Economic and Revenue Update

August 8, 2022

Office of Economic and Revenue Forecasts

&

City Budget Office

Presentation Outline

Part I: Current Conditions: Economic Update

1. Brief summary of recent developments at both national and regional level, to provide context for the new forecast

Part II: Looking Forward: Revised Economic Forecasts

1. Review projections for this year and beyond for both the national and regional economies
2. Present recommendation regarding which economic scenario (Baseline, Pessimistic, or Optimistic) should underlie the revenue forecast

Part III: Revenue Forecast

1. Discussion of forecasts for most significant General Fund revenues, including Sales, B&O.
2. Summary of forecasts for General Fund revenues for 2022, 2023 and 2024
3. Summary of selected non-General Fund revenues that support general government activities, and an in-depth review of Payroll Expense Tax revenues to date and the revised forecast.

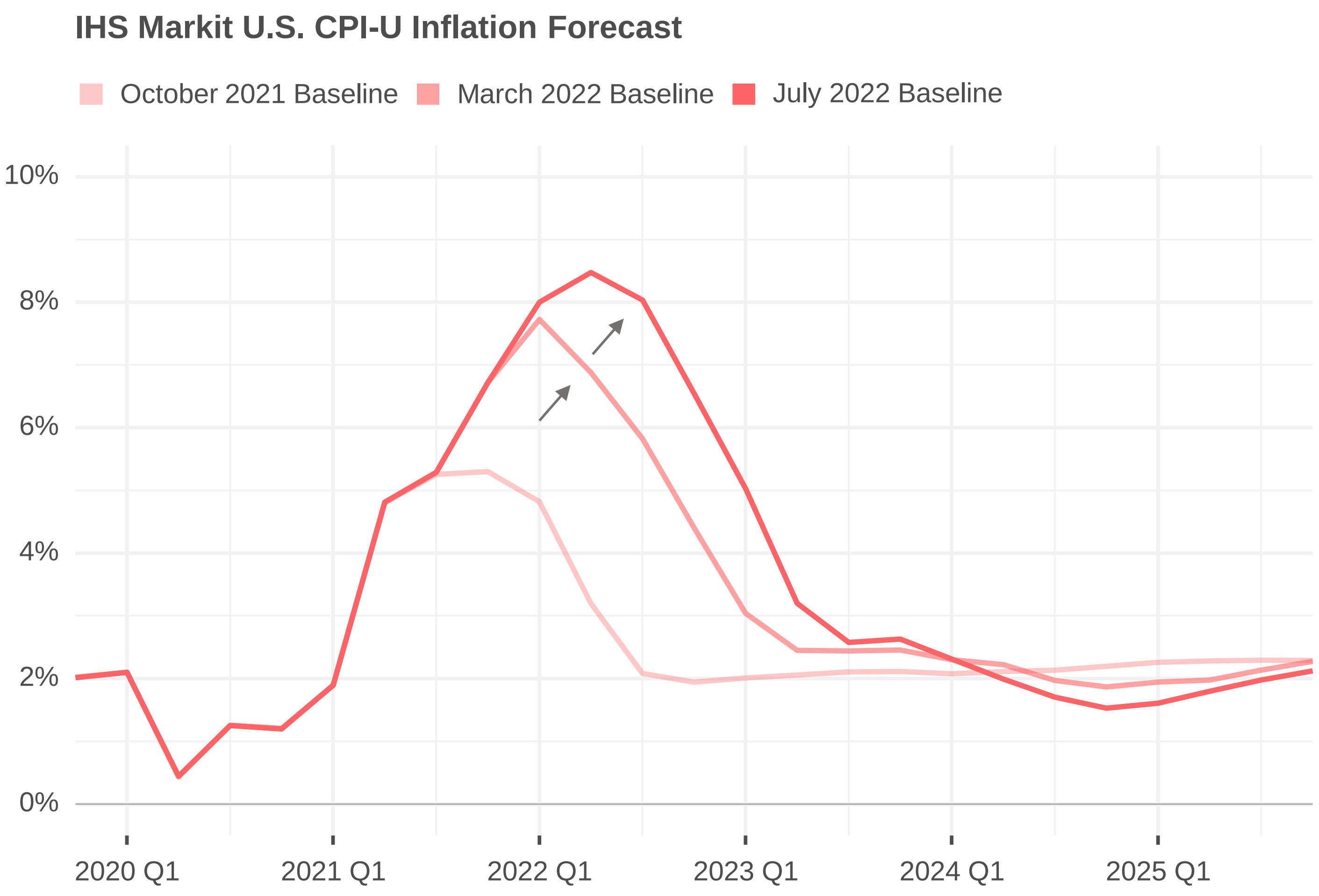
Economic Update

Overall Economic Conditions Have Deteriorated Since April Forecast

- Inflation and the efforts to contain inflation have become dominant factors in the economy.
- Recent data has revealed that U.S. Gross Domestic Product (GDP) decreased in the first half of the year, although overall employment growth remains strong.
- The Federal Reserve has responded to these mixed signals with an aggressive strategy to increase interest rates and reduce inflation.
- Now, the key question for the economy is whether these steps can reduce inflation without significant impacts to the currently strong labor market. If not, a recession could result.
- Although developed in early July before the latest Fed Rate increase and the GDP announcement, the national forecast upon which we base our work largely anticipated the most recent developments regarding interest rates and GDP.

