THE SEATTLE BUDGET—A LOOMING CRISIS?

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EXECUTIVE SUMMARY

The Municipal League of King County has been studying and monitoring local government for more than 100 years. Over the years, we have looked into issue areas as wide-ranging as regional infrastructure, land use, transportation, government corruption, civil rights, mental health, and education. This report looks at City of Seattle general fund spending over time and examines threats to the current financial status of the City.

In the past 50 years Seattle’s general fund spending has grown more than 250 percent. What were once considered “basic” government services such as police, fire, parks and libraries have expanded significantly. More has come to be expected of government today, especially services that were once provided by churches and charitable organizations, the private sector, or not provided at all. For example, in 2017, functions such as human services, housing, education, and economic development, which were not in the 1967 budget, represent some 12% of the general fund.

Our goal is to draw the public’s attention to the City functions whose funding relies heavily today on a boom in sales and property taxes from construction, on voter-approved levies, and on federal funds, sources that may be at substantial risk. Declining revenue from any of these sources would create a revenue shortfall and require hard decisions to close the gap. And if a “perfect storm” of declining revenues from all three of these sources were to hit, our policymakers would face an extraordinary challenge in governance and priority-setting. It is the Municipal League’s intent to launch a dialogue between candidates for City office and voters about how a revenue crisis might be addressed.

- **Economic Slowing.** The City budget could be challenged by either a downturn in construction revenue or a slowing...
of overall economic growth. The tech sector continues to grow but other areas are seeing some weakness, including large employers which are cutting jobs. The national economy may face some softness over the next months. President Trump’s America First stance could be a threat to the region’s trade-based economy.

- **Voter Weariness with Additional Property Taxes.** The Legislature’s solution to the thorny issue of school funding means an increase in Seattle property taxes that may come as a shock to homeowners. There are also several revenue proposals headed for the ballot this year and next, including Veterans and Human Services (King County) and Families and Education (Seattle). At some point, voters may say enough and levies will not be renewed.

- **Loss of Federal Funds.** The current administration’s proposed budget cuts important sources of revenue, and Congress has expressed priorities that do not include robust funding for municipal services. These could cut grants that come to Washington State, Seattle and indirectly to nonprofits in Seattle. The formula-based distribution of funds may change significantly as City demographics shift due to lack of affordable housing and relocation of low-income families outside the City boundaries.

The City has come to rely on special levies to fund basic services. It relies deeply on a windfall construction boom and on federal funding. These revenue sources are unpredictable and may present a looming financial crisis, as Seattle continues to expand services to cope with social problems identified by citizens as high priority for government action. While the future is uncertain, the City may increasingly find it is hard pressed to pay for all the things it wants to do.

This report offers a high-level overview of how general fund revenues and spending have changed. It makes no attempt to suggest solutions. Rather, the Municipal League believes that this year’s City elections present profound policy issues for debate: How would we manage drastic revenue declines? How does Seattle balance its progressive values and the looming reality of limited resources? Are there limits to what government can do to solve social problems? Do we need new revenues? What innovative practices can be put in place to prepare for the possible shortfall and yet address the City’s needs?
INTRODUCTION

In a high level overview, this report looks at City of Seattle general fund spending and how it has grown over the years. The report looks at the City’s revenue sources, the state of the budget today and, finally, it examines the threats to the current financial status of the City. The report focuses on general fund revenues and spending, excluding City Light and utilities, capital budgets and transportation.

In the last 50 years, the City has substantially expanded its governmental role, with over a dozen new departments and offices, and an expanded suite of services to address urban social issues, comprehensive planning, economic development, regulation, the arts, and more.

