value of IT-owned assets and is examined each biennium to ensure target levels are maintained throughout the forecast period.

Facilities Services – Facilities Services' reserve policy target is based on the fund's 10 year Major Maintenance Plan and is set to meet City facilities repair and replacement needs.

Parks Enterprise – The reserve target for Parks Enterprise Fund is two months of operating expenses to ensure ongoing operations during low business volume months. Excess reserves are dedicated to future operating/capital projects for the program.

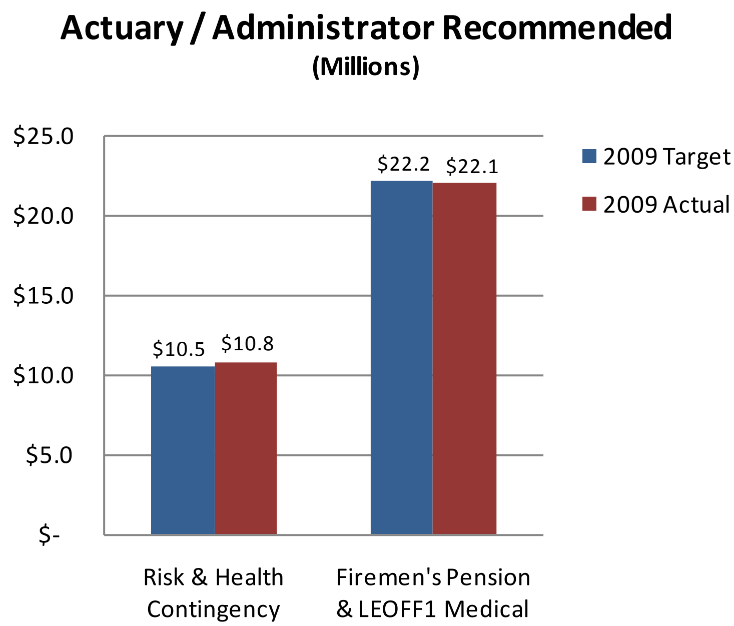
Solid Waste – The Solid Waste Fund balance is used to support cash flow needs and projects.

Actuarially/Administrator Recommended
(Reserve policies are based on actuary or third-party administrator's reviews and recommendation)

The City's risk, pension and health benefits funds hold reserves to ensure that future costs are met. In most all cases, an actuary or the fund's third-party administrator provide expert opinion regarding recommended target reserve levels based on historical and current trends, as well as projections for future liability. Council has the option to adjust targets as determined prudent.

Reserves

The following chart displays the target and actual actuarially/administrator recommended fund reserves as of December 31, 2009.



The following table displays 2009 year-end actual reserve and target reserve levels for the actuary/administrator-recommended category of reserves. All funds in this category are at or near their target. However, it should be noted that the target for the LEOFF 1 Medical Fund is shown as the current balance available. The actuarially-determined amount is closer to $36 million, but the City has not adopted a target of maintaining reserves to cover the full liability.

Reserves by Group	2009 Actual Reserve EFB	Actual % (if Applicable)	2009 Target Reserve EFB	Surplus (Deficit)
Actuarially/Administrator Recommended				
General Self-Insurance	$5.7		$5.8	($0.0)
Unemployment Compensation	$0.1		$0.2	($0.1)
Workers' Compensation	$2.0		$1.8	$0.2
Health Benefits - IBNR & 10% Contingency	$3.0		$2.8	$0.2
Risk & Health Contingency	**$10.8**		**$10.5**	**$0.3**
Firemen's Pension Fund	$6.7		$6.8	($0.1)
LEOFF I Medical Reserve	$15.4		$15.4	$0.0
Firemen Pension & Leoff1 Medical	**$22.1**		**$22.2**	**($0.1)**
Total Actuarially/Administrator Recommended	**$32.9**		**$32.7**	**$0.2**

Individual Actuarially/Administrator Recommended Fund Policies:

General Self-Insurance (GSI) – GSI Fund's reserve target is set by the most recent actuarial study (reviewed annually) and an amount to set the "risk margin" at a 70% confidence level.

Unemployment Compensation – The target for Unemployment Compensation reserves is set at an amount equal to budgeted benefit expenses.

Workers' Compensation – Workers' Compensation reserve target is set by the most recent actuarial study (reviewed annually) and an amount to set the "risk margin" at a 70% confidence level.

Health Benefits – A third-party administrator reviews the City's Health Plan annually to ensure the Plan's continued viability, compliance with the Local Government Self-Insurance Plan (State of Washington) and other legal regulations. Health Benefit reserves targets are set to cover "incurred but not reported" (IBNR) claims, as recommended by the fund's third-party administrator and an additional "risk margin" of 10% of estimated claim expenses.

Firemen's Pension – The Firemen's Pension reserve target is based on actuarial determined liabilities.

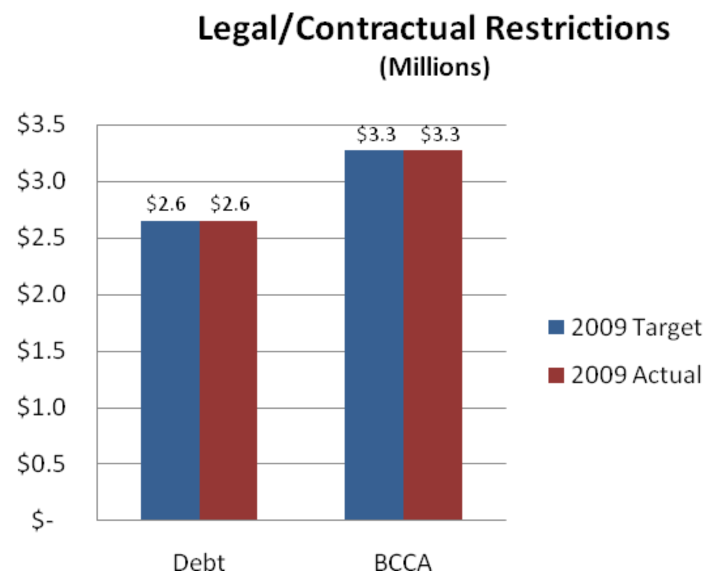
LEOFF I Medical Reserve – The LEOFF I fund target was originally based on actuarial projections of future liabilities; however, the target is currently shown as the balance available. This amount is sufficient to cover future liabilities through 2021 at which time the City would have to use a pay-as-you-go basis without the infusion of other reserves.

Reserves

Legal Restrictions (Reserve policies are governed by legal mandates or codes)

The City also holds reserves to meet legal and contractual obligations.

The following chart displays the target and actual fund reserves as of December 31, 2009 that are legally or contractually restricted.



The following table provides the actual and target reserve levels for legally or contractually restricted fund reserves as of December 31, 2009. All funds are at their target.

Legal Restrictions	2009 Actual Reserve EFB	2009 Target Reserve EFB	Surplus (Deficit)
Interest & Debt Redemption-Regular Levy	$1.2	$1.2	$0.0
LID Guaranty	$0.3	$0.3	$0.0
Utility Revenue Bond Redemption	$1.1	$1.1	$0.0
Debt	**$2.6**	**$2.6**	**$0.0**
Hotel/Motel Tax	$3.3	$3.3	$0.0
Total Special Purpose	**$3.3**	**$3.3**	**$0.0**
Total Legal Restrictions	**$5.9**	**$5.9**	**$0.0**

Individual Legally/Contractually Restricted Fund Policies:

Interest & Debt Redemption – Reserves in this fund are required by bond covenants to meet principal and interest payments on Limited Tax General Obligation (LTGO) bonds.

Local Improvement Debt (LID) Guaranty – The reserve policy for the LID Guaranty (associated with the LID Fund) is established by State Code and requires a balance not less than 10% of the net outstanding obligations guaranteed by the fund.

Utility Revenue Bond Redemption – Reserves in this fund are required by bond covenants to ensure adequate funds to meet principal and interest payments on Utility Revenue Bonds.

Hotel/Motel Tax – The reserve policy for the Hotel/Motel Tax Fund is based on the Operating Agreement between the City and the Bellevue Convention Center Authority (BCCA). The proceeds from the sale of the old convention center site are currently held as part of the BCCA Backup Financing Plan.

