

# SECTION 2



# BUDGET DEVELOPMENT



## SECTION 2: BUDGET DEVELOPMENT

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## FINANCE DIRECTOR'S MESSAGE

The following summary from the Finance Director provides the background to decisions made in preparing the 2021-2022 Proposed Budget for the City of Bainbridge Island. The financial and policy context within which the City operates determines both the options available and the choices made by the City in preparing the Proposed Budget.

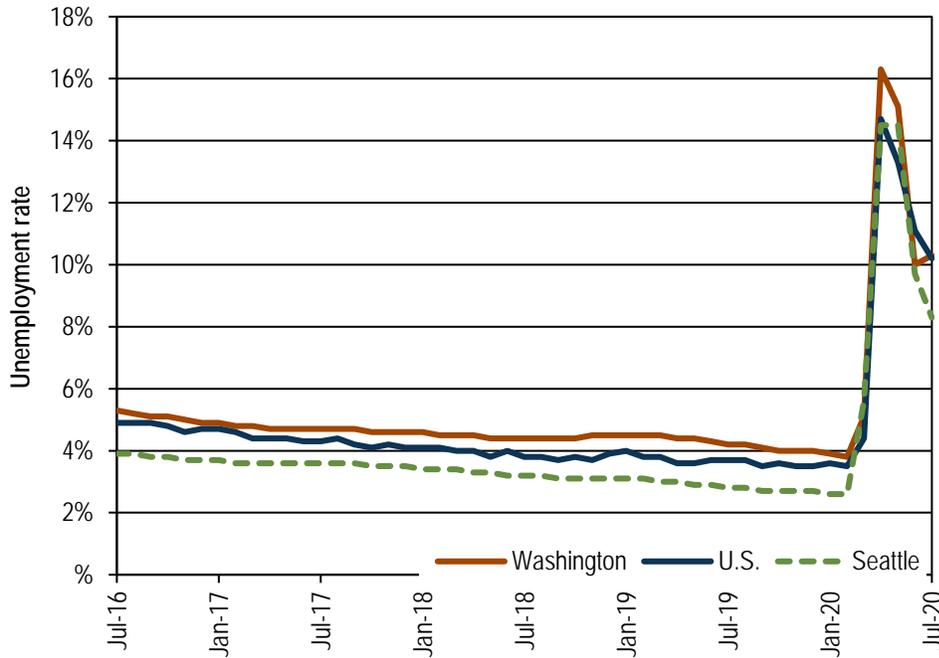
### **Background and Budgetary Trends**

The COVID-19 pandemic has had significant ramifications to global as well as state and local economies as the United States officially entered recession in February 2020. The national economic drop in February marks the end of the expansion that began in June 2009 and lasted 128 months, the longest on record. Due to sudden and extensive impacts, the City of Bainbridge Island (City) is experiencing modest to large decreases in certain key revenues including sales, lodging, parking, gas taxes and other revenues. The effects will likely continue through the rest of 2020 with potential impacts and volatility into 2021 and 2022.

The recommendations included in this proposed budget preserve essential functions and services while maintaining the City's ongoing fiscal discipline and strong financial policies by matching ongoing revenues and expenditures. The proposal utilizes a modest level of fund balance to pay for critical infrastructure improvements and high-priority one-time operating expenditures. The City's continued adherence to its financial policies is important to ensure a long-term strategic approach that preserves existing services and maintains resources to meet future uncertainty and challenges.

The City's financial performance in the first quarter of 2020 largely followed past years and the modified budget for the year. In this context, the first documented case of the novel coronavirus in North America was discovered in January and by early March, businesses and schools began to proactively address the emerging situation with temporary closures. Governor Inslee initiated a series of public health-related business and personal restrictions throughout the State of Washington. What was first called the "Stay Home, Stay Healthy" program has transitioned to a "Safe Start" set of county-by-county and industry-by-industry guidance. The limitations imposed by these programs support public health by slowing the spread of the virus and have had negative economic impacts.

In 2020, Washington's economy has lost a total of 245,400 jobs since January. As of July, the overall unemployment rate for the state was 10.3%. Unemployment in the Seattle area was 9.3% and in Kitsap County 9.5%. More recent positive data indicates 44,500 new jobs were added in July in Washington State, but the overall unemployment rate is still very high compared to long-term trends. Of note in the latest report was the statewide loss in construction jobs. This trend mirrors a decrease and trend in construction sales tax that the City received (see discussion below) in 2020. The biggest statewide gains were noted in transportation, warehousing, and utilities.



Source: U.S. Bureau of Labor Statistics, and Employment Security Department Workforce Information and Technology Services August 2020

**Financial Vulnerability to Economic Uncertainty due to COVID-19**

The Association of Washington Cities (AWC) conducted a survey earlier in 2020 to assess the financial stress cities are currently facing. The survey results indicate that most cities’ budgets, including the City of Bainbridge Island, suffered during the early months of the pandemic. There is significant uncertainty regarding the long-term impact of COVID-19 and the length of the current recession.

Each city has a different financial profile, with different associated strengths and weaknesses. Cities which rely on revenues such as sales tax, the hotel/motel tax, and user fees, as well as those cities with low reserve levels are at particular risk. Expenditure risks include high public safety and debt service expenditures, which are difficult to change, as well as historical staffing levels. The City of Bainbridge Island has a financial infrastructure which was relatively resilient in 2020 as it did not include a high level of volatile revenues or unnecessary spending.

While the impacts of COVID-19 have had some impacts on service levels at the City of Bainbridge Island, the City’s strong reserves, diversity of certain revenue sources, low debt, and modest staffing levels have helped to mitigate some of the more drastic effects felt by some cities around the Puget Sound region. Similar to other jurisdictions in Washington State, the City’s general fund is highly supported by property taxes (see discussion below).

**Key Revenue Sources**

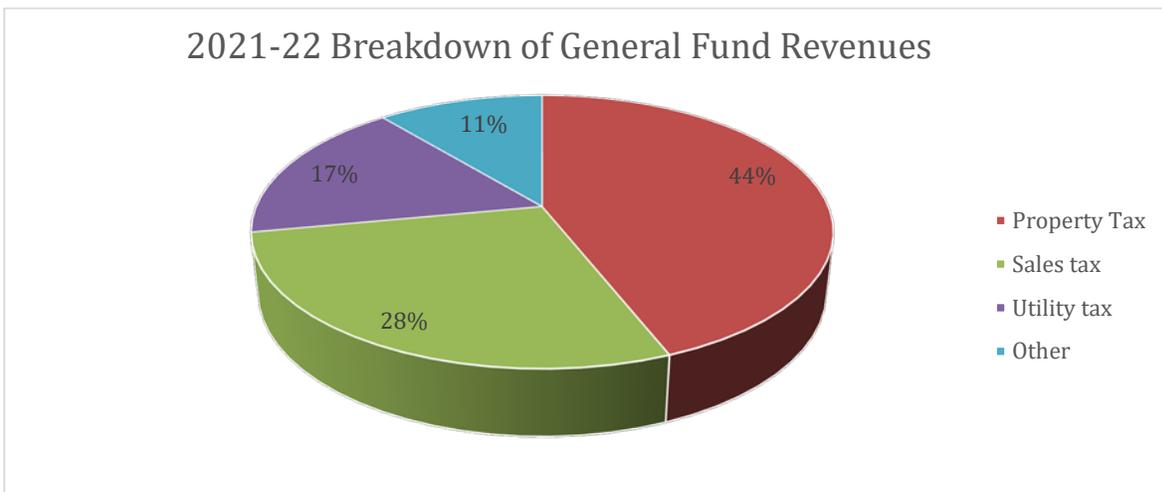
Most City revenues have steadily improved since a sharp decrease in the early spring along with gains in statewide and regional employment following a historic decline in April. The improvement may also be linked to Kitsap County entering Phase 2 of the State of Washington “Safe Start” program, which allowed



many of the “non-essential” businesses to re-open in a reduced capacity to resume business. The City is currently forecasting modest improvements in 2021 and 2022 revenue with an overall assumed revenue growth of about 2% over 2020. The City financial capacity tool and various regional economic models the City uses to assist forecasting suggest continued caution. The small data set utilized to forecast 2021-2022 were derived from recent City improvements in revenue from earlier forecasts generated in May but only include a few months of actual results since the recession began. Continued refinement and changes to City revenue forecasts in the future will likely occur as the recession unfolds.