Our goal is to draw the public’s attention to the shift over time from a limited number of early “basic” or charter services to a much expanded set of City functions whose funding relies heavily today on voter-approved levies, a boom in sales and property taxes from construction, and federal funds, sources that may be at risk. A decline in any of these revenue sources would significantly affect the City budget and require hard choices to close funding gaps. If a “perfect storm” of declining revenues from all three of these sources were to hit, our policymakers would face an extraordinary challenge in governance and priority-setting. It is the Municipal League’s intent to stimulate a dialogue between candidates for City office and voters about how such a crisis might be addressed. We make no attempt to suggest solutions, but rather to engage our community in thinking about values and priorities and today’s role for government.

HISTORIC OVERVIEW

In 1966, the Washington State Legislature voted to make the mayor responsible for the budget rather than the City Council. So late that year, the nine-member City Council with just two staff members drew up its annual budget for 1967. It was a balanced budget with general fund operating spending of about $41 million, most going to the City’s responsibilities to its citizens as outlined in the City Charter—police, fire, parks, libraries and transportation. Revenues came from property taxes and the business and occupation tax enacted by the state Legislature in 1935 during the depths of the Depression.

In 1967, Mayor Dorm Braman dutifully submitted the first budget under a strong mayor-strong council system. The system worked fairly well over the years, but it was buffeted by the boom-bust nature of the Seattle economy. Boeing cut employment two years later by 75,000 jobs, leading to an economic slump that lasted through much of the 1970s. Another downturn in 1980 led to a task force set up in 1981 by the Seattle Metropolitan Chamber of Commerce to examine chronic budgetary issues. The task force recommended looking at salary levels for City employees and dramatic cuts to what it considered “non-essential” services.

Fast forward to 2017 and the City is undergoing one of its most dramatic economic booms. Employment is rising, especially in the tech sector. Construction cranes dot the skyline, so much so that almost a third of City income in 2016 came from real estate fees. For the second year in a row, Seattle has the largest number of cranes in the country. It is also an era of contradictions. Wealth is rising dramatically, but so is homelessness. Construction is adding thousands of apartments and townhouses, but rents have risen so
fast that many lower income residents can no longer afford to live in the City. The City’s operating budget is now a sophisticated, nearly 1,000-page document with numerous subfunds, new initiatives and proposals.

Seattle today is a vastly more complicated place than it was 50 years ago. In 1967, the Smith Tower was still the tallest building. You could check the time from a large clock on the roof of the Bon Marche. Blue laws prevented the sale of wine in grocery stores. The economy was driven by Boeing and forest products. As the Seattle World’s Fair prepared the region for its debut on the international stage in 1962, dozens of sawmills still operated from Everett to Tacoma. The population was slowly declining from 560,000 in 1960 to 530,000 in 1970. Today most of that resource-based industry is gone, eclipsed by coffee, software, biotech, computer and video games, global trade, aerospace and, of course Amazon and Starbucks. The economy is booming and Seattle is now the fastest growing urban area in the country with a population of more than 700,000.

Nearly 20 years ago, when the dot.com bubble burst, the rate of revenue increase suddenly slowed but the City initially determined that existing program costs could go forward. Eventually the City was forced to make drastic cuts – community centers and pools closed, maintenance was delayed, and even police and fire forces were challenged. “When there is no elasticity in the revenue base, the funding will run out,” said Woody Wilkinson, former City budget director. “Then you are down to closing fire stations to keep senior citizen centers open.”

**THE STATE OF THE BUDGET TODAY**

Over the past 50 years Seattle general fund spending, adjusted for inflation, has grown more than 250 percent. A substantial part of the increase has been in expanded City services into areas outside of what the drafters of the original City Charter considered “basic” services, with an increasing reliance on levies and federal funding to fill the gap.

Seattle added significant new services, in part driven by federal programs and shifts in federal spending. Some were added through the 1970s Model City and Great Society programs. Others were added in the 1980s under President Ronald Reagan’s New Federalism programs. Seattle has always been a progressive city, with voters willing to add spending to upgrade basic services like city streets and sidewalks, transit, parks and libraries, as well as to support the disadvantaged. In recent years, Seattle government has placed levies on the ballot for voter approval to cover both basic programs and expansions that reflect the progressive nature of the City.