Options:
Council has the option of maintaining current targets or modifying them.

Recommendation:
Maintain established reserve targets which are based on the City's guiding principles, but consider changes once the implications of the budget process are determined.

Policy Issue #2

Should some or all of the reserves be considered in aggregate for setting targets?

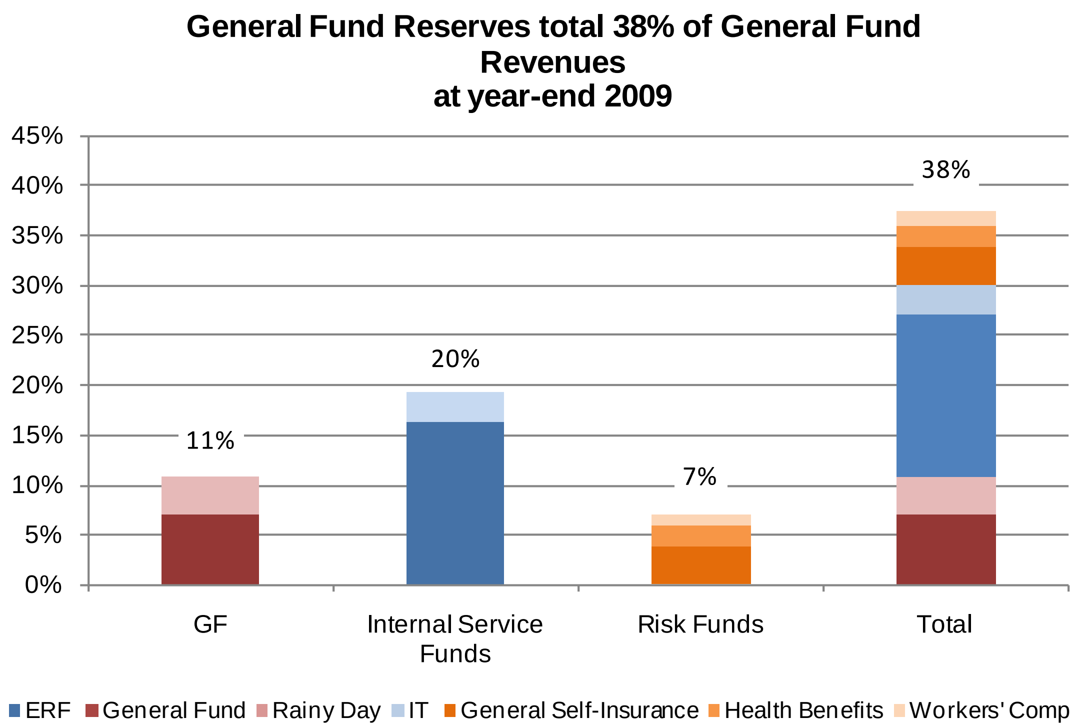
Background:

The City's reserve policies are designed to address the risk exposure of the particular activity. Reserve target levels are established to balance between the need to provide adequate resources for cash flow and contingency purposes at a reasonable cost. Fiscally sound reserve policies include merging related reserves when the financial risk is not compromised.

The General Fund's current reserve policy assures that Bellevue will be in a position to weather economic tides or to respond to natural disasters. The General Fund policy sets the target at 15% of annual revenues. This current formula does not take into account the General Fund's portion of other fund's reserves. The General Fund "owns" a portion of City service providers fund reserves, including:

- Equipment Rental Fund
- Information Technology Fund
- Facilities
- General Self-Insurance, Workers' Compensation
- Health Benefits.

The following chart displays total General Fund "owned" reserves at December 31, 2009.



Standard & Poors and Moody's Investors Services found that Aaa cities of similar size to Bellevue typically maintain a fund balance in the range of 20-30%. Our financial advisor believes that these percentages include only General Fund and Rainy Day reserves, but it is difficult to ascertain whether this is truly an "apples-to-apples" comparison given the fact that so many cities set up their accounting systems in different manners. For example, some do not have separate internal service or risk funds.

Some of the City's targets for reserves are currently calculated on a "consolidated" basis. For example, the Utilities Department calculates target reserve levels for each utility based on the strength provided by the availability of cross-utility support. Sharing risks among the utilities reduces the overall reserve levels for each utility.

It should be noted that, for cash flow purposes, all of the City's funds are available for interfund borrowing. Currently, City policies allow the Finance Director to do interfund borrowing up to six months. This interfund borrowing has been used periodically to eliminate the need to seek external financing through a bank when sufficient cash is available internally in other funds (for example, to bridge cash flow just prior to the receipt of property tax revenue). Beyond the six-month time period, Council authorization is required.

Options:
The Council could maintain existing separate policy targets or amend the policies to establish an aggregate target for the General Fund-type reserves.

Recommendation:
Maintain current separate policy targets until the financial implications are determined and further research regarding aggregating reserves can be completed.

Reserves

Policy Issue #3

When should reserves be used and, if used, should there be a timeframe for restoring target levels?

Background:
The City's reserve policies guide management of meeting short-term and long-term goals and objectives. The need for government reserves is no different from a family setting aside sufficient savings to respond to an unexpected emergency event. The event, such as the loss of a job, usually results in the loss of family income. Like families, governments need to prepare for "rainy days". It simply makes good sense and it is one of the critical components of a strong financial management system. Prudent financial management practices suggest that cities should consider their level of dependency on intergovernmental funds, levels of insurance to protect against loss for litigation, the kinds and extent of natural disasters, and their liquidity or ability to draw upon cash reserves to meet emergency needs.

The National Advisory Council on State and Local Budgeting (NACSLB) published a report in 1998 of approximately 60 best practices in budgeting and financial management for state and local governments. Among the recommended practices is: Develop a Policy on Stabilization Funds**:**

> *"Governments should maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures."*

Municipal bond rating agencies also advocate for a "fund balance" or budget stabilization fund. Rating agencies look closely at the kinds of expenditure pressures cities are facing, particularly in salary and health benefit costs, pension costs and other costs that can significantly increase over time. They also look at demands placed on municipalities related to federal, state, or county actions, unfunded mandatory requirements, or actions of the legislature or electorate to limit or modify resources commonly collected by local jurisdictions. Even in the face of ever-increasing fiscal pressure put on cities, rating agencies are, at the same time, advocating that adequate levels of generally available resources be maintained to meet declining economic cycles, cash crunches, unforeseen emergencies, or extraordinary opportunities.

The City's financial advisor, Seattle Northwest Securities, indicates that the spending of reserves, to some extent, is anticipated by rating analysts in this environment and that they have not necessarily reacted negatively to declines in held reserves when the issuer has a plan to rebuild the reserves. The City's financial advisor stated that General

Reserves

Fund reserves closer to 10% (minimum) for a year or two would probably be acceptable as long as a repayment plan for replenishing the reserve over the next two or three years is put in place.

Options:
Council could maintain current reserve levels or direct the City to use reserves as necessary for their intended purpose and assure that a repayment plan is in place to replenish to target levels.

Recommendation:
Maintain current reserve target levels until the Council completes its early review of the budget proposals.

CIP

Policy Issues:

1. What is the optimal split of tax revenues between the operating and capital budgets?
2. What are appropriate types of expenditures to be charged to the CIP?
3. Should ongoing maintenance costs related to capital projects continue to be funded from a portion of the sales tax dedicated to the CIP or should it come from another source?

Current Policy:

- *With few minor exceptions, CIP projects are based upon formal long-range plans adopted by the Council to ensure alignment with Council's direction.*
- *CIP projects should reflect all costs that can be clearly shown to be necessary and applicable to complete the project*
- *Preserve existing capital infrastructure before building new facilities.*

Existing Guiding Principles:

1. Maintain what we build and buy.
2. Public investments should be made strategically in order to leverage them for the greatest public good.
3. Public investments should seek a balance, over time, between maintaining our existing infrastructure and meeting the demands of growth and development.

Policy Issue #1

What is the optimal split of tax revenues between the operating and capital budgets?

Background:

Balancing the combination of spending across operating and capital budgets allows the City to better deliver the Outcomes that the Community wants.