Initiative I-976 known as the “\$30 car tab initiative” was passed by state-wide voters in 2019. This initiative eliminated the authority of Transportation Benefit Districts to levy vehicle license fees. While the initiative was set to take effect in December of 2019, it has been delayed due to legal challenges. Revenues from vehicle license fees have historically generated about \$400,000 per year in the Transportation Benefit Fund (TBF), used to pay for street maintenance, with an additional \$200,000 starting in 2019 to be used for traffic calming and climate mitigation projects. Currently the case is awaiting final adjudication in the State Supreme Court with an expected decision sometime this fall. Funds collected since the initiative passed are legally restricted and cannot be spent until a final decision is reached. The City has budgeted the use of prior existing TBF fund balance to pay for these program services in 2021 and 2022. If the initiative prevails, the City will need to consider various options for funding road repairs at either current or reduced service levels in 2023 and beyond.

The City’s revenue portfolio continues to rely heavily on the general property tax, which in the State of Washington is a stable revenue source that typically grows annually at a rate of 1%, plus the value of new construction. As property tax accounts for more than 40% of General Fund revenues, the stability of this revenue stream helps the City maintain core services during periods of economic volatility.

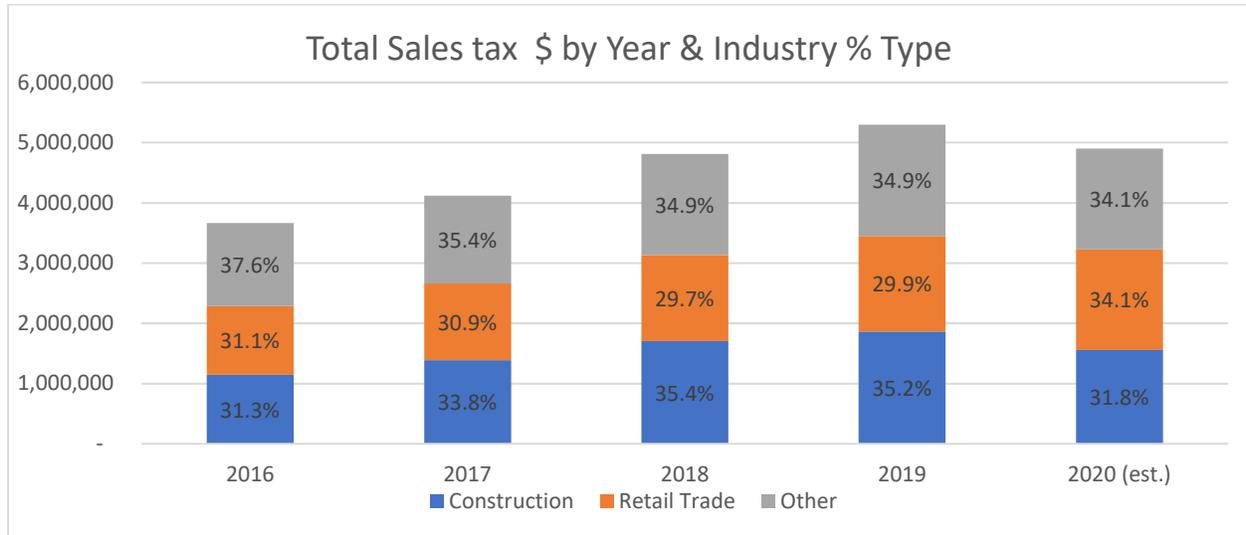


Source: City of Bainbridge Island

Sales tax is the City’s second largest tax-supported revenue, accounting for approximately 28% of General Fund revenues, estimated at a total of \$10.2 million in the 2021-2022 biennium. 2020 sales tax revenues have declined about 8% or \$275,000 as compared to the same months in 2019. Sales tax from construction has historically comprised the largest portion of sales tax, at nearly 36% of the total. 2020 has seen this number shift downward to 32%. Retail trade now contributes the largest share of sales tax, with nearly 34%



of the total amount. The City forecasts a 4% increase for sales tax revenue in 2021 compared to 2020, with an additional 2% increase in 2022. Staff continue to carefully scrutinize the composition of sales tax going forward and look for new or continued trends that could impact the financial condition of the City.



Source: City of Bainbridge Island

Recent Real Estate Excise Tax (REET) revenues, historically the third largest portion of the City’s revenue portfolio, have remained relatively stable during the pandemic but have decreased since the peak in 2017. Funds are restricted and may be used to support certain capital construction projects and other eligible expenses. In 2020 through August, the total revenue from REET is down 3% compared to the recent 5-year average but up 11% over 2019. The volume of sales is down 17% and average sales prices is up 21% compared to the 5-year average, which suggests a shortage of inventory of available homes to sell. Regionally, based on the first half of 2020, the Puget Sound Housing Market increased by 1.4% year-over-year. The housing market index is a quarterly measure of residential real

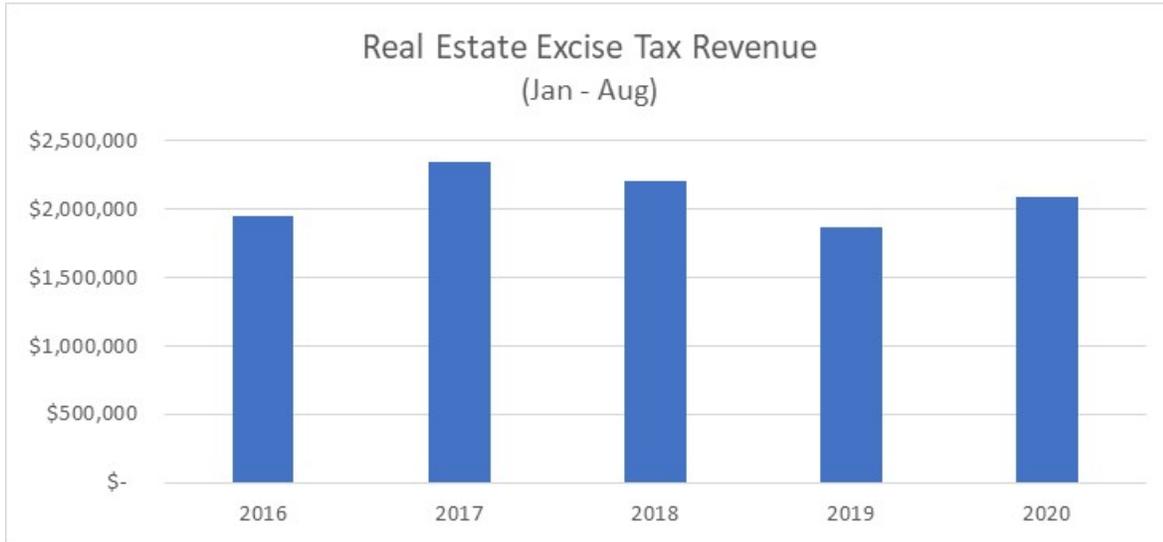


Source: Western Washington University

estate activity in the Puget Sound region (King, Pierce, Snohomish and Kitsap Counties). The composite index, which has a value of 1.00 in 1996, is designed to rise or fall as the housing market improves or deteriorates. The purpose is to indicate directional change in residential real estate activity and is supported by an overall change in supply, demand, and affordability. An upward movement in the housing market index indicates improvement in the residential real estate market, as measured by home sales, time on the market, and the ratio of the average closed sales price. Recent trends in the overall index suggest a pattern consistent with the pattern on Bainbridge. That is, an increased demand, decreased time on the market and the increase in average sales



price.



Source: City of Bainbridge Island

**Budget Process**

The budget process is an organized and collaborative series of steps and discussions that allows for policy development, service level planning within the current financial context, and internal and external communications. The budget document serves as the signature policy document in which the City establishes key priorities and policies for funding services. The budget is also used to develop short and long-term service level plans within a financially constrained structure. Finally, the budget process creates a tool for communicating changes and priorities to the public and within the organization.

The development of the City’s Operating and Capital Budget involves three phases: formulating budget requests, City Manager review and proposal, and City Council review and adoption.

During the summer of 2020, the City Council and staff reviewed capital plans. The capital budget planning process included review by Public Works and Planning and Community Development Department staff, in addition to the Planning Commission, the Utility Advisory Committee, and the community.

Planning for the operating budgets commenced with Council review and approval of a consolidated set of financial policies, providing an up-to-date framework within which budget development occurs. Operating budget development began in June. Over the summer, department directors and staff worked to develop budgets in alignment with the City goals that were identified at a Council retreat earlier in the year and reaffirmed at a Council meeting in June. Based on the Council goals, several departments proposed targeted increases or changes to their operating budgets. Department staff took a zero-based budget approach to non-personnel expenses, while Finance staff performed a line item review of all personnel-related expenditures. This fall the City Proposed Budget will be discussed in a series of budget discussions starting in September and concluding with a final budget ordinance in November.