Some of the City’s newest initiatives, listed in the Proposed and Adopted 2017 Budget Executive Summaries, point to its current priorities. The Mayor’s 2017 Proposed Budget reflects more than $9 million of additional general fund spending for public safety staffing, information technology projects, and recruitment and training. Other highlights of the proposed budget include about $14 million to fund a new approach to homelessness and human services, approximately $1.25 million for a transportation incident response function, and the establishment of a new Office of Labor Standards. For the full 2017 proposed budget summary, please use this link: [2017 Proposed Budget Summary of Changes](http://example.com).
Following the Council’s budget review, revisions were made. The six largest Council changes, in descending order, include one appropriation for economic development, two appropriations for transportation and four for human services.

- **Equitable Development Initiative Projects, $6,500,000.** The Council created a reserve to implement six community-initiated equitable development projects as priorities for mitigating further displacement and increasing access to opportunity.

- **Sidewalk Study and Construction, $900,000.** New resources will fund an assessment of sidewalk conditions citywide, which will support ongoing strategic investments in sidewalk repairs.

- **Enhance Homeless Services for Families, $767,000.** The Council added $347,000 for extended hours and increased access to a day shelter; $200,000 to fund lockers and storage of belongings at emergency shelters; and $220,000 to support transitional housing providers who will no longer receive federal McKinney-Vento funding in 2017.

- **Child Care Space Mitigation Fund, $670,548.** The Council added one-time funding to mitigate the displacement of before- and after-school childcare providers losing space in Seattle Public School buildings due to increased enrollment.

- **Increase Support for Domestic Violence and Sexual Assault Services, $637,000.** The Council increased support for domestic violence and sexual assault services by providing advocates to assist survivors of domestic violence and sexual assault; a legal navigator; housing stability services for youth traumatized by sexual assault-related trauma; and low-barrier services for survivors of commercial exploitation.

- **Updates to the City’s Parking Program, $546,999.** The Council increased funding for SDOT’s parking program to build on the department’s data-driven approach to parking management. The Council also increased the hourly rates that the City may charge for paid on-street parking, and provided funding for the expenses SDOT will incur in implementing some rate changes.

For more change summaries, click on the following link: [City of Seattle Adopted Budget Summary of Changes](#). More than $10+ million of these new services are not among the original basic services—police, fire, parks, libraries and transportation, which historically were covered by the general fund.

In recent years, the City, with a limited tax base, has used voter-approved levies to fund some of these basic services, freeing up funds to support the newer services. For example, the Seattle Public Library levy accounts for $19.1 million, or almost a quarter of that department’s budget. The use of levies subject to renewal limits their availability for major capital needs like the seawall and bridges.

A comparison of the general fund expenditures over 50 years requires a number of caveats. The chart below represents a general picture of the growth of the City budget. Budget formats have changed over seven mayors and a number of budget directors. City departments have been reorganized. Functions such as the bus system, zoo and aquarium have transferred to other governments or become independent nonprofit organizations. The chart provides numbers from six budgets spanning the last 50 years, excluding transportation due to too many changes in funding and function for effective comparison.
The transition to new services developed over the 1970s and increased under the Reagan administration in the ‘80s. General fund contribution to the four listed charter services was 68 percent in 1967 and dropped to 63 percent in 2017. Budgets for the police and fire departments totaled 47 percent of the general fund in 1967, but now total 43 percent. The growth of the general fund compared to the original “basic” services is illustrated in the following graph.

Today’s City budget certainly includes many other functions that we in 2017 consider “basic”: for example, administration, infrastructure, maintenance, courts, and technology. These are not in the forefront of public consciousness or concern when citizens are polled on their priorities. Other functions of government today such as emergency response and public health are similarly almost taken for granted until there is an emergency: an earthquake or a communicable disease outbreak.