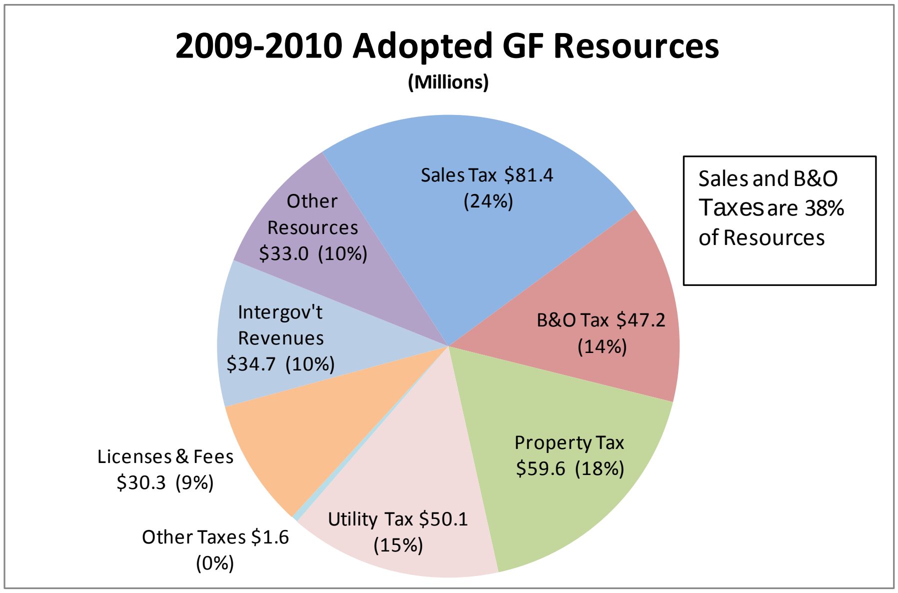
Capital budgets allow the City to acquire, build and replace assets that will benefit the City and support services and programs over a long period of time. Operating budgets provide services and deliver current programs. The appropriate split between operating and capital is different for each City and is influenced by its goals, revenue mix, and general financial condition.

Source	Percent to Operating	Percent to Capital
Sales Tax	74%	26%
B&O Tax	74%	26%
Real Estate Excise Tax	0%	100%
Property Tax	91%	9%
Utility Tax	100%	0%

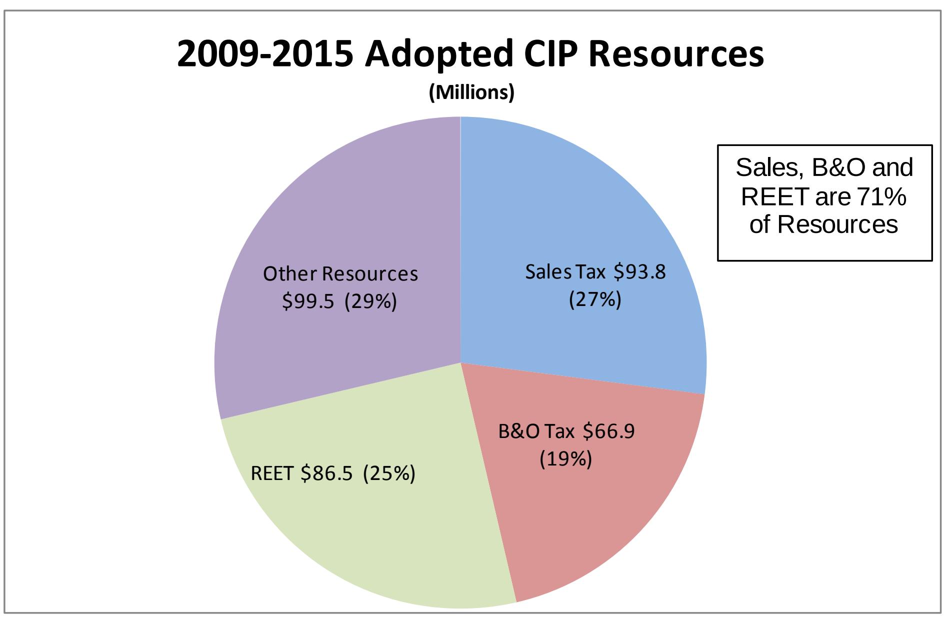
Having funding available from these tax sources has allowed the City to make significant capital investments over the years.

The following table and charts show the current split of revenues between the City's Operating and CIP Budgets. Information on how other cities fund their capital budgets is provided later in the section.

The following chart illustrates the funding sources for the City's General Fund (GF).



The current policy split of revenue has served Bellevue well, as is evidenced by fewer operating impacts than have been experienced by other local jurisdictions during this recession, and the City's ability to make significant strategic investments in capital projects during times of economic growth. The following chart shows resources currently allocated to the CIP.



The next table and chart, repeated from the revenue section, illustrate that the majority of CIP funding is currently economically sensitive and benefits from the use of "one-time" funding. When combined with a "pay-as-you-go" policy for funding capital investments, this naturally constrains CIP investments during times of economic downturn. For the General CIP, one-time funding is increased during economic booms, creating additional capacity for capital investments with long-term benefits. Because the City's General Fund is partially supported by property tax (18%), greater predictability and stability are provided to the operating budget (programs and services) during times of economic downturn.

General CIP – Sources of Revenue

Source	Percent of Total Revenue	Stable or Economically Sensitive
Sales Tax	27%	Economically sensitive
B&O Tax	19%	Economically sensitive
Real Estate Excise Tax	25%	Economically sensitive
Grants & other	29%	Stable, when available, but uncertain in initial planning stages for projects

There is no set formula or "Best Practice" for determining how a City should allocate revenue between operating and capital needs. Following is information on how other local cities fund their capital budgets, as well as their treatment of studies and M&O in relation to their capital budget.

Capital Funding – Comparison to Other Cities

CITY:	Bellevue	Sammamish	Kirkland	Redmond	Renton
Labor and Personnel Costs	Yes	No	Yes	Yes	Yes
Major Funding Sources	Sales tax, b&o tax, REET, impact fees, gas tax, grants, Intergovernmental, transfer from other funds	Grants, REET, impact fees, intergovernmental, transfers from other funds	Sales tax, REET, impact fees, gas tax, intergovernmental, transfers from other funds	Business tax, REET, impact fees, gas tax, grants, intergovernmental, transfer from other funds	Business license fees, REET, impact mitigation fees, gas tax, grants, intergovernmental, transfers from other funds
Planning Projects in CIP	Yes	No	No	Yes, very limited	Yes
Ongoing M&O supported by CIP	Yes	No	No	No	Not Available

Bellevue's current approach has been sound and has served us well. In these challenging times, it is appropriate to consider adjustments to our current approach while being cautious and thoughtful in implementing those adjustments. The Budget One process will provide Council with an opportunity to carefully evaluate the impacts of adjusting the split between operating and capital budgets in the context of all proposals for funding. In July, Council will be able to clearly see those operating and capital projects that will or will not get funded using the "normal" allocation method, and can evaluate the benefit of funding capital investments against operating proposals in order to best achieve the City's priorities.

Options:
The City can either continue the historic allocation method or change the allocation.

Recommendation:
Maintain current practice until early review of total operating and capital budget proposals by Council is completed.

Policy Issue #2

What are the appropriate types of expenditures to be charged to the CIP?

Background:

The CIP Plan generally includes all major capital projects. CIP projects should reflect all costs that can be clearly shown to be necessary and applicable to the project being built or program being conducted. These costs generally include costs for all phases of a project (i.e., design, right-of-way, and construction). They include City staff charges for time spent actually working on those projects: for example, project management, design, review, inspection, survey, and real property services. Planning studies represent another type of cost that have sometimes been included in the CIP Plan. Two areas for which Council has indicated an interest in considering policy changes include:

- the use of CIP funding sources to support ongoing M&O associated with CIP projects, and
- the funding of planning studies that may result in future CIP projects that construct infrastructure and/or facilities.

The funding of ongoing M&O is discussed in Policy Issue #3. We will focus this discussion on the use of the CIP to fund planning studies.