**Near-term Budget Influences**

As mentioned above, the United States officially entered a recession in February that was sparked by COVID-19. While it is still early to predict the long-term ramifications of this event to the City, the City has



so far has weathered the 7% decrease in revenues in 2020 by engaging a short-term spending control plan and by utilizing reserves. Finance will remain diligent in monitoring short and long-term effects as the crisis continues to unfold into 2021 and 2022. This budget assumes 2020 is the worst year of the economic recession, with modest recovery in 2021 and 2022.

The City tracks policy reserves for the General Fund, as well as for each utility fund. For 2021, the reserves include an Emergency Reserve, with a target of \$1.0 million and a minimum General Fund balance of 25% of ongoing revenues, or \$4.5 million for the coming biennium. The City also maintains reserves in each utility fund, as described in the financial policies. The City has fully funded all reserves since the end of 2013, with a General Fund balance that in recent years has significantly exceeded the minimum target. The 2021-2022 Proposed Budget fully funds the General Fund reserves and utility fund reserves.

Fund balance is available for one-time projects or investments, such as the City's portion of the Country Club bulkhead project and operating initiatives such as work to implement the Comprehensive Plan and certain major maintenance projects.

The City's financial policies require that recurring expenditures are supported by recurring revenues. It is the current budget policy to support all on-going expenditures, including debt service, with on-going revenues. This approach ensures a balanced and sustainable budget, sizing expenditures at a level that is supported by appropriate revenues and is particularly helpful in times of financial duress. In order to meet these policies, the 2021-2022 Proposed Budget includes some reductions in expenditures to match forecast lower revenue levels.

The City reacted to the decline in overall general governmental revenue in 2020 by implementing a reduced spending plan where expenditures were intentionally reduced to save the City about 10% or \$2.7 million below budgeted amounts. This strategy stabilized the financial condition of the City while maintaining adequate fund balances. The resulting financial condition helped to minimize budget reductions in 2021-22.

Staffing for 2021-22 will be reduced by 5 full-time equivalent vacant positions and include the addition of two full-time positions. The high point of City staffing was in 2008, with 152 full-time equivalent (FTE) positions. By comparison, proposed City staffing for 2021 includes 127.10 FTE, which is a decrease over the previous approved staffing level of 130.10 FTE.

### **Long-term Financial Planning**

This biennial budget includes choices that position the organization to maintain long-term financial sustainability. Key issues and assumptions worth noting are included below. Throughout budget development, staff review and respond to emerging issues to ensure sound financial plans and a sustainable financial future:

- Utility revenues for all three utilities are set by previously approved rate ordinances. Rates will increase 3% in 2021 on certain specific water and sewer rates and an additional 2% per year starting in 2022.
- The City continues to face increases in recurring expenses that are externally driven. Currently, annual impacts of this type generate roughly \$750,000 in new costs for salaries and benefits to deliver existing services. These increases accumulate year-over-year, so are expected to grow by a larger amount each year. This is a challenge faced almost universally by both public and private sector organizations, as medical and pension expenses and general inflation rises even during an economic downturn. Personnel



costs are largely driven by bargained labor contracts and are assumed to increase by 2% in 2021 and 2022 while medical costs are assumed at an increase of 7% for 2021 and 6% in 2022.

- The City has continued to commit resources toward capital projects and asset management at a level that reflects an emphasis on stewardship and long-range sustainability of significant public assets. This includes sound management of roads, facilities, fleet, equipment and utility infrastructure. Overall new projects not including equipment purchases for the biennium total approximately \$10 million.
- The City continues to carefully manage debt, which is currently 10% of the legal limit for limited tax general obligation bonds and 2% of the legal limit for voted bonds. Careful stewardship of financial resources led to the City's 2019 upgrade to a Aaa credit rating from Moody's Investors Service. This is the highest possible credit rating, which lowers the interest rate when the City issues debt.

### **Conclusion**

Bainbridge Island is a unique, multi-faceted community, and the municipal organization works hard to serve the critical needs and priorities that have been identified as integral to community's goals. The City does this within a framework that emphasizes financial sustainability and accountability. The City uses a variety of tools and analysis to guide in financial forecasting to ensure this financial sustainability. The City also continues to pursue innovation and efficiency, providing the highest level of service with our existing resources supported by careful and continuous control of costs.



## FINANCIAL POLICIES

The City's adopted municipal code is the main policy document of the City of Bainbridge Island. It establishes policy and guidelines for most City operations. In addition, the City defines its approach to operations or the scope of duties and responsibilities through additional policies and practices.

Stewardship of public funds on behalf of the community is the primary financial responsibility of the City of Bainbridge Island. Policies that define and maintain the City's fiscal stability have been created to help City officials plan fiscal strategy with a consistent approach. By adhering to its stated policies, City Council and City management seek to continually improve the City's financial stability and provide adequate funding for the services desired by the public. The City Council reviews the Financial Policies as a key initial step of budget development. In 2020, Council reviewed and adopted an updated set of financial policies. The entire text of the policies is included in the Appendix to this document, with certain key provisions cited below.

### **Key Policy Statements**

The primary purpose of financial policies is to provide guidelines for the City Council and staff to use in making financial decisions that ensure core services are maintained and the Council's vision for the community is achieved.

The City shall adopt a balanced budget. The City defines a balanced budget as one in which current biannual budgeted revenues in addition to fund balances are equal to or greater than current biennium budgeted expenditures. In addition, the City's budget shall maintain recurring expenditures at a level less than recurring revenues.

The City shall consider its financial capacity when making budget decisions. Staff shall deliver to Council a ten-year Financial Capacity Analysis as part of the biennial budget process. For each Financial Capacity Analysis, the financial assumptions shall be reasonable and shall take into account an appropriately chosen set of inflation factors and an appropriate set of economic projections. The Administration's chosen assumptions for revenues, expenditure inflation factors and economic measures shall be disclosed to the Council.

The City will strive to maintain a diverse and stable revenue stream to protect against short-run volatility of any single revenue source.

The City shall maintain a structure for all fees and charges where the beneficiary of the service pays the cost of that service except to the extent that the Council has determined that provision of the specific service in question provides a benefit to the general public.

On a periodic basis, Building and Development Services (B&DS) rates shall be reviewed, with a goal of full cost recovery for the B&DS Fund.

The City will maintain expenditure categories according to state statute and administrative regulation.



Capital expenditures shall meet the requirements of generally accepted accounting principles (GAAP).

The City's capital asset policy states physical inventory count of capital and attractive assets will occur every five years. The inventory count will verify the existence, condition and location of all assets. This GFOA recommended practice establishes a method for assessing assets so the City can appropriately plan and budget any capital maintenance or replacement needs.

The Capital Improvement Plan and the City operating budget will be reviewed at the same time to ensure that capital and operating needs are balanced with each other and support overall City goals.

The Equipment Rental and Revolving (ER&R) Fund is a self-sustaining internal service fund established to pay the timely replacement cost of existing equipment and vehicles that meet the capitalization thresholds set forth in the Capital Asset Policy. It is the policy of the City of Bainbridge Island ER&R fund to charge rental rates sufficient to replace ER&R fund equipment with an additional reserve amount for unforeseen losses or catastrophic events.

The City grant policy requires Council approval prior to submittal of an application for grants over \$50,000, unless pre-authorized for acceptance by the City Council through ordinance or resolution. The \$50,000 threshold must include as part of the estimate any City "in-kind" labor used as matching funds and City staff will describe to the Council the amount that is provided through the grant and the amount that is provided through in-kind matching funds.

In the issuance and management of debt, the City shall comply with the state constitution and with all other legal requirements imposed by federal, state, and local rules and regulations, as applicable. Long-term borrowing shall be confined to the acquisition and/or construction of capital improvements and shall not be used to fund operating or maintenance costs.

Reserve funds enable the City to deal with unforeseen emergencies and changes in economic conditions. Reserve targets are set by the City Council for the General Fund, and for each utility fund.

The accounting system will maintain records on a basis consistent with accepted national standards for local government accounting and the Washington State Auditor's Budgeting, Accounting and Reporting System.

The City will ensure that City records are audited annually, resulting in a financial opinion. The results of the audit will be available to the public through the City's website.

## BUDGET PROCESS

Budget development is a continuous process that begins in January and culminates with the passage of a final budget in November or December. During the year, the City tracks budget to actuals to improve on the next year's budget. On a quarterly basis, Council considers a consolidated set of citywide budget and capital project adjustments, and amends the current year's budget, as necessary. Many of Council's actions, community input, and new legislative mandates throughout the year have budgetary implications that also need to be incorporated into future budgets.