Seattle has added a number of new services and areas of responsibility—today there are over a dozen new departments and offices that did not exist in 1967. Their impact on the general fund is significant. For example, in 2017: Human Services $90.6 million, Housing $29.2 million, Education $10.4 million, and Economic Development $9.3 million—together just these four departments represent 12% of the general fund.

### City of Seattle Budgets
*Dollars in millions (2017), adjusted for inflation*

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*Source: City of Seattle*
THE CITY’S MAJOR REVENUE SOURCES

Federal funds are an important part of the City budget, and could pose a risk in the near future as the Trump administration’s proposed budget would make substantial reductions in federal spending to cities. In a lawsuit challenging the Trump administration’s threat to withhold funds to “sanctuary cities,” the City said it expects to receive more than $150 million in federal funds this year, including $2.6 million in grants from the Department of Justice. While unlikely to pass in its present form, the Trump budget does point to a philosophical change in policy, in line with conservative goals to provide tax cuts, grow the military, and cut discretionary spending.

The City budget comprises significant revenue from the recent construction boom. More permits were issued in 2012, 2014, 2015, and 2016 than in any other year since 1990. 2016 is set to surpass all years except 2015, but year-end totals are not available yet as of this writing. As of July 1, 2016, over 20,000 of the units permitted had not yet been completed. In early 2016, revenues were in excess of $500 million, up from slightly more than $200 million in January 2012. The City recognizes the volatile nature of these funds and forecasts a gradual drop through 2017 and 2018. New construction is an exception to the 101% property tax limit, meaning that the City and other taxing districts are receiving substantial property tax revenue from the new construction.

The City would face repercussions from a possible slowing of economic growth. The construction sector is showing signs of overbuilding with some downtown high-rise buildings not completely leased. The executive summary for the 2017 budget makes the point:

Construction activity remains a key driver of this growth. Revenues from the sales tax on construction labor and materials and the business and occupation taxes paid by businesses in the construction sector continue to grow. Construction now represents a historically large percentage of General fund revenues. While this represents good news in the short term, it also creates risk in the long term. Reviewing the history of our local economy, it is clear Seattle cannot sustain this level of construction activity forever. When the sector cools, revenues will fall. The current revenue forecast assumes that 2016 will be the peak year for construction activity and anticipates a gradual slowing over 2017 and 2018. If a sharper decline occurs, revenues could fall substantially and spending reductions relative to the proposed budget would become necessary. In this context, the proposed budget makes some investments in ongoing programs, but seeks to invest some of the new general fund resources in one-time expenditures to address current needs, but not create future obligations.

Basic revenue sources available to support the general fund have remained unchanged for a number of years—sales, property, business and occupation taxes, plus utility taxes, grants and federal funds.

Sales Tax: State legislation creating a sales tax was extended to cities in 1970, allowing them to add 0.5 percent. An additional 0.5 percent was enacted in 1980. Currently the total sales tax in Seattle is 10.1 percent—6.5 percent to the state, 2.7 percent to the City and 0.9 percent to Sound Transit. Only about 1 percent of the City sales tax goes to operations of the City.
Property Tax: Property taxes are the largest source of revenue for the City, about a quarter of the general fund. Property taxes have been limited to a citywide increase of 1 percent since Initiative 747 was enacted in 2001. In November 2007, the State Supreme Court declared the initiative sponsored by anti-tax activist Tim Eyman unconstitutional. But the Legislature a few weeks later reinstated the 1 percent lid. During the arguments before the high court in 2006, the state estimated that in the six years since it passed, the measure had blocked about $1.6 billion in property tax increases. That total would be more than $4 billion today.

The loss of property tax income because of the 1 percent limit as a result is substantial. In recent years, special levies have become an integral part of City finances, departing from a time when the levies were used for special or capital projects. What they’ve done, according to one long-time observer, is move major items from the general fund to special levies (Bridging the Gap and Parks being the largest) thereby “freeing up” funds for other uses. Some argue that the lid and the growth of special levies are directly tied to each other, i.e., without the additional income from property taxes, cities and counties resorted to levies to make up the difference. School districts also turned to operating levies to cover rising costs.