The 2009-2015 General CIP includes approximately $5 million in funding for planning studies. Planning studies often determine the feasibility of future CIP projects and/or support the preliminary design of future CIP projects. Because of that connection to the construction phase, theses studies were funded through the CIP. The CIP includes one-time discrete planning projects and ongoing planning projects.

Council asked us to identify studies charged to the CIP.

The following table provides a list of planning study projects included in the 2009-2015 General CIP Plan.

Studies Charged to the CIP

CIP Plan No:	Project Name	2009-2015 Amount ($ thousands)
Discrete Projects		
PW-R-130	High Capacity Transit Study	$143
PW-R-149	Eastlink Analysis and Development	1,070
P-AD-27	Planning/Design for Existing/Future Parks (Meydenbauer Bay Park Master Plan)	1,000
P-AD-80	Green Infrastructure Master Plan	150
G-76	Electric Service Reliability Study	350
CD-21	Eastgate Subarea Plan	285
	Subtotal Discrete Projects	$2,998
Ongoing Programs		
PW-R-44	Transportation Planning Studies	$728
P-AD-27	Planning/Design for Existing/Future Parks	718
PS-19	Public Safety Facility Studies	104
CD-2	Community Development Planning	900
	Subtotal Ongoing Programs	$2,450
	Total	**$5,448**

Options:
Council can maintain the current practice of funding studies in the CIP, choose to exclude all planning studies, or choose a hybrid approach based on particular principles or criteria.

Recommendation:
Maintain current practice until early review of total operating and capital budget proposals by Council is completed.

CIP Policy Issue # 3

Should ongoing maintenance costs related to capital projects continue to be funded from a portion of the sales tax dedicated to the CIP or should it come from another source?

Background:
The City's current policy is intended to ensure that the City can operate and maintain what it builds in order to preserve its infrastructure. One change, or enhancement, under Budget One is that all M&O costs will be carefully evaluated and ranked, regardless of their funding source.

Ongoing M&O costs related to capital projects are budgeted in the General Fund and are funded with a portion of sales tax revenue originally earmarked for the CIP. This funding is referred to as "CIP M&O sales tax distribution".

The CIP M&O distribution for 2010 totals $7.8 million. This amount is approximately $2.0 million less than in previous years because of the offset of property tax resulting from the two 2% and one 3% property tax increases approved by Council for the Supplemental CIP and Mobility & Infrastructure Initiative. This offset occurred because of the statutory limitations prohibiting the use of banked capacity for capital projects.

Council asked us to provide more detail regarding costs that comprise M&O.

The following table includes the 2010 M&O amounts by department.

Department	2010 Amount ($ millions)	% of Total
Parks	$6.1	63%
Transportation	1.6	16%
Police and Fire	1.0	10%
ITD	0.7	7%
Facilities	0.4	4%
Total CIP M&O	$9.8	100%
Reduction to Distribution - Supplemental CIP	(1.1)	
Reduction to Distribution - Mobility Initiative	(0.9)	
Total CIP M&O Distribution	$7.8	

Council asked us how many fewer projects were being funded over time as a result of funding CIP M&O.

The allocation of CIP revenue directly impacts the number of projects that can be funded by the CIP. The number of projects that could be funded depends on the size of the project. Project costs generally range from $100,000 to $10 million.

The following provides some rules of thumb for what could be bought with $1-2 million:

For $1 million, the City could:

- design and construct approximately 0.4 miles (2,000 lineal feet) of sidewalk - - - $500 per lineal foot; or
- overlay about 7 lane miles of roadway - - - $130,000 per lane mile

For $2 million, the City could:

- design and develop a neighborhood park; or
- replace an existing turf field with synthetic sportsfield surfacing at one ballpark (really $1-2M depending on field configuration, lighting needs, and other site specific elements)

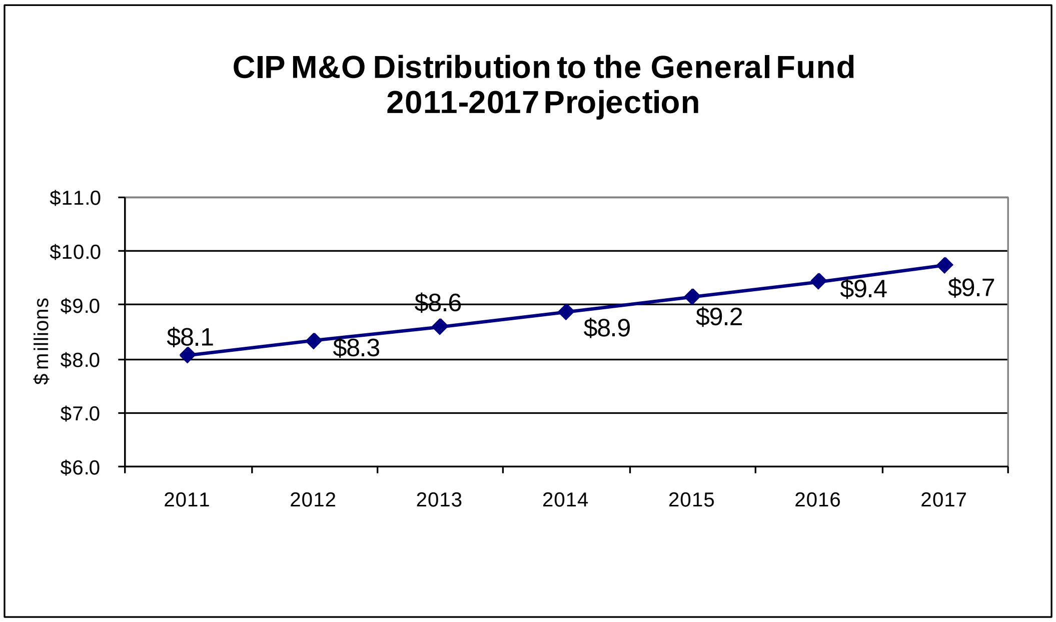
Council asked us to provide more information regarding the M&O components by department and the drivers.

The following table illustrates the primary drivers for M&O costs and examples for each department.

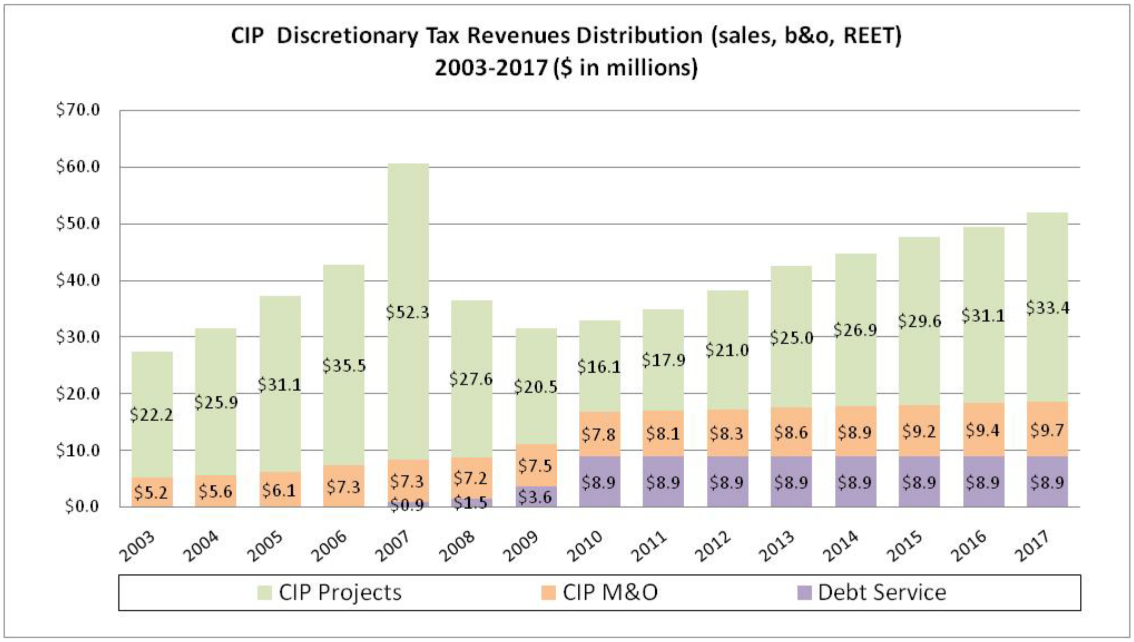
Primary Drivers and Examples of M&O by Department

