

April 18, 2008

TO: Pierce County Executive
Pierce County Council
Department Directors

FROM: Patrick Kenney, Director of Budget and Finance

RE: Budget Situation White Paper

Over the last several months we have often discussed our General Fund budget environment with you and members of your staff. I thought it advisable to outline our situation in this summary "white paper" so that everyone has access to the same information. Briefly stated this is what has happened since early last fall.

1) P.A.L.S. Revenues

Revenues being received at P.A.L.S. are running considerably below the levels from the 2005-2007 period, and \$4,500,000 below the 2008 budget. The P.A.L.S. Department is in the process of reducing their expenses in light of this downturn in development activity (vacancies, overtime, extra hire, professional services, etc.). However, these reductions will only partially off-set this revenue shortfall.

2) Investment Revenues

For the most part we invest available county cash balances in short term maturities (overnight to 2 years). Since last fall those interest rates have been reduced by the Federal Reserve Board from 5.25 % to 2.25%, a reduction of 57%. That drop will result in a total reduction of \$9,000,000 in interest revenues. About 70% of that amount will affect 2008 revenues, with the full impact occurring in 2009 as existing "high interest" investments mature and monies are reinvested at new lower interest rates.

3) Sales Tax

Much of the last several years solid growth in sales tax revenues resulted from new development activity. As development has slowed considerably in recent months (see P.A.L.S. Revenues above), we have seen a corresponding impact upon sales tax revenues. Through the first quarter of 2008 there has been no increase in sales tax revenues compared to the first quarter of 2007.

4) Other Development Related Revenues

We are also experiencing significant decreases in other development related revenues which affect the General Fund (e.g. recording fees, R.E.E.T. administrative fees). In addition due to a) less new development activity, b) fewer sales of existing property, and c) sales at lower prices – we are experiencing a significant decline (35% – 40%) in Real Estate Excise Tax revenues. These revenues go into non General Fund departments for capital improvements (roads, parks, rivers, general facilities, airport), and will greatly affect construction programs in those funds.

As of the end of the first quarter 2008, the General Fund revenue growth was only .8% above 2007 first quarter. It would have been 0% if the 2008 child support billings for January and February had been delayed until April as was the case in 2007. Our General Fund expenditure budgets increased by 7% in 2008; 4-5% for inflationary impacts upon existing services, and the rest for new staff and programs.

This imbalance between revenue and expenditure growth percentages requires us to take action now to avoid huge budget deficits. We have already covered \$4,000,000 of this deficit through a supplemental budget adjustment approved by the Council earlier this year. That budget cutback relied primarily on one-time balances in other funds (Insurance, G.I.S., and Debt Service Funds), and did not result in any staffing or program reductions. However, continued revenue declines have necessitated our call for department reductions of 1.5% in 2008 and 3.0% in 2009. It is very likely that these budget reductions will result in staffing and service cutbacks.

Once we receive there cutback proposals, the Executive will review and prioritize. It is not likely that a strict across-the-board reduction will be implemented – some services are more important than others. It is also possible that cutbacks larger than 1.5% - 3.0% will be required from some departments in order to spare cutbacks in very high priority services.

We will also be examining other strategies to reduce the impact upon your General Fund budgets – more use of fund balances, take home vehicles, funding for outside groups, overtime usage, and any available “budget magic”.

This revenue downturn has been both quick sharp and unprecedented for Pierce County. It is quite possible that we will see no growth in General Fund revenues in 2008 over 2007. In my memory that has not happened in at least 25 years – even when Lakewood, University Place and Edgewood incorporated in 1996, and even when the Lakewood police contract ended in 2004-2005. By comparison, the actual revenue growth in the recent years has been 6.9% in 2006 and 7.5% in 2007. The drop from last years 7.5% growth rate has been precipitous.

I do not foresee a quick turnaround for several reasons:

- 1) Interest rates are likely to fall farther due to Federal Reserve Board action in the next few weeks.
- 2) Property taxes from new construction will likely be considerably less in 2009 than was the case in 2004-2008 due to the aforementioned decline in development activity.

- 3) Development activity remains low and is not projected to pick up until well into 2009 (at best). Even then it probably will not approach the levels of 2004-2006.

Consequently we are looking at a 3% cutback in the General Fund in 2009 versus your current 2008 budgets. This is twice the 1.5% slated for 2008 for the following reasons:

- a) The 2009 prognosis referred above.
- b) The fact that we used almost \$4 million in one-time fund balances to support the first round of 2008 budget adjustments, and these one-time monies will not be available in 2009.
- c) The full impact of the interest rate cuts will be effective in 2009 (only 70% in 2008).

As you prepare your budget cutback proposals please keep in mind that these reductions will take us down to what may be considered the "new normal level" of resources. Without a major new source of General Fund revenue (e.g. Utility Tax), the concerns outlined in this memo and the massively important 1% property tax limitation (I-747) will likely result in tight budget years for the foreseeable future.