An additional limitation imposed by state law says that total tax collections for any given taxing district cannot increase by more than one percent from the prior year (not including new construction and voter-approved levies), so it is called the “101% limit.” During boom years, the 101% limit causes tax rates to fall below the 1% limit, creating “head room” for rates to float up if assessed values drop in later years. This phenomenon means that tax rates increase during slumps in real property values, sometimes significantly.

B & O Tax: The Business and Occupation tax is the third largest source of income for the City, accounting for a little more than 20 percent, or $253 million in 2016.

Federal Funds: The City budget is also composed of significant federal funds, about $150 million in 2016. Many of these funds are distributed to non-profit organizations to perform some City services. This has implications for the City—if federal funds are reduced, the organizations are likely to look to City Hall for relief.
THE CHALLENGES

Today the City may not be facing another dot.com or real estate bubble or another Boeing bust, but a potential “perfect storm” is brewing that could challenge the City once again. We have substantially broader services to fund that citizens have come to expect and a revenue system that may not be sustainable. Former budget director Woody Wilkinson told us, “The funding eventually will run out.” This report does not question the need for the additional services, but points out that our understanding of “basic” city functions has changed significantly over the years, and we may want to plan for the worst case scenario that may occur.

Even with the booming economy and strong City revenues, polls of citizen priorities reveal that Seattleites are experiencing unprecedented concern about social inequality, housing affordability, and a growing homeless population. Despite increases in spending on social services and housing, homelessness and affordability problems have gotten worse and the community’s concerns seem to be rising.

The City this month enacted an income tax on high income individuals—total income above $250,000 a year for individuals and $500,000 for filing a joint return. The ordinance says the tax provides “solutions for lowering the property tax burden and the impact of other regressive taxes,” an indication that the City Council also sees they are hitting the levy ceiling. Funds also could be used for “replacing federal funding potentially lost through President Trump’s budget cuts, providing public services, including housing, education, and transit, and creating green jobs and meeting carbon reduction goals.”

However the income tax faces imminent legal challenge once it is signed into law, and it will need to overcome a number of legal hurdles, including a provision in the state constitution that provides that all “property must be taxed uniformly” and a state Supreme Court decision dating to the 1930s which held that income is “property,” and that, as a result, a graduated progressive income tax is unconstitutional. In addition, the state legislature passed a law in 1984 that precludes cities and counties from taxing “net income,” and there is some question whether Seattle has the authority to enact an income tax. Whether this new income tax could compensate for a decline in the City’s revenue base depends on a number of factors, including whether the tax is approved by the courts, how long the legal battle delays implementation of the tax, and the timing and extent of declines in the City’s revenues.

Another challenge resides in debates about how effective the City’s spending has been. In a recent piece in Crosscut, Jordan Royer, a maritime industry executive who worked for mayors Paul Schell and Greg Nickels, asked why no one is considering the effectiveness of the increase in taxes and spending: “The fact that revenues and spending have increased so dramatically while roads, homelessness and other services seem to have deteriorated can only point to a management problem,” Royer wrote. “Whether this is the result of politically driven decisions that make basic services more costly to deliver or because there is a lack of accountability in the system, more money will not fix it.”

And the City may be facing “voter fatigue” as the new McCleary property taxes for schools kick in and existing levies come up for renewal. In order to pay for an additional $1.7 billion for education, property
taxes in Seattle are likely to rise substantially, as much as $440 on a median-priced $500,000 property. The new tax will also impact business interests and renters as landlords pass on the tax increase. But thus far Seattle voters have kept passing more taxes. The last Bridging the Gap measure had a campaign running against it and still passed with a huge majority.

There are now almost 20 additions to the property tax among the City, King County and the Seattle School District. The charter departments of libraries, parks and transportation are now partially funded by levies and a new parks district. The willingness of voters to add additional property tax may be reaching the limit.