\*The City of Bainbridge Island adopts a biennial budget with a full budget process once every two years. In the mid-biennium, there is a review and necessary adjustments are made.

\*The Adopted Budget is monitored and amended as necessary during the budget year.

## KEY ASSUMPTIONS IN 2021 – 2022 BUDGET DEVELOPMENT

The City developed the 2021-2022 Proposed Budget beginning with some key citywide assumptions, and with additional detailed spending developed on a department-by-department basis.

Estimated beginning fund balances for each fund for 2021 are based on actual 2020 performance through August. An on-going theme for the City's key assumptions for revenues and expenditures are impacts due to COVID-19 closures and restrictions. Currently, there is a great deal of uncertainty. Economic indicators heading into 2020 were solid and the 2020 Modified Budget anticipated modest gains in some revenue sources with the potential of smaller decreases to less substantial revenue sources. Midway through the third quarter of 2020, the City has several months of revenue data reflecting the specific impacts due to COVID-19. Estimated revenue and expenditure forecasts are based on the current understanding of regional economic conditions and the City's specific experience through the month of August.

### **Revenue Estimates**

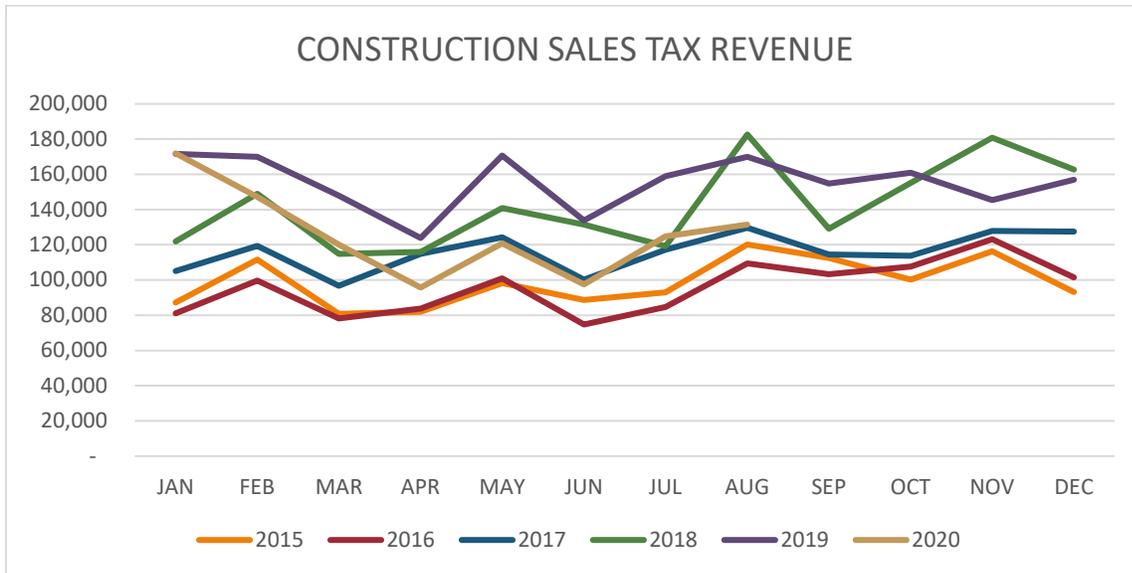
Revenue estimates were prepared for each source after an analysis of the City's past five years of revenue performance and expected near-term economic variabilities. In some cases, such as the statutory limits to increases to property tax, external factors guide the revenue estimate. In other cases, actual performance indicated a reduction or increase was warranted, and for other revenue sources, a general inflator was applied to the average of recent years' actuals.

### **Property Tax**

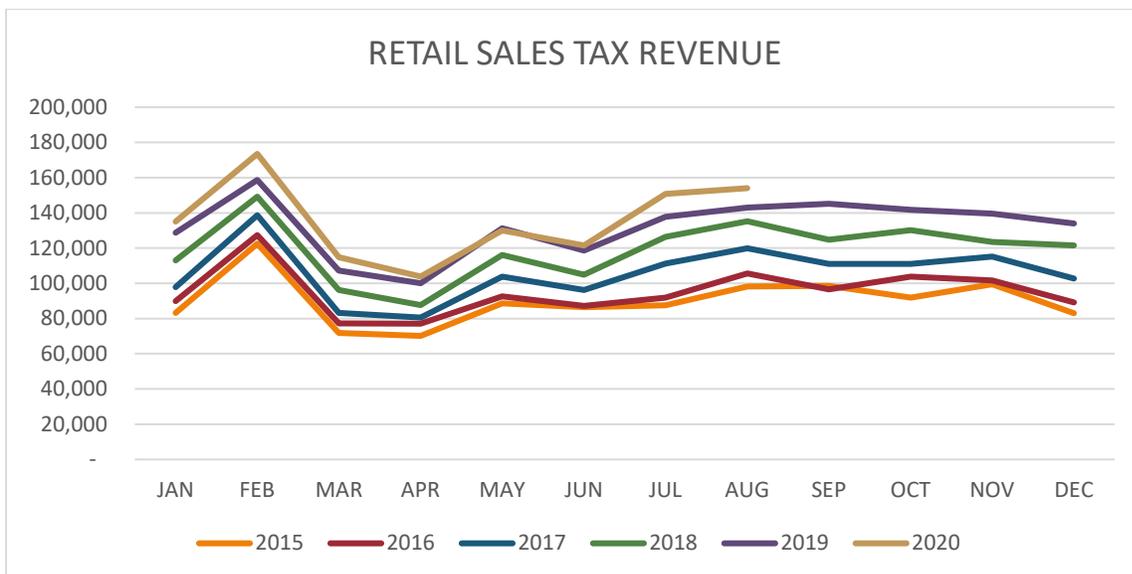
Growth in property tax in Washington State is limited to 1% plus value of new construction. Recent development has led to increases in construction. However, we are not expecting construction trends to continue at the same rate. Therefore, estimated assessed value of Bainbridge Island property is expected to grow albeit at a lesser rate than we have experienced in the last five years. The 2021 – 2022 Biennial Budget assumes revenue of \$7.9 million in 2021 and \$8.0 million in 2022. For the next two years the budget assumes a 1.25% increase and 1.75% year over year increase in property tax revenue there-after.

### **Sales Tax**

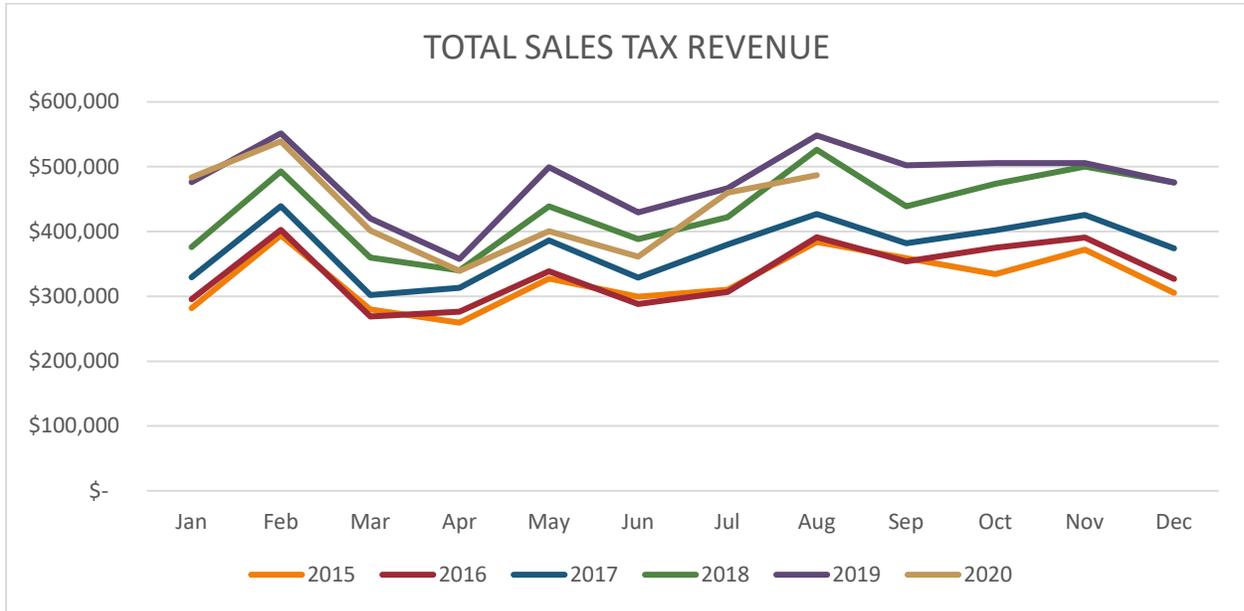
Prior to the COVID-19 pandemic, the strong local economy generated significant growth in sales tax. In the past three years, the City experienced double-digit year-over-year growth in sales tax collection. One reason for the strong growth in the recent past was the large influence of construction-related sales tax on the total. Construction sales tax revenue is typically 30 to 35% of the sales tax base. In the last five years construction sales tax revenue has been averaging 12% growth. Development is highly influenced by economic conditions and historically comprises a large portion of the City's sales tax revenue, reducing the City's sales tax revenues during economic downturns. The effect of current and future COVID-19 state-wide and local public health-related business restrictions, along with other major factors including interest and employment rates, demand for new housing, and local land use policies will greatly influence forecasting future sales tax collections. Through August 2020, construction sales tax has decreased 19% from the same time frame in 2019.