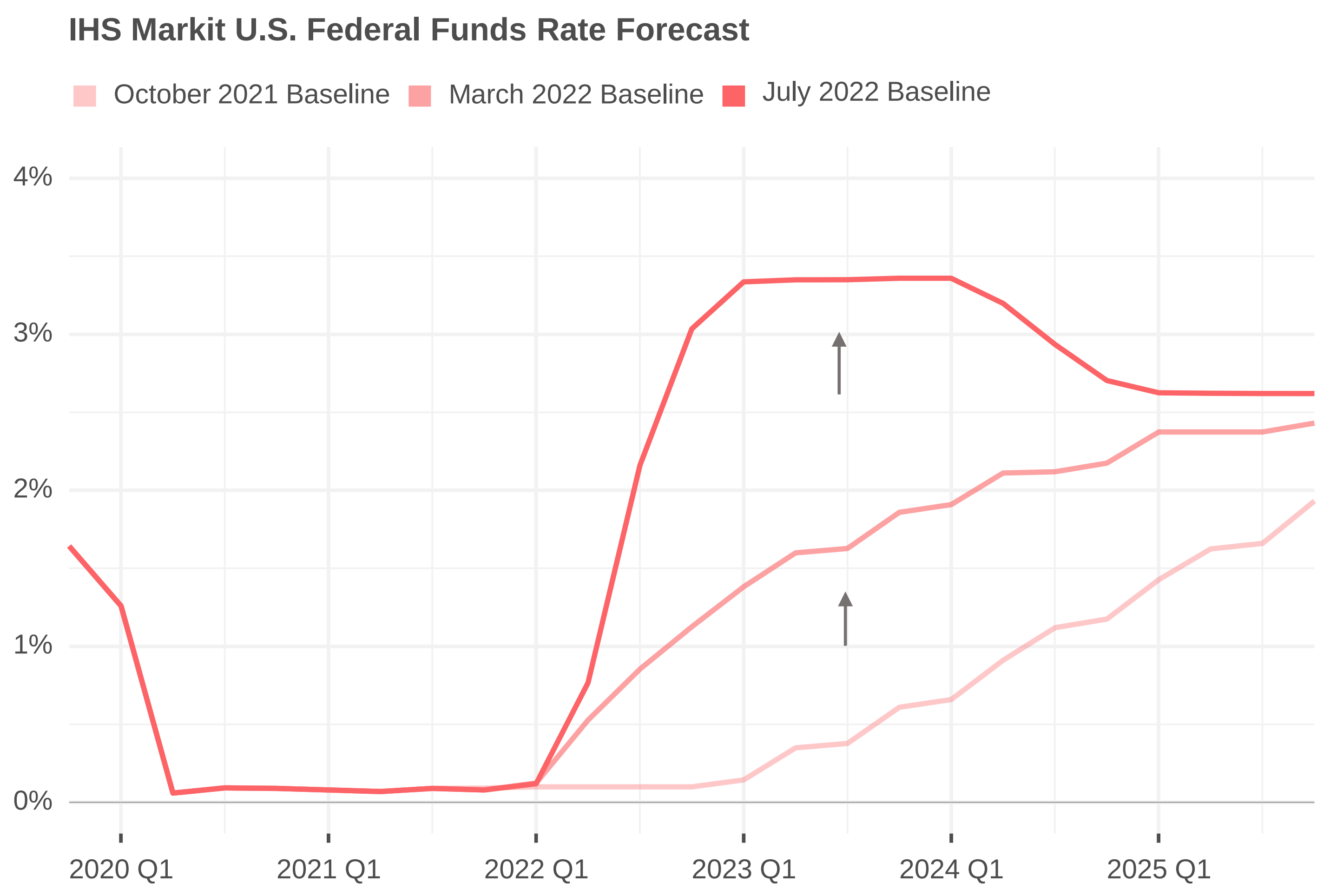
Inflation Accelerated Quickly and Has Now Reached a 40-Year High

- Since last fall, inflation has nearly doubled, and forecasts now anticipate that relatively high rates will persist into next year.
- Most recent data at the national level show that consumer prices have increased by 9.1% over the last 12 months.
- The comparable figure for the Seattle Metropolitan Area is 10.1%.
- Food and energy are significant drivers, but excluding those elements, the local “core” inflation rate is still 8.8%.
- The long-term forecast of moderating price increases is consistent with the Fed’s strong commitment to controlling inflation.