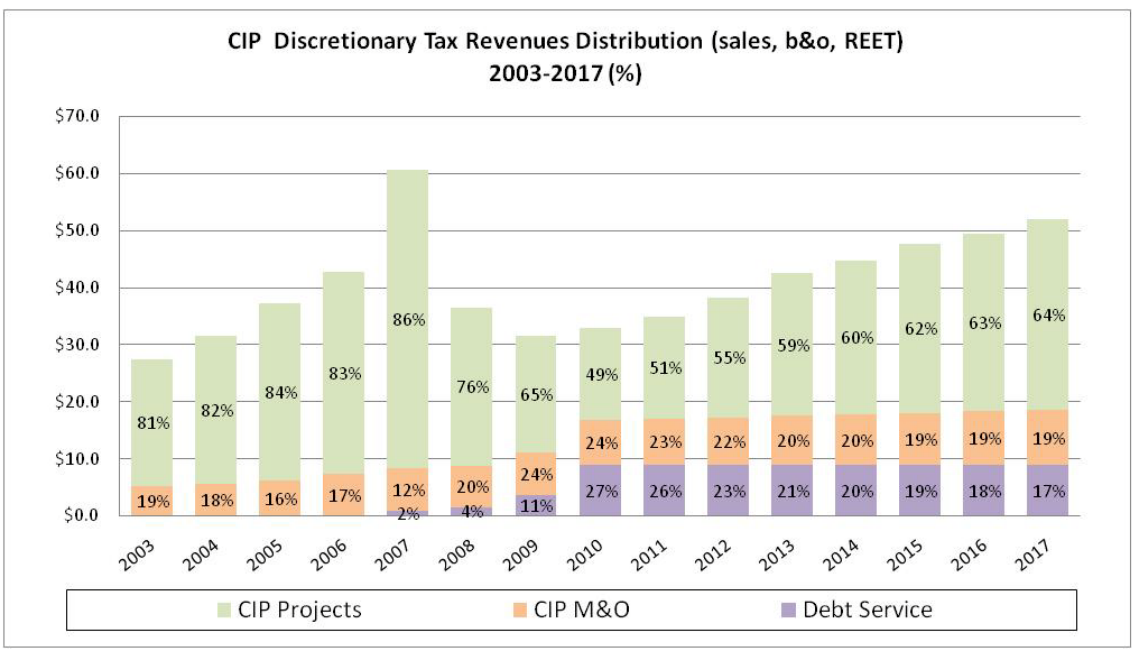
Department	Primary Drivers	Examples
Parks	• Development of several significant community parks over the past several years • Landscape improvements and smaller capital projects	South Bellevue Community Center • Building maintenance and site amenities Mercer Slough Environmental Education Center • Building maintenance, site amenities, and the cost of the program staff (1 FTE) Sportsfield improvements at several Bellevue School District sites • Maintenance of fields which generates ongoing program revenue
Transportation	• Addition of new travel lanes, sidewalks and bike lanes, and new and/or upgraded signals and street lighting • Landscaping and irrigation systems	• Incremental costs, including additional electricity costs, irrigation system costs, and cost of water
Police & Fire	• Technology investments in MDC/AVL and CAD	• Costs for the Mobile Data Computers/ Automated Vehicle Locations System (MDC/AVL) and the Computer Aided Dispatch System (CAD) fund hardware/software maintenance, connection fees, wireless access fees, and replacement
ITD	• Investment in the Finance and Human Resources System	• Costs include software/hardware maintenance and replacement and staffing (4 FTEs) to maintain the system
Facilities	• New City Hall additional M&O, as directed by the Finance Plan	• Normal maintenance and operations costs for operating the building (including utilities, custodial, security, and preventive maintenance) • Contribution to fund major maintenance replacement (including major components such as roofs, heating and ventilation equipment, elevators, generators)

Under current policy, the M&O distribution is projected to increase to approximately $10 million by the end of the upcoming CIP period (2011-2017), as illustrated in the following graph. As you will see on the following page, their relative percentage of overall CIP costs is actually reduced over the forecast period.



The following two graphs illustrate the impact of both CIP M&O and debt service for City Hall on the discretionary tax revenues available for CIP (first in $, then %). When the original Finance Plan was developed for the new City Hall in 2002, Council chose to hold the then-current CIP (2003-2009) “harmless” and used reserves to pay annual debt payments through 2009. As such, debt service consumes a larger share of the CIP beginning in 2010.





The following table illustrates the options for funding CIP M&O.

Council asked us to provide options to address the M&O component funded with sales tax that otherwise would have been available for capital, such as a five-year transition plan.

Options for Funding CIP M&O

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Current Practice	$7.5	$7.8	$8.1	$8.3	$8.6	$8.9	$9.2	$9.4	$9.7	$10.0	$10.4	$10.7
This table Illustrates the impact on the operating budget of shifting the M&O costs to the General Fund.												
Option 1: Grandfathering			-$0.3	-$0.5	-$0.8	-$1.1	-$1.3	-$1.6	-$1.9	-$2.2	-$2.5	-$2.9
No further funding of M&O by CIP, future M&O costs compete with other operating expenditures.												
Option 2: Transition over time												
A.) Immediate transition			-$8.1	-$8.3	-$8.6	-$8.9	-$9.2	-$9.4	-$9.7	-$10.0	-$10.4	-$10.7
B.) 5-year transition			-$1.8	-$3.7	-$5.5	-$7.3	-$9.2	-$9.4	-$9.7	-$10.0	-$10.4	-$10.7
C.) 7-year transition			-$1.4	-$2.8	-$4.2	-$5.6	-$7.0	-$8.3	-$9.7	-$10.0	-$10.4	-$10.7
D.) 10-year transition			-$1.1	-$2.1	-$3.2	-$4.3	-$5.3	-$6.4	-$7.5	-$8.5	-$9.6	-$10.7

Note: *The amounts shown with an "-" are in addition to the current gap in the General Fund operating budget.*

Options:

Council can choose to maintain current practice, grandfather funding for CIP M&O at the current level, or transition funding for CIP M&O to operating over time.

Recommendation:

Maintain current practice until early review of total operating and capital budget proposals by Council is completed.

Other Major Initiatives

In January 2009, the Council endorsed the Mobility & Infrastructure Initiative Plan. This plan was the product of extensive Council discussions throughout the prior year centered on funding high priority transportation and other capital investments to mitigate growing congestion problems in the City.

The projects included in this plan were estimated to cost approximately $299 million, and were expected to be constructed within the next 10 years:

Mobility & Infrastructure Projects	**Project Cost Estimates**
NE 4th	$51M
NE 6th ext	6M
120th	14M
NE 15th	84M
124th	3M
Other Downtown projects	16M
ITS capital improvements	2M
Downtown Circulator	3M
Ped/Bike/Neighborhood sidewalks	15M
Metro Site	18M
Bel-Red Land Acquisition	32M
Finance Costs	55M
Total	**$299M**

The plan outlined a strategy to generate funding to pay for these investments. The financial strategy was intended to generate the revenue necessary to pay for these improvements, and was based on the philosophy that those who benefit from the improvements should help pay for them. The funding plan used a balanced set of resources, including property tax, impact fees, local improvement districts, grants, incremental tax growth, and several other revenues including the following.