Retail trade also makes up approximately 30 to 35% of total sales tax revenue. Retail trade sales tax revenue in the last five years has been averaging 9% growth. While retail sales tax revenue is also dependent on overall economic conditions, the year over year growth has been more consistent than construction sales tax revenue. Through August 2020, retail trade sales tax has increased 6% over the same time frame in 2019. While retail sales collection has been trending upward in the last few months, the recent improvements include only a few months of actual results since the recession began. Continued refinement and changes will likely occur as the recession continues into 2021-22.

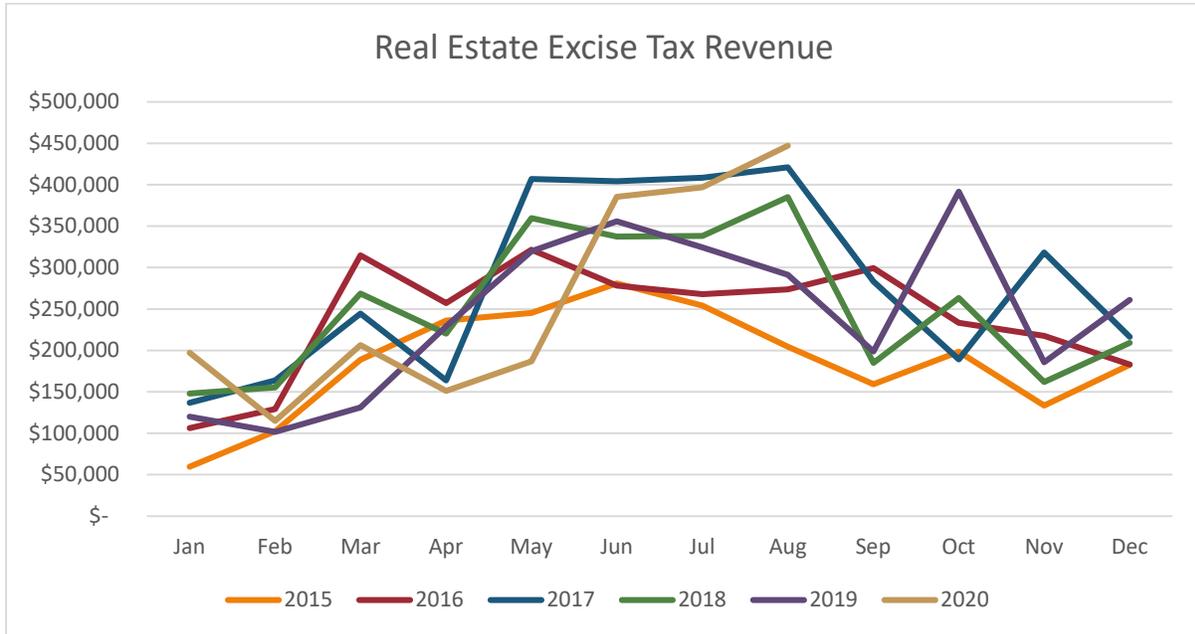


In summary, total sales and use tax through August 2020 has decreased 8% from August 2019. We are anticipating social distancing and COVID-19 restrictions to continue through 2020. This will slow construction in the near future and foreseeably into 2021 and 2022. However, we are assuming some modest recovery in 2021. In 2021 we assumed a 4% increase in sales and use tax over the 2020 Revised Budget, and in 2022 we assumed another 2% increase over 2021.



**Real Estate Excise Tax**

Washington State law allows cities to impose up to a 0.5% excise tax on property sales, which is known as the Real Estate Excise Tax (REET). The City experienced substantial growth in REET from 2014 to 2017. The height of REET revenue collection in 2017 was an annual total just over \$3.3M. Since 2017, REET revenue has contracted. REET revenue in 2018 was \$3.0M and 2019 was \$2.9M. Growth in REET revenue between the years of 2014 through 2017 can be attributed to both volume and average selling price increases. However, in the past two years volume of properties sold has decreased, while the average selling price continues to rise. The number of properties sold in 2017 was 804 compared to the number of properties sold in 2019 which was 658. This is an 18% decrease. The average selling price in 2017 was \$804,500 compared to the average selling price in 2019 which was \$894,000. This represents an increase of approximately 11%. Analysis of recent data in 2020 reflect similar trends. Total 2020 REET revenue through August is \$2.0 million or 11% higher than the same time frame in 2019. Volume is down 3% with 436 properties sold, while the average selling price is up 16% at \$976,100. Given these trends, the REET revenue forecast for the next biennium is \$2.9 million in both 2021 and 2022.



**Expenditure Estimates**

Expense estimates were prepared for specific expenditures after an analysis of the City’s past five years of expense performance and expected near-term services. The City’s Financial Policies state recurring expenses must remain below recurring revenues. The economic downturn that has occurred due to COVID-19 compels the City to realign current service levels with Council priorities and forecasted recurring revenues.

**Personnel Costs**

Consistent with best practices, the City reviewed the factors that it uses to distribute personnel costs across operating and capital funds. For example, personnel costs related to Human Resources are distributed based on the number of full-time equivalent employees, while the Senior Accounting Technician responsible for accounts payables is mainly distributed based on a three-year average count of payment vouchers by fund. Departments including City Council, Public Safety, and the Municipal Court are entirely allocated to the General Fund. To prepare for the 2021-2022 budgets, staff updated the data on allocation factors based on information from the most recent years. Staff used updated data to distribute personnel costs and incorporated this information into the budgets. These changes represent a redistribution of personnel expenses rather than a net increase or decrease to City personnel spending.

Personnel costs were calculated for 2021-2022 biennium using current proposed position lists and approved salary schedules along with estimated costs provided by external service providers such as the Department of Retirement Services and the Association of Washington Cities (AWC). Vacant positions are estimated at mid-range step. Personnel costs increase by 2% in 2021 and 2022, as an assumption for a cost-of-living increase based on current International Association of Machinists (IAM) collective bargaining agreement and expected increases due to employees moving up the established position steps. Medical costs increase by 7% for 2021 and 6% in 2022, based on current information from AWC.

**Other Costs**



Other central costs such as insurance and utilities were updated based on recent actual costs or estimates from outside service providers.

Capital costs were updated based on the Capital Improvement Plan proposed with the budget.

Operating transfers were updated to match budgeted expenditure levels.

Departmental costs were developed for existing programs and services at approved service levels. Changes in costs for additional services or enhanced services are detailed in the department budget sections.

**Other Key Assumptions**

The City completed a water and sewer utility rate study in 2019 and implemented the recommended rates. The 2021-2022 Proposed Budget assumes continuation of the approved rate structure over the biennium.

The City is in the process of completing a Building and Development Services Fund rate study. The study is not expected to be complete until late fall of 2020. The impacts of the rate study are not considered for the purpose of forecasting revenue generated by the Building and Development Services Fund.



## GENERAL FUND RESERVES

During 2020, Council reviewed and approved the City’s comprehensive financial policies, including the following reserve targets and definitions.

- **Emergency Reserve:** established to pay for unexpected emergencies that cannot reasonably be accommodated by current budget appropriations. The target level for this reserve is \$1.0 million.
- **General Fund Stability Reserve:** defined as the dollar amount of unencumbered fund balance, excluding amounts held in restricted or designated reserves. The year-end target level for this reserve is 25% of ongoing General Fund revenues, or approximately \$4.5 million in 2021 and 2022.
- The 2021-2022 Proposed Budget provides for additional items to be tracked as part of financial management. These amounts include the following:
  - Specially-tracked General Fund monies. These include PEG Capital Reserve, Police Investigative Reserve, Police Marine Reserve, Public Arts Subfund.
  - General Fund reserve for 2023-2024 capital plans. This reserve is the net City investment required to fund the current CIP for projects that will begin in those two years.