Here for example is a list of levies, bonds and capital projects that currently comprise the additional parts of the property tax. The list shows when levies would need to be renewed or when bonds are paid off.

**Seattle:**

1. Families and Education 2018
2. Pre School 2018
3. Library Levy 2019
4. Affordable Housing 2023
5. Transportation 2024
6. Elections 2025
7. Seawall Bond 2042
8. Park District Ongoing

**Seattle Public Schools:**

9. Operating Levy 2019
10. Capital 2023

**King County:**

11. Veterans & Human Services 2017
12. Regional Health 2017
13. AFIS 2018
14. Open Space 2019
15. Harborview 2020
16. Justice 2021
17. Children 2021
18. Communications 2024
19. Mental Health (Open)
CONCLUSIONS

All of this raises big questions. Is the City budget sustainable? What happens when the current influx of construction taxes goes away or when voters stop approving operating levies? How should policy makers address the accumulation of voter-approved single-issue levies and general fund supplanting? Can the City continue to expand its services? Is there a point at which increasing the tax burden to fund progressive causes contributes to pricing less affluent residents out of the City? How should the City balance affordability and provision of social services given the constraints on its funding mechanisms?

These big questions take on pressing urgency as the City over the next few years faces that possible “perfect storm” that could severely impact the City’s revenue base and, as a result, its ability to extend necessary services to its residents. The storm has three possible waves hitting the city:

- The City budget in the next few years could be challenged by either a downturn in construction revenue or a slowing of overall economic growth. While Amazon continues to grow and is now the largest tax payer in the city, other areas are seeing some weakness, especially as some large employers are making substantial job cuts. Already there are signs that the construction boom may be losing steam—some high rises are not fully leased while a number of projects already permitted have yet to break ground. In addition, the national economy could face some softness over the next months—the recovery already is in its eighth year, making it one of the longest recoveries in history. In addition, President Trump’s America First stance could be a threat to the region’s trade-based economy where one in every three jobs is tied to trade.

- Voter weariness with additional property taxes. The Legislature’s solution to the thorny issue of school funding means an already known increase in Seattle property taxes that may come as a shock to homeowners, on top of tax increases due to rising property values. There are also several property tax proposals headed for the ballot this year and next, renewing expiring levies for Veterans and Human Services (King County) and Families and Education (Seattle). At some point, voters may say enough and levies will not be renewed.

- The City could lose federal funds as a result of the Trump administration’s budget that cuts important sources of revenue. The current national administration’s budget coupled with a Congress whose expressed priorities do not include robust funding for municipal services may cut grants that come to Washington State, Seattle and indirectly to nonprofits in Seattle. While an administration’s budget isn’t binding—Congress sets spending levels—the budget presented by President Trump represents a wish list with numbers attached. How that wish list comes out of the congressional budget process presents potential serious problems for the City.

Washington State has one of the most regressive tax systems in the nation, which means the burden for paying for government falls most heavily on the least wealthy. Increasingly that burden is hitting
middle-income residents and businesses as property taxes rise with the growing real estate market values in the city. Even renters are affected as property owners raise rents in response to higher taxes.

If Seattle does need more revenue, one solution gaining increasing support is an income tax on wealthy individuals and families. Although it faces legal challenges and an uncertain future in the courts, early estimates by the City indicated that the tax would raise about $125 million in the first year.

But the effort to enact an income tax only points to a deeper issue for the City: its reliance on special levies to fund basic services presents a looming financial crisis. While the future is uncertain, the City may increasingly find it is hard pressed to pay for all the things it wants to do. We thus believe it imperative that our leaders and our citizens have an open, honest conversation about the City budget, funding priorities, and the real trade-offs that are required. There is no one right answer, but developing a City budget that strikes the right balance necessitates asking hard questions.
This report was written by Stephen H. Dunphy under a contract with the Municipal League Foundation. The author wishes to thank Advisory Board member Bill Stafford who provided research assistance and the librarians in the “Seattle Room” at the Downtown Library for their expert assistance.

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