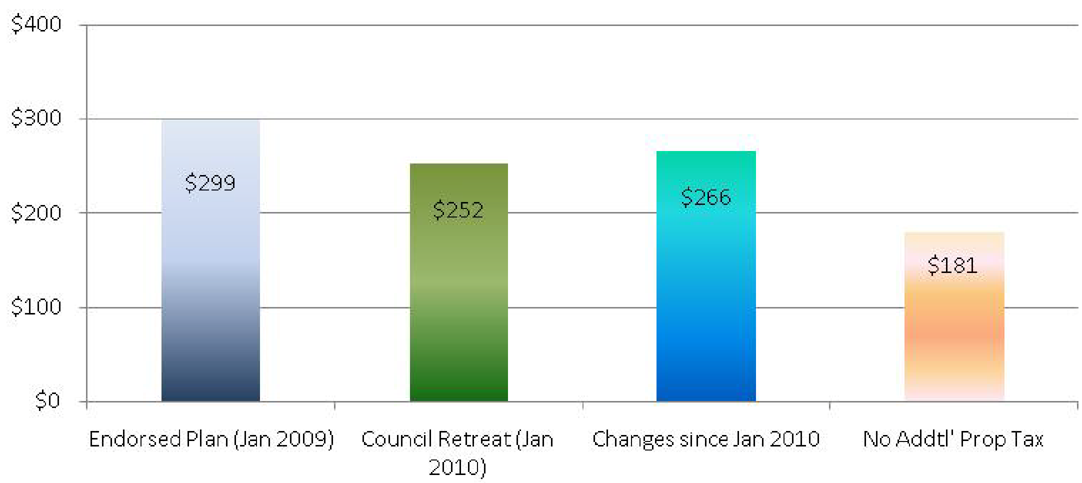
Revenue Sources	**10-Year Revenue Estimate**
Baseline Revenues:	
• New Bel-Red Taxes (incremental growth)	$10M
• ROW Dedication	19M
• Storm Drainage Fees	10M
• Incentive zoning	22M
• Grants	12M
Impact Fees	65M
LID Funding	56M
Property Tax (ten 3% property tax increases)	105M
Total Revenue	**$299M**

The plan contemplated 10 consecutive property tax increases of 3% each to support the initiative. However, due to the economic downturn, Council decided to forego the 2010 property tax increase. Additionally, Council ultimately decided on lower impact fees phased in over a longer period of time. The revenues were updated to reflect these changes. The impact of the reduction in revenue estimates (bonds supported by the property tax), as well as other updates to the revenues made over the ensuing year, are shown in the following chart.

Council asked what the resource comparison for CIP and Mobility look like without property tax revenues.

Resources ($M)	Endorsed Plan (Jan 2009)	Council Retreat (Jan 2010)	Changes since Jan 2010	No Addtl' Property Tax Scenario
Baseline Revenues:				
New Bel-Red Taxes	$10	$10	$10	$10
ROW Dedication	19	-	-	-
Storm Drainage Fees	10	10	10	10
Incentive Zoning	22	8	8	8
Grants	12	33	33	33
Impact Fees	65	40	40	40
Local Improvement District	56	56	56	56
Property Tax supported bonds	**105**	**95**	**95**	**10**
Supplemental CIP	-	-	7	7
Local Revitalization Funding	-	-	7	7
Total Resources	**$299**	**$252**	**$266**	**$181**

If no future property taxes were levied (all other things being equal), the impact to the revenues funding the plan is illustrated below.



Council Budget Workshop

April 26, 2010

Debt

Policy Issues:

1. Does Council want to consider the use of long-term debt, or continue on a pay-as-you-go basis, or use a hybrid approach?
2. If so, what revenue will be used to support the debt (existing or new)?

Current Policy:

- *Limit debt to short-term obligations, primarily for cash flow purposes. Debt incurred will be paid back before the end of the current CIP (i.e.,7 years).*
- *Use of long-term debt is minimized.*
- *Exceptions for extraordinary circumstances.*

Existing Guiding Principles:

1. Maintain Aaa bond rating.
2. Long-term debt should generally be issued only for long-lived assets.
3. Financial management plan for repayment of debt is essential.
4. Review of debt and refinancing when conditions are favorable is essential to effective debt management and capital planning.

Policy Issue #1

Does Council want to consider the use of long-term debt, continue on a pay-as-you-go basis, or use a hybrid approach?

Background:
Historically, CIP projects have been funded on a "pay-as-you-go" basis. Use of long-term debt in the CIP has been minimized. Debt is limited primarily to short-term obligations, primarily for cash flow purposes. Debt incurred is typically paid back before the end of the current CIP (i.e., 7 years).

There are exceptions to this policy for extraordinary circumstances, where Councilmanic or voted long-term debt has been issued to achieve major City goals that otherwise could not have been achieved, or would have been delayed an unacceptable amount of time. Examples of these exceptions include the issuance of long-term debt to purchase and renovate City Hall, the issuance of the "Supplemental CIP" bonds to support major capital improvements, and, more recently, the 3% property tax increase for 2009 which will support additional bonds to fund capital improvements.

State statutes allow cities to issue general obligation debt that is backed by the full faith and credit of the City. However, the statutes limit this type of debt to 2.5% of the City's assessed valuation for each of the following three purposes:

1. General Purposes – Debt issued in this category can be used for any purpose allowed by law. It can be either voted or non-voted ("Councilmanic") debt.

2. Parks and Open Space – Debt issued in this category must be used for parks and open space and/or recreation facilities. All debt in this category must be approved by the voters.

3. Utilities – Debt issued in this category must be used for utility infrastructure. All debt in this category must be approved by the voters.

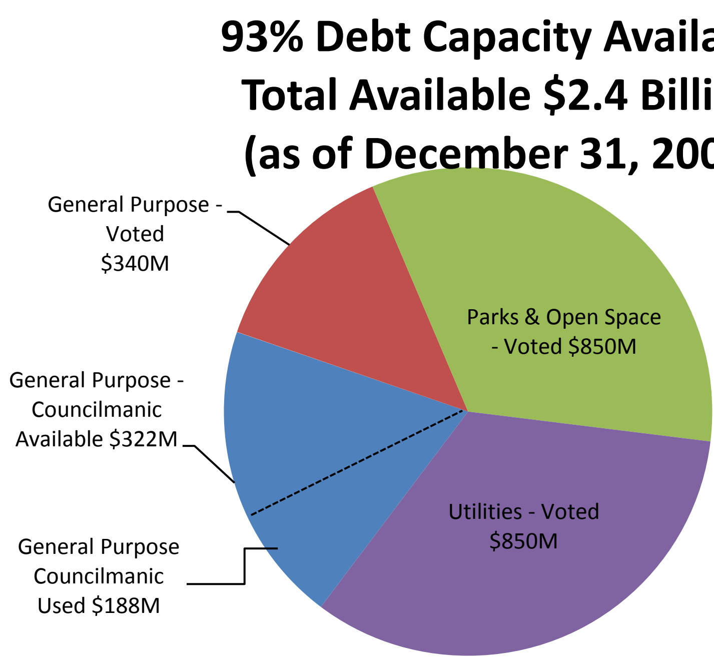
Debt

Based on statutory limit (RCW), the City's current available debt capacity is $2.4 billion. Of this amount, $322 million is available for General Purpose Councilmanic debt. The table below provides a summary of the City's current debt capacity by type.

Council asked us to provide more information regarding available debt capacity for the Mobility & Infrastructure Initiative.

($ in millions)

	General Purposes					
Description	**Non-Voted Councilmanic Debt**	**Voted**	**Total**	**Parks and Open Space Voted**	**Utilities Voted**	**Total Capacity**
Statutory Limit	$510	$340	$850	$850	$850	$2,551
Total Debt Outstanding	$188	$0	$188	$0	$0	$188
Estimated Available Debt Capacity	$322	$340	$662	$850	$850	$2,363



In addition to the limitations required by the RCWs, Council decided to take a more conservative approach several years ago and imposed further policy limits on the City's use of debt to assure strong financial health. The table below illustrates the further restriction.