The table below provides detail behind the total shown for the General Fund policy reserves at the end of 2021 and 2022. The budgeted total balance of the General Fund year-end is \$12.9 million for 2021 and \$11.5 million for 2022, which exceeds the amount required to fund the reserves by \$7.1 million and \$3.7 million respectively.

### Detail of General Fund Reserves at end of 2021 and 2022

General Fund Reserve Category	2021	2022
<b>Emergency Reserve</b>	1,000,000	1,000,000
<b>General Fund Stability Reserve Minimum</b>	4,500,000	4,600,000
<b>Other Specially-Tracked General Fund Monies</b>	300,000	300,000
<b>Reserve for 2023-2024 CIP</b>	-	1,901,000



## FINANCIAL CAPACITY/FISCAL HEALTH

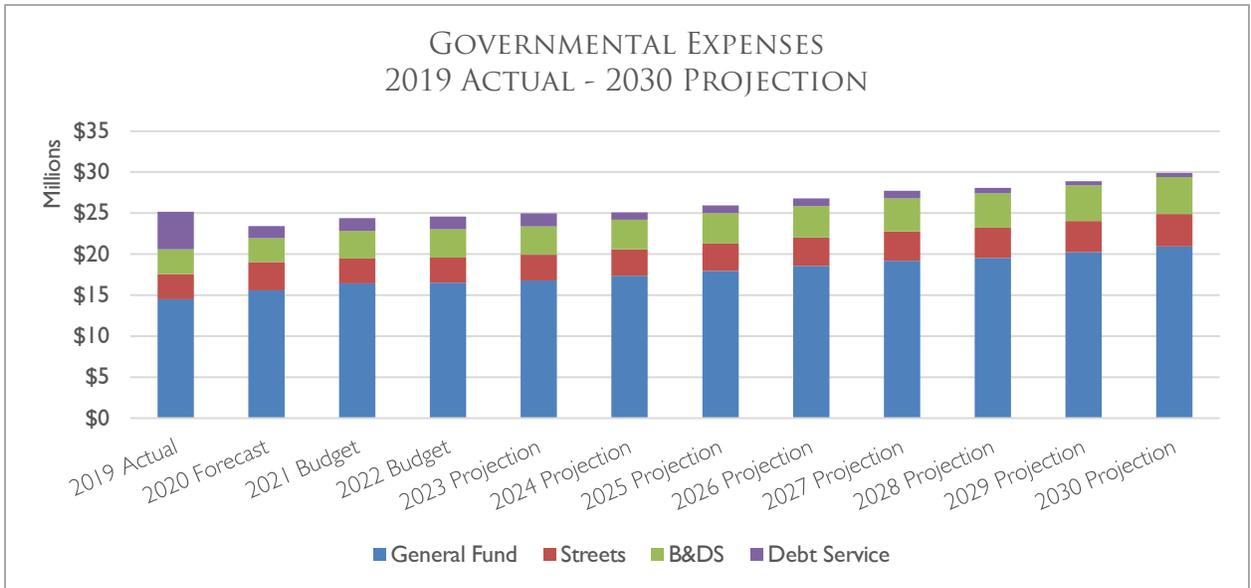
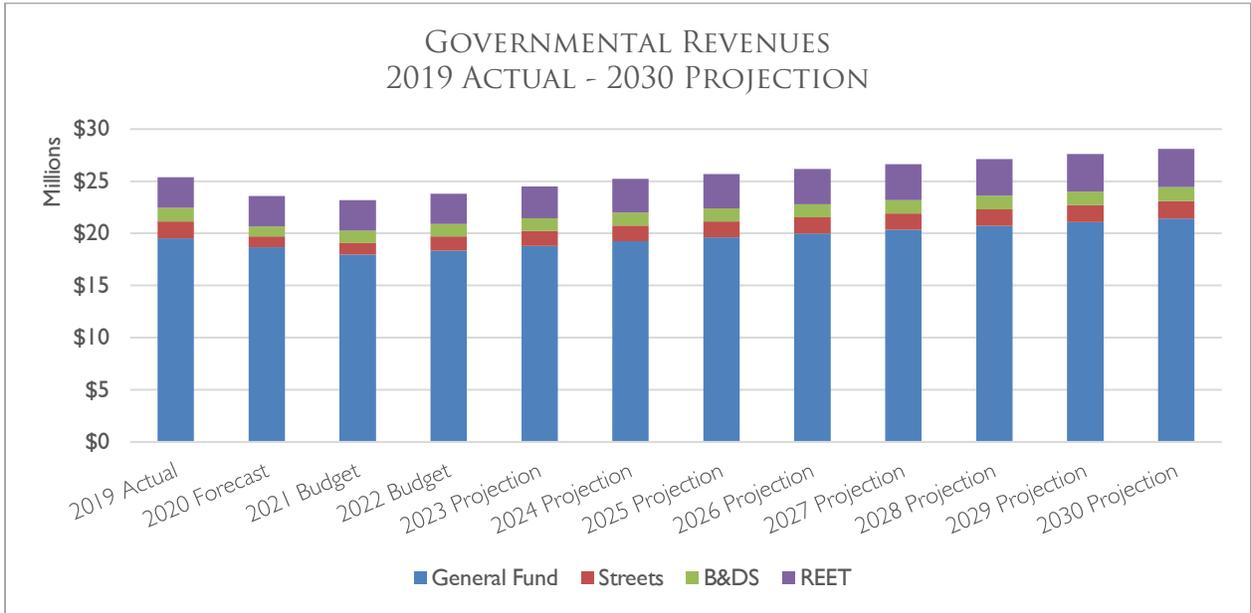
In an effort to support the review of the long-term viability of the City's financial structure, the Finance Department provides a ten-year forward look at the City's projected financial performance by fund. This is called the "Financial Capacity Analysis" (FCA) and is based on analyses completed by staff and presented at midyear and as a fundamental part of the budget process to Council and the community.