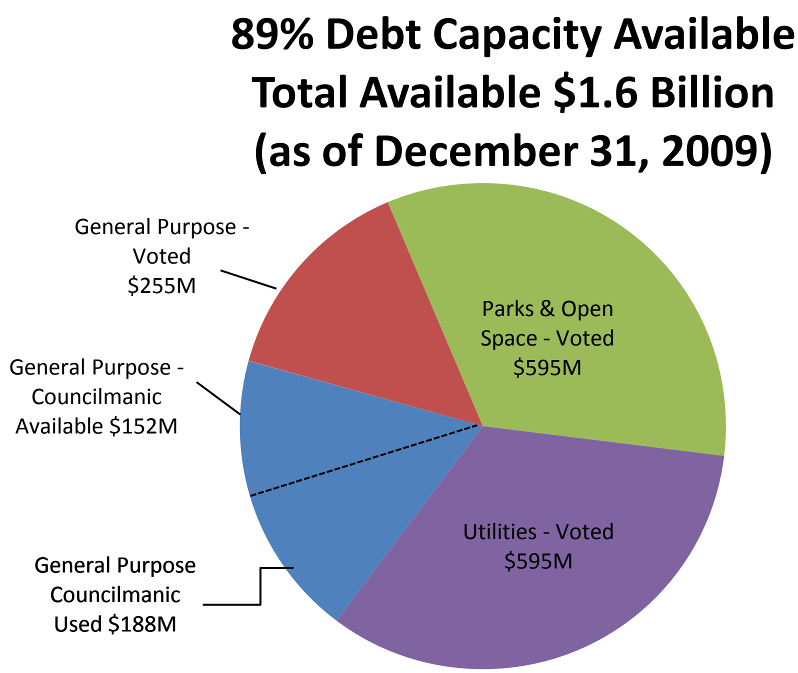
Type of Debt	Statutory Limitations	Policy Limitations
General Obligation:	2.5%	1.75%
Non-Voted	1.5%	1.00%
Voted	1.0%	0.75%
Parks and Open Space	2.5%	1.75%
Utilities	2.5%	1.75%
Revenue	No Limit	No Limit
Local Improvement District	No Limit	No Limit

Based on these further restrictions, the City's current available debt capacity is $1.6 billion. Of this amount, $152 million is available for General Purpose Councilmanic debt. The table below provides a summary of the City's current debt capacity by type based on Council policy.

	($ in millions)					
	General Purposes					
Description	Non-Voted Councilmanic Debt	Voted	Total	Parks and Open Space Voted	Utilities Voted	Total Capacity
Council Policy Limit	$340	$255	$595	$595	$595	$1,786
Total Debt Outstanding	$188	$0	$188	$0	$0	$188
Estimated Available Debt Capacity	$152	$255	$407	$595	$595	$1,598

Below is a table illustrating the $188 million in outstanding debt.

Debt Outstanding (as of 12/31/09)	Non-Voted Councilmanic Debt ($ in millions)
1995 Convention Center	$4
1998 Marina	3
2002 Convention Center-Improvement	10
2003 Metro Site	3
2004 City Hall	103
2006 City Hall II	5
2008 Supplemental CIP	13
2009 LOC	30
1991 & 1994 BCCA Lease/Purchase	18
Total Debt Outstanding	$188



The Mobility & Infrastructure Plan endorsed by Council in January 2009 outlines general policy guidance for a financial strategy to generate the funding to pay for the capital investments included in the Plan. This Plan contemplated the use of two types of long-term debt, General Purpose Councilmanic debt and Local Improvement District (LID) bonds, which are included in the table below.

Type of Debt	Funding Source	Will this impact City's Debt Capacity	Can this impact the City's Credit?
General Purpose Councilmanic debt	3% property tax increase	Yes	Yes
Local Improvement District (LID) bonds	LID special assessments	No	Yes

Local Improvement Districts

A Local Improvement District (LID) is a method of financing capital improvements constructed by the City that provides a special benefit to the properties within the boundary of the LID. The LID formation process leads to the sale of bonds and the retirement of those bonds via annual special assessments paid by the property owners within the district. State law (RCW 35.54.095) also requires that a “Guaranty Fund” be established through the special assessments with a balance of no less than 10% of the outstanding obligations guaranteed by this fund.

Generally speaking, bonds sold by the City for an LID are either LID bonds or General Councilmanic bonds. In the case of LID bonds, the City’s debt capacity is not impacted; however, in either case, if the Guaranty Fund is depleted, the City will be required to replenish the Fund. There is a risk that the City’s credit can be negatively affected if the debt payments are not fully funded.

Options:

The City can either continue on a pay-as-you-go basis or use additional long-term debt or a hybrid approach to address capital needs.

Recommendation:

Maintain current practice until the impacts on the budget are determined, but continue to explore the use of long-term debt as an option.

Policy Issue #2

If Council decides to issue debt, what revenue will be used to support the debt (existing or new)?

Background:

The issuance of debt provides a financing mechanism, much like taking out a mortgage on a home. It does not provide an ongoing source of money to repay the "loan". Annual debt payments associated with issuing long-term debt can be financed by existing and/or new revenues.

As stated earlier, the City's current CIP is funded primarily on a pay-as-you-go basis. The revenues available in the General CIP include sales tax, B&O tax, grants, and real estate excise tax (REET). Grants are earmarked for certain projects. REET is much more economically sensitive and one-time in nature and not likely a good candidate to support ongoing debt payments. Whatever sales tax or B&O tax that is not programmed in the current CIP could be used to support debt issuance.

Because the property tax derived from the City's banked capacity cannot be used to fund debt, the "Supplemental CIP" bonds were actually funded from sales tax. The two consecutive property tax increases (2% in 2007 and 2% in 2008) were offset by an equal reduction in the sales tax that is distributed to the City's General Fund, thereby creating sales tax as a funding source for the debt in the General CIP.

Council has asked staff to provide more information regarding use of debt to finance additional capital projects, in particular to provide additional funding for Mobility & Infrastructure projects. New sources of revenue could be used to pay for debt, including voted property tax increases or LID special assessments. LIDs, for example, were contemplated as part of the funding sources for the Mobility & Infrastructure Initiative.

Council asked us to provide a clear statement of the funding sources for the Mobility & Infrastructure Initiative short-term plan.

Current funding for the short-term Mobility & Infrastructure Initiative totals $20.0 million. The short-term plan includes $7.4 million of the remaining "Supplemental CIP" bonds, $10 million in bonds supported by the 2009 3% property tax increase, and $2.6 million in federal grants. Council has allocated a total of $14.2 million to date in Mobility projects. The funding sources and projects are illustrated in the following chart.

Category	Amount ($ in 000s)
Funding	
Supplemental CIP Funding (two 2% levy increases)	$14,000
Supplemental CIP Spending	(6,600)
Supplemental CIP Funding transferred to Mobility Initiative	$7,400
Federal Grant (120th Avenue NE Improvements)	2,600
Long-term Debt (2009 3% levy increase)	10,000
Total Funding	$20,000

Category	Amount ($ in 000s)
Project Costs	
Adopted by Council on February 1, 2010:	
NE 4th Street Extension (PW-R-160)	$3,600
120th Ave NE Improvements (PW-R-161)	8,600
NE 6th Street Extension (PW-R-162)	1,000
Subtotal Projects Adopted on February 1, 2010	$13,200
Adopted by Council on March 8, 2010	
NE 15th Street Multi-Modal Corridor (Segment 1)	1,000
Total Project Costs	$14,200
Remaining Funding Available	$5,800

The City's Aaa general obligation and Aa1 Councilmanic bond rating allows us to borrow at the lowest interest rates. Current market conditions for the municipal bond market are favorable. Liquidity in the market is good and demand has been gradually increasing lately.

Council asked us to provide more information regarding the ability to borrow and the cost of borrowing.

One unknown at this time is the future of interest rates. As the economy recovers, interest rates are expected to rise. As a result, investors will start moving some of their money into stocks that will create some lessening demand in bonds leading to slightly higher interest rates.

The following table shows the estimated bond issue costs based on $10, $50, and $100 million bond issues:

	Bond Issue Costs						
Type and Size of Bond	**Underwriter (1)**	**Bond Counsel (2)**	**Financial Advisor**	**Bond Rating (3)**	**Other**	**Total**	**% of Bond Size**
1. LID Bonds							
a. $10 million	$50	$27	$35	N/A	$2	$114	1.14%
b. $50 million	$250	$60	$35	N/A	$3	$348	0.70%
c. $100 million	$500	$80	$35	N/A	$3	$618	0.62%
2. GO Bonds							
a. $10 million	$50	$20	$30	$21	$2	$123	1.23%
b. $50 million	$250	$50	$30	$40	$3	$373	0.75%
c. $100 million	$500	$70	$30	$64	$3	$667	0.67%
3. Revenue Bonds							
a. $10 million	$70	$25	$30	$27	$2	$154	1.54%
b. $50 million	$350	$65	$30	$48	$3	$496	0.99%
c. $100 million	$700	$85	$30	$87	$3	$905	0.90%

(1) Underwriter fees as a percent of total size are estimated to be 0.5% for LID and GO Bonds, and 0.7% for Revenue Bonds.