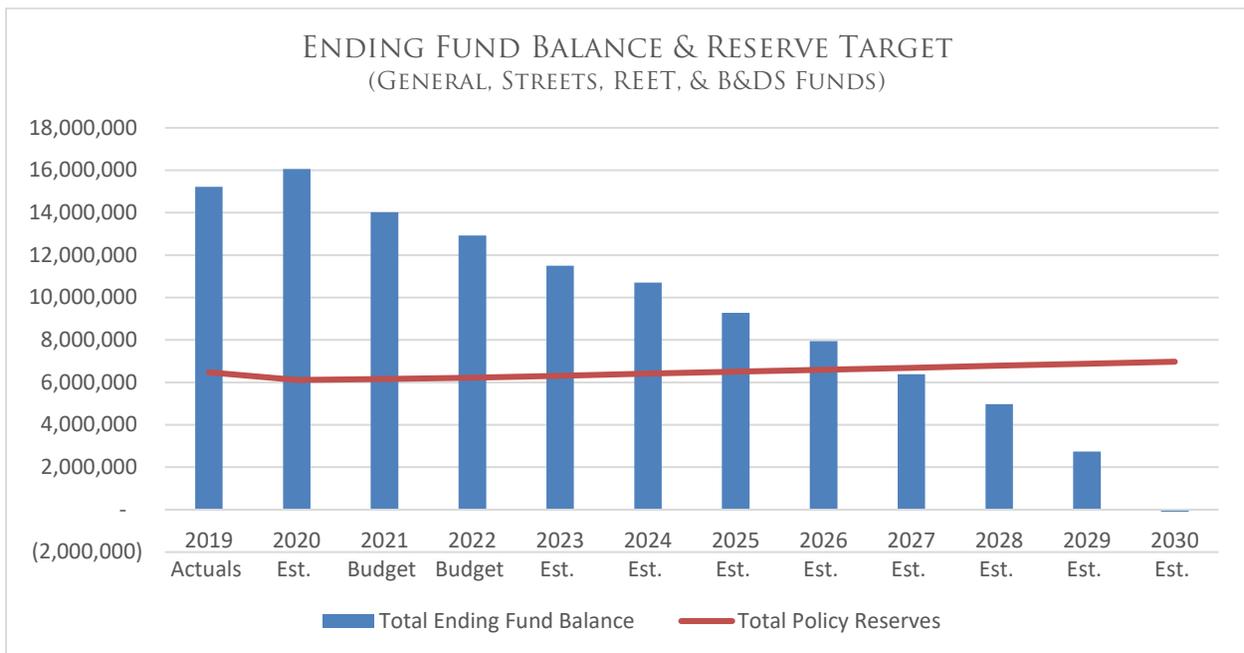
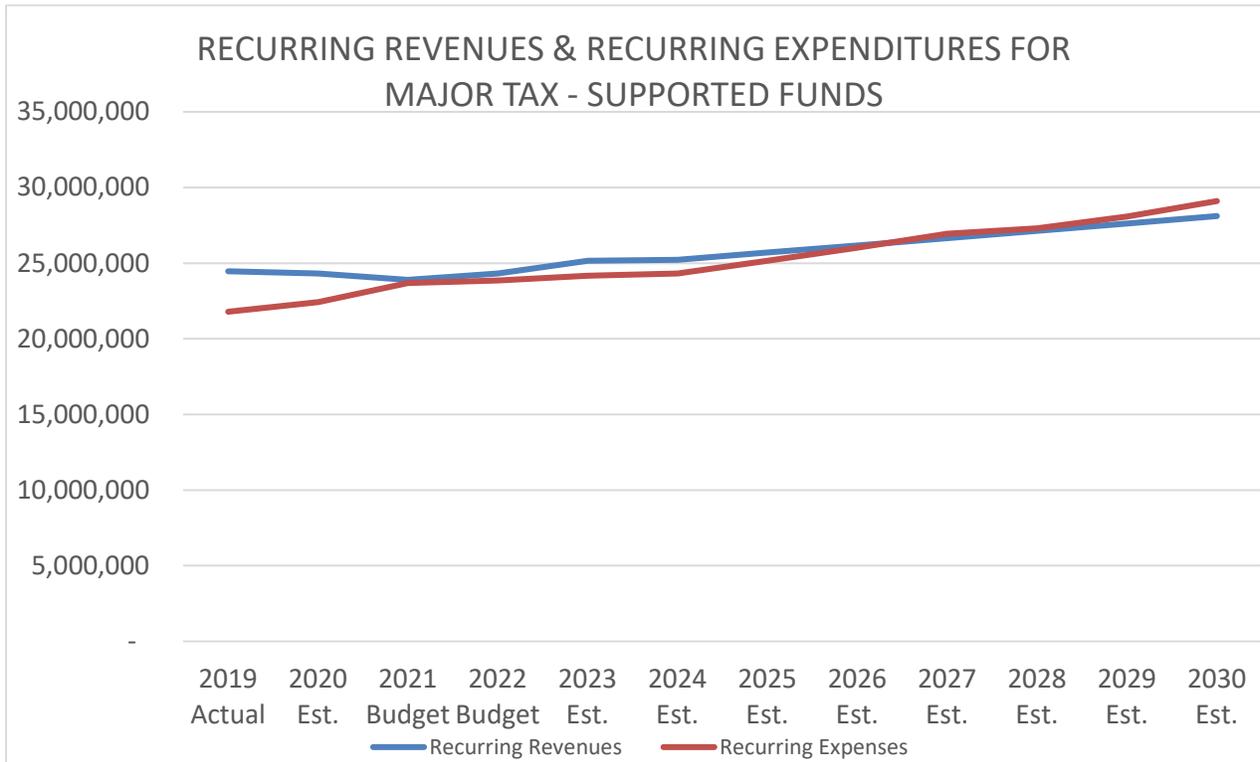
This forward-looking analysis focuses on long-range planning to guide macro-level financial planning in support of maintaining City services and financial stability, while moving toward its goals. The analysis is based on past actual results, current estimates and budgeted forecasts, and relies on a range of assumptions and escalators that require regular review. Thus, it can provide a useful look at the results of overall budget decisions and multi-year trends and impacts. We update this tool periodically, usually in conjunction with annual budget development, and as part of Council financial briefings, and use the updated information to provide context for future decision making.

The City has built General Fund balance over the past ten years which is supporting planned capital investment and allowing the City to respond to the financial challenges of the COVID pandemic in a measured way. Absent new revenues or significant changes to spending patterns, the City's long-term recurring expenses escalate at a faster pace than our recurring revenues. The City will continue to monitor the issue over the next five years and act accordingly. Going forward, reserves are fully funded for the next biennium. Periodic future updates will provide staff and Council with the information to position the City for continued financial stability.

To help interpret the information presented in the following charts, the below assumptions are presented as background and are incorporated into the FCA results for years after 2022:

- General Fund Sales Tax revenue growth of 2%, and Property Tax growth of 1.75%;
- For all funds, personnel costs assume an annual increase of 4.25% for salary costs and benefits costs;
- General operating expenses assume an annual increase of 2%;
- Capital project expenses and revenues matched to current CIP through 2026. For 2027-30, the model uses historical averages for grant revenues and capital expenses;
- No change to policy reserve targets or expenditure of reserve funds;
- Street annual preservation program at \$650,000, increasing annually along with operating costs at 2%;
- Real Estate Excise Tax revenue growth in 2023-24 at 5% and 2% thereafter;
- Building and Development Services annual revenue growth of 2%;
- Streets annual revenue growth of 2%







## BASIS OF ACCOUNTING & BUDGETING

The basis of accounting determines how and when to recognize revenues and expenditures in the financial accounts of the City, and then to report them on the City's financial statements.

In the City's financial statements, governmental funds use a modified accrual basis of accounting (see glossary), while proprietary funds use accrual (see glossary). Beginning in 2002, the Governmental Accounting Standards Board Statement No. 34 required an additional set of government-wide financial statements that use accrual accounting.

The City's budget is prepared using the modified accrual basis of accounting. Revenues and receivables are recognized in the year in which they are available to fund that year's expenditures. Expenditures are recognized in the year the liability is incurred.

One major function of the City's budget is to evaluate what projects and programs, in addition to normal operations, the City plans to fund in the coming budget biennium and how the City will pay for those plans. Support can come from expected budget-year revenues, fund balance, new long-term debt or a combination of these resources.

CITY OF BAINBRIDGE ISLAND - 2021 PRELIMINARY BUDGET  
LIMITS ON DEBT

Washington State law places limits on the amount of debt that cities may issue. Those limits cover all direct debt of the City. The City Council has the authority under RCW 35.42.200 to obligate the taxpayers without a vote of the people for up to a net aggregate total of 1.5% of the 'taxable property value' (assessed value) within the City. In addition, with a 60% vote of the people, the City can issue bonds of up to 2.5% of the assessed value for general purposes plus up to 2.5% for utility purposes plus up to 2.5% for open space and park facilities. The total for all purposes may not exceed 7.5% and the total for general purposes may not exceed 2.5% whether or not a vote has been held. There are no limits (other than political or market driven ones) on the amount of debt that can be issued which is not an obligation of the taxpayers (utility revenue debt and local assessment debt).

<b>LIMITED TAX GENERAL OBLIGATION BONDS (Can be approved by a majority City Council vote)</b>	<b>1/1/2021 OUTSTANDING</b>	<b>PERCENTAGE OF LEGAL LIMIT</b>
2011 LTGO (Construction & Refunding) Bonds	2,950,000	
2019 LTGO (Construction & Refunding) Bonds	9,520,000	
<b>TOTAL LTGO BONDS</b>	<b>\$ 12,470,000</b>	
Public Works Trust Fund Loans	1,734,227	
<b>TOTAL DIRECT DEBT</b>	<b>\$ 14,204,227</b>	10.3%
<b>LEGAL LIMIT</b>	<b>138,332,894</b>	
<b>REMAINING (UNUSED) MARGIN</b>	<b>\$ 124,128,666</b>	
<b>SPECIAL LEVY GENERAL OBLIGATION BONDS (All types require a 60% vote of the people)</b>		
For General Purposes	0	
For Utility Purposes	0	
For Parks & Open Space	1,740,000	
<b>TOTAL SPECIAL LEVY BONDS</b>	<b>\$ 1,740,000</b>	
<b>TOTAL GENERAL OBLIGATION DEBT</b>	<b>\$ 15,944,227</b>	2.3%
<b>LEGAL LIMIT</b>	<b>691,664,469</b>	
<b>REMAINING (UNUSED) MARGIN</b>	<b>\$ 675,720,242</b>	
<b>ASSESSMENT DEBT</b>		
Public Works Trust Loan for South Island Sewer	1,190,000	
2011 LID Street Bonds	112,089	
<b>TOTAL ASSESSMENT DEBT</b>	<b>\$ 1,302,089</b>	No legal limit
<b>REVENUE DEBT</b>		
Public Works Trust Loan #2 for Waste Water Treatment Plant	1,200,049	
Public Works Trust Fund Loan for Eagle Harbor Beach Mains	2,226,386	
<b>TOTAL REVENUE DEBT</b>	<b>\$ 3,426,435</b>	No legal limit

CITY OF BAINBRIDGE ISLAND 2021 PRELIMINARY BUDGET  
LONG-TERM DEBT AND DEBT SERVICE

EXISTING DEBT	ORIGINAL ISSUE	1/1/2021 BALANCE	2021 PRINCIPAL	2021 INTEREST	12/31/2021 BALANCE	FINAL MATURITY
PWTF Loan - New Storm Drain Decant Facility Design	179,025	38,180	9,545	191	28,635	Jun-2024
PWTF Loan - New Storm Drain Decant Facility Construction	782,000	205,789	41,158	1,029	164,631	Jun-2025
PWTF Loan - South Island Sewer LID Construction	5,600,000	1,190,000	297,500	5,950	892,500	Jun-2024
PWTF Loan - Sewage Treatment Plant Upgrade Design	389,215	84,348	21,088	422	63,260	Jun-2024
PWTF Loan - Sewage Treatment Plant Upgrade Construction Loan #1	3,618,000	1,053,117	210,623	5,265	842,494	Jun-2025
PWTF Loan - Sewage Treatment Plant Upgrade Construction Loan #2	3,564,500	1,200,049	200,008	6,000	1,000,041	Jun-2026
PWTF Loan - Dec 2007 Storms - Street Repairs	449,632	189,318	23,665	5,679	165,653	Jun-2028
2011 LTGO Bonds - Sewer Treatment Plant Upgrade Construction	5,700,000	2,950,000	245,000	118,000	2,705,000	Dec-2030
2011 LID Bonds - Winslow Way Construction	755,300	112,089	37,364	5,111	74,725	May-2023
2013 Voted Refunding Bonds	5,230,000	1,740,000	545,000	69,600	1,195,000	Dec-2023
PWTF Loan - Sewer Beach Mains Design	383,542	163,472	20,434	817	143,038	Jun-2028
PWTF Loan - Sewer Beach Mains Construction	3,474,933	2,226,388	185,532	5,566	2,040,856	Jun-2032
2019 Refunding LTGO Bonds	2,735,000	2,485,000	310,000	93,200	2,175,000	Jun-2028
2019 LTGO Bonds - Police/Court Facility	7,255,000	7,035,000	245,000	264,850	6,790,000	Dec-2039
<b>TOTAL EXISTING DEBT</b>	<b>\$ 40,116,147</b>	<b>\$ 20,672,750</b>	<b>\$ 2,391,917</b>	<b>\$ 581,680</b>	<b>\$ 18,280,833</b>	

**2021 BUDGETED NEW DEBT**

No new debt is budgetted for 2021 at this time.

**TOTAL EXISTING DEBT AND BUDGETED NEW DEBT \$ 40,116,147 \$ 20,672,750 \$ 2,391,917 \$ 581,680 \$ 18,280,833**

**The following types of debt are not included above:** Interfund Debt, Compensated Absences, Net Pension Liability, Other Post-Employment Benefits, Post-Closure Landfill Costs, Accounts Payable, and Accrued Payroll.

CITY OF BAINBRIDGE ISLAND - 2022 PRELIMINARY BUDGET  
LIMITS ON DEBT

Washington State law places limits on the amount of debt that cities may issue. Those limits cover all direct debt of the City. The City Council has the authority under RCW 35.42.200 to obligate the taxpayers without a vote of the people for up to a net aggregate total of 1.5% of the 'taxable property value' (assessed value) within the City. In addition, with a 60% vote of the people, the City can issue bonds of up to 2.5% of the assessed value for general purposes plus up to 2.5% for utility purposes plus up to 2.5% for open space and park facilities. The total for all purposes may not exceed 7.5% and the total for general purposes may not exceed 2.5% whether or not a vote has been held. There are no limits (other than political or market driven ones) on the amount of debt that can be issued which is not an obligation of the taxpayers (utility revenue debt and local assessment debt).

<b>LIMITED TAX GENERAL OBLIGATION BONDS (Can be approved by a majority City Council vote)</b>	<b>1/1/2022 OUTSTANDING</b>	<b>PERCENTAGE OF LEGAL LIMIT</b>
2011 LTGO (Construction & Refunding) Bonds	2,705,000	
2019 LTGO (Construction & Refunding) Bonds	8,965,000	
<b>TOTAL LTGO BONDS</b>	<b>\$ 11,670,000</b>	
 Public Works Trust Fund Loans	 1,407,715	
<b>TOTAL DIRECT DEBT</b>	<b>\$ 13,077,715</b>	9.5%
	<b>LEGAL LIMIT</b>	
	<b>138,332,894</b>	
	<b>REMAINING (UNUSED) MARGIN</b>	
	<b>\$ 125,255,179</b>	
 <b>SPECIAL LEVY GENERAL OBLIGATION BONDS (All types require a 60% vote of the people)</b>		
For General Purposes	0	
For Utility Purposes	0	
For Parks & Open Space	1,195,000	
<b>TOTAL SPECIAL LEVY BONDS</b>	<b>\$ 1,195,000</b>	
<b>TOTAL GENERAL OBLIGATION DEBT</b>	<b>\$ 14,272,715</b>	2.1%
	<b>LEGAL LIMIT</b>	
	<b>691,664,469</b>	
	<b>REMAINING (UNUSED) MARGIN</b>	
	<b>\$ 677,391,755</b>	
 <b>ASSESSMENT DEBT</b>		
Public Works Trust Loan for South Island Sewer	892,500	
2011 LID Street Bonds	74,725	
<b>TOTAL ASSESSMENT DEBT</b>	<b>\$ 967,225</b>	No legal limit
 <b>REVENUE DEBT</b>		
Public Works Trust Loan #2 for Waste Water Treatment Plant	1,000,041	
Public Works Trust Fund Loan for Eagle Harbor Beach Mains	2,040,854	
<b>TOTAL REVENUE DEBT</b>	<b>\$ 3,040,895</b>	No legal limit

CITY OF BAINBRIDGE ISLAND 2022 PRELIMINARY BUDGET  
LONG-TERM DEBT AND DEBT SERVICE

EXISTING DEBT	ORIGINAL ISSUE	1/1/2022 BALANCE	2022 PRINCIPAL	2022 INTEREST	12/31/2022 BALANCE	FINAL MATURITY
PWTF Loan - New Storm Drain Decant Facility Design	179,025	28,635	9,545	143	19,090	Jun-2024
PWTF Loan - New Storm Drain Decant Facility Construction	782,000	164,631	41,158	823	123,473	Jun-2025
PWTF Loan - South Island Sewer LID Construction	5,600,000	892,500	297,500	4,462	595,000	Jun-2024
PWTF Loan - Sewage Treatment Plant Upgrade Design	389,215	63,260	21,088	316	42,172	Jun-2024
PWTF Loan - Sewage Treatment Plant Upgrade Construction Loan #1	3,618,000	842,494	210,623	4,212	631,871	Jun-2025
PWTF Loan - Sewage Treatment Plant Upgrade Construction Loan #2	3,564,500	1,000,041	200,008	5,000	800,033	Jun-2026
PWTF Loan - Dec 2007 Storms - Street Repairs	449,632	165,653	23,665	4,970	141,988	Jun-2028
2011 LTGO Bonds - Sewer Treatment Plant Upgrade Construction	5,700,000	2,705,000	255,000	108,200	2,450,000	Dec-2030
2011 LID Bonds - Winslow Way Construction	755,300	74,725	37,364	3,408	37,361	May-2023
2013 Voted Refunding Bonds	5,230,000	1,195,000	565,000	47,800	630,000	Dec-2023
PWTF Loan - Sewer Beach Mains Design	383,542	143,038	20,434	715	122,604	Jun-2028
PWTF Loan - Sewer Beach Mains Construction	3,474,933	2,040,856	185,532	5,102	1,855,324	Jun-2032
2019 Refunding LTGO Bonds	2,735,000	2,175,000	325,000	80,500	1,850,000	Jun-2028
2019 LTGO Bonds - Police/Court Facility	7,255,000	6,790,000	255,000	252,600	6,535,000	Dec-2039
<b>TOTAL EXISTING DEBT</b>	<b>\$ 40,116,147</b>	<b>\$ 18,280,833</b>	<b>\$ 2,446,917</b>	<b>\$ 518,251</b>	<b>\$ 15,833,916</b>	
<b>2022 BUDGETED NEW DEBT</b>	No new debt is budgetted for 2022 at this time.					
<b>TOTAL EXISTING DEBT AND BUDGETED NEW DEBT</b>	<b>\$ 40,116,147</b>	<b>\$ 18,280,833</b>	<b>\$ 2,446,917</b>	<b>\$ 518,251</b>	<b>\$ 15,833,916</b>	

**The following types of debt are not included above:** Interfund Debt, Compensated Absences, Net Pension Liability, Other Post-Employment Benefits, Post-Closure Landfill Costs, Accounts Payable, and Accrued Payroll.