(2) Bond Counsel fees have a fixed and a variable component. For a $10 million GO bond issue, the fee is calculated as follows: ($11,390 +0.165% of amount over $5 million = $19,640).

(3) Bond rating fees do not apply for LID bonds which are considered "nonrated".

Actual bond issue costs that the City has paid in the last several years have ranged from $21,000 (.07%) for the $30.0 million 2009 LTGO BAN (Line of Credit) to $1.1 million (1.0%) for the 2004 $102.7 million LTGO bonds (new City Hall).

By locking long-term interest rates at a lower rate now, the City can finance a portion of the capital needs sooner rather than later. The City may face the risk of rising interest rates and construction inflation rates by delaying the financing of capital projects. The following table provides an example of the cost of delaying projects compared to the cost of long-term borrowing.

Council asked us to provide information regarding whether we should be issuing more long-term debt now while interest rates are low and are likely to increase over time.

Debt

Financing Method	Inflation/Interest Costs	Difference	Breakeven (in years)
Cash - Delay project for 10 years	$6.3 million		
20 yr Bonds @ 4.5%	$5.5 million	$800,000 Savings	8.91
20 yr Bonds @ 5.5%	$6.9 million	$600,000 Cost	10.63

Assumptions

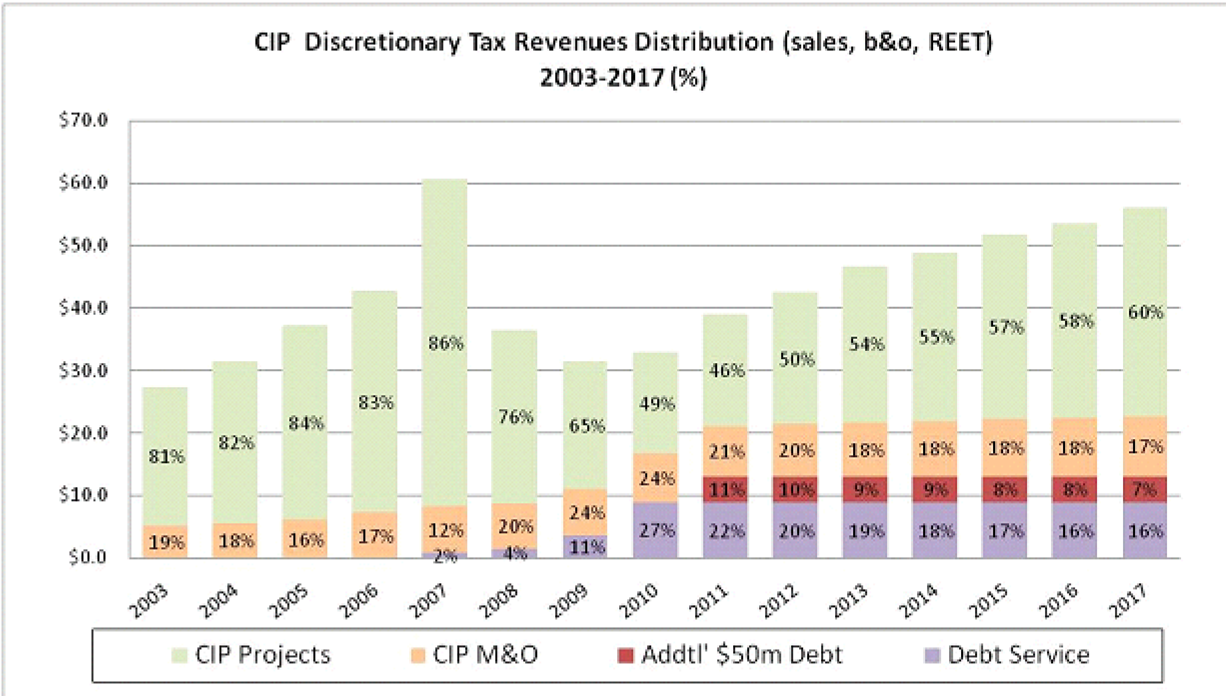
- *Project cost $10 million*
- *Cash to fund project is not available for at least 10 years*
- *20-year bond interest rates 4.5% and 5.5%*
- *Construction cost inflation 5% annually*

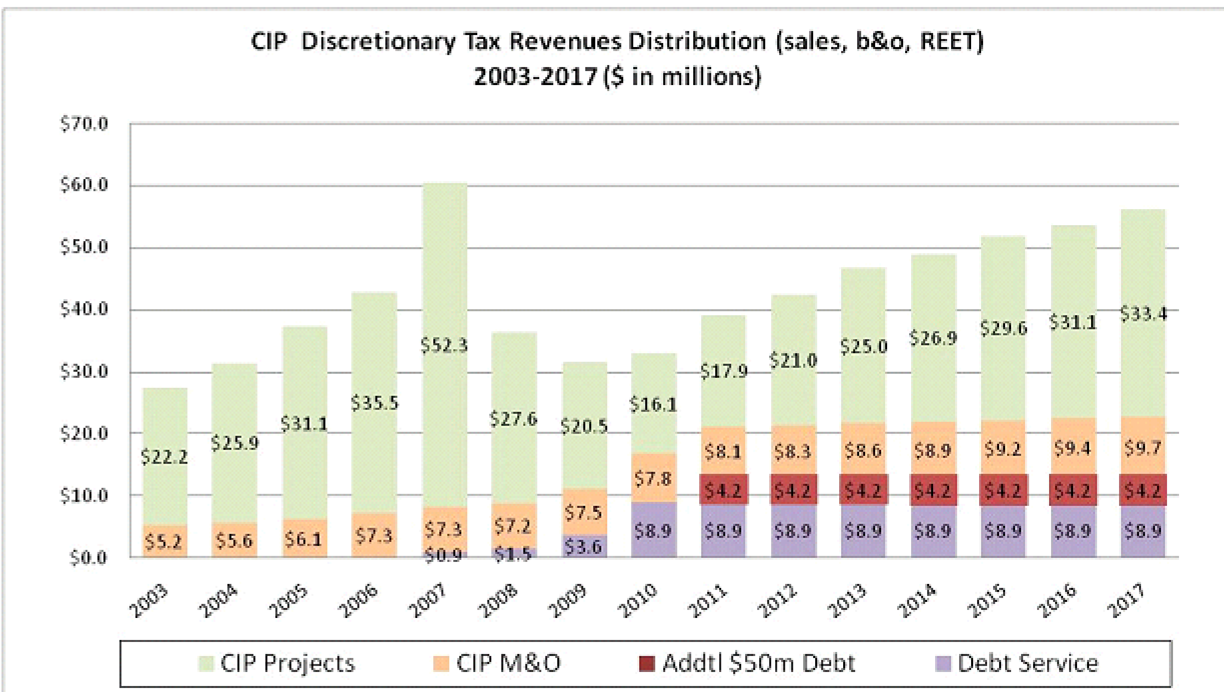
This chart illustrates that the City would save approximately $800,000 in future construction inflation costs for this hypothetical project by issuing 20 year bonds at 4.5%. Conversely, the cost of financing bonds at 5.5% will be higher by approximately $600,000. Holding construction inflation factors constant at 5%, the breakeven points (that is, point at which borrowing costs are equal to inflation costs) are approximately 8.91 years and 10.63 years for 4.5% and 5.5% bonds respectively.

There are a number of important economic factors that should be considered when determining what financing method to use. The following lists some of the factors to consider:

- Bid environment – The current bid environment is very favorable, with recent bids averaging 30% under engineer's estimate.
- Low borrowing rates – Current interest rates are low compared to the last several years.
- Uncertainty regarding future construction costs
- Uncertainty regarding future interest rates.

The impact of additional debt issuance, without a new funding source is illustrated in the graphs below.





Options:
If the City chooses to issue additional long-term debt, it can be funded out of either the existing CIP or new revenue.

Recommendation:
Maintain the current pay-as-you go method until early review of the budget by Council, but continue to explore the use of the existing CIP versus new revenue.