The Fed's Aggressive Response Has Become an Important Economic Driver

- At their July meeting the Fed's governing body raised the rate it charges to banks by 0.75%. This followed an increase of the same amount in June. Increases of this magnitude and speed have not been seen since the early 1980's. And further increases are still anticipated.
- Previous forecasts had anticipated a significantly slower path of smaller increases, in response to an economy that was on a more stable path of recovery and expansion.
- The current baseline national forecast anticipates that rates will be increased further before they are then brought down to the longer-run levels that were expected previously.



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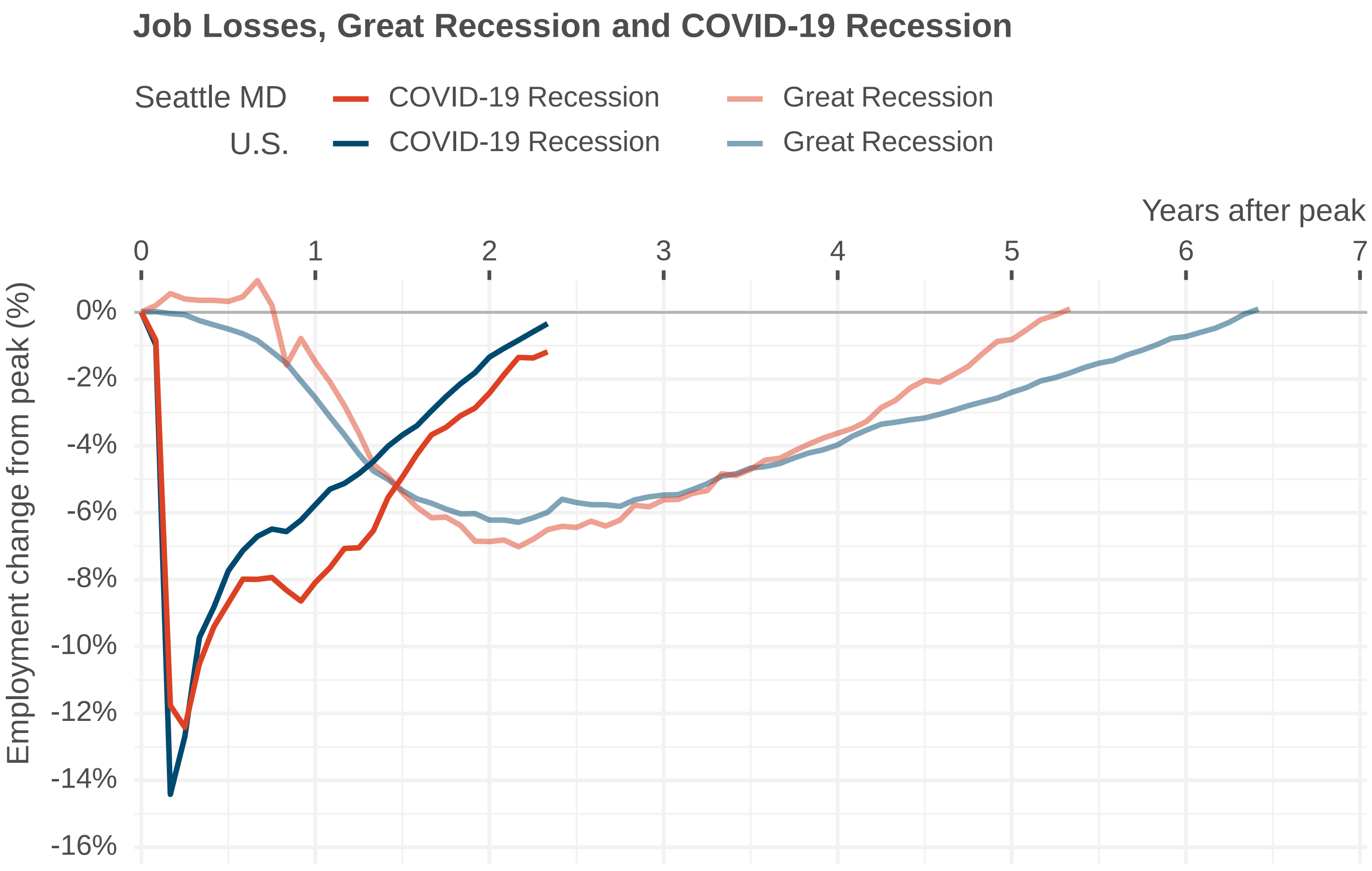
Although Inflation Has Accelerated, the Employment Recovery Has Continued



Source: U.S. Bureau of Labor Statistics and Washington State Employment Security Department

- While inflation has accelerated and GDP has declined over the first half of this year, overall employment remains strong.
- Hiring slowed down somewhat in the second quarter, but national labor market remains very tight, with 1.8 job openings per unemployed person in June.
- As of June, total national employment was within 0.3% of pre-pandemic levels.
- In the region, strong job growth over the past two years has driven total employment to within 1.2% of the levels seen in earlier 2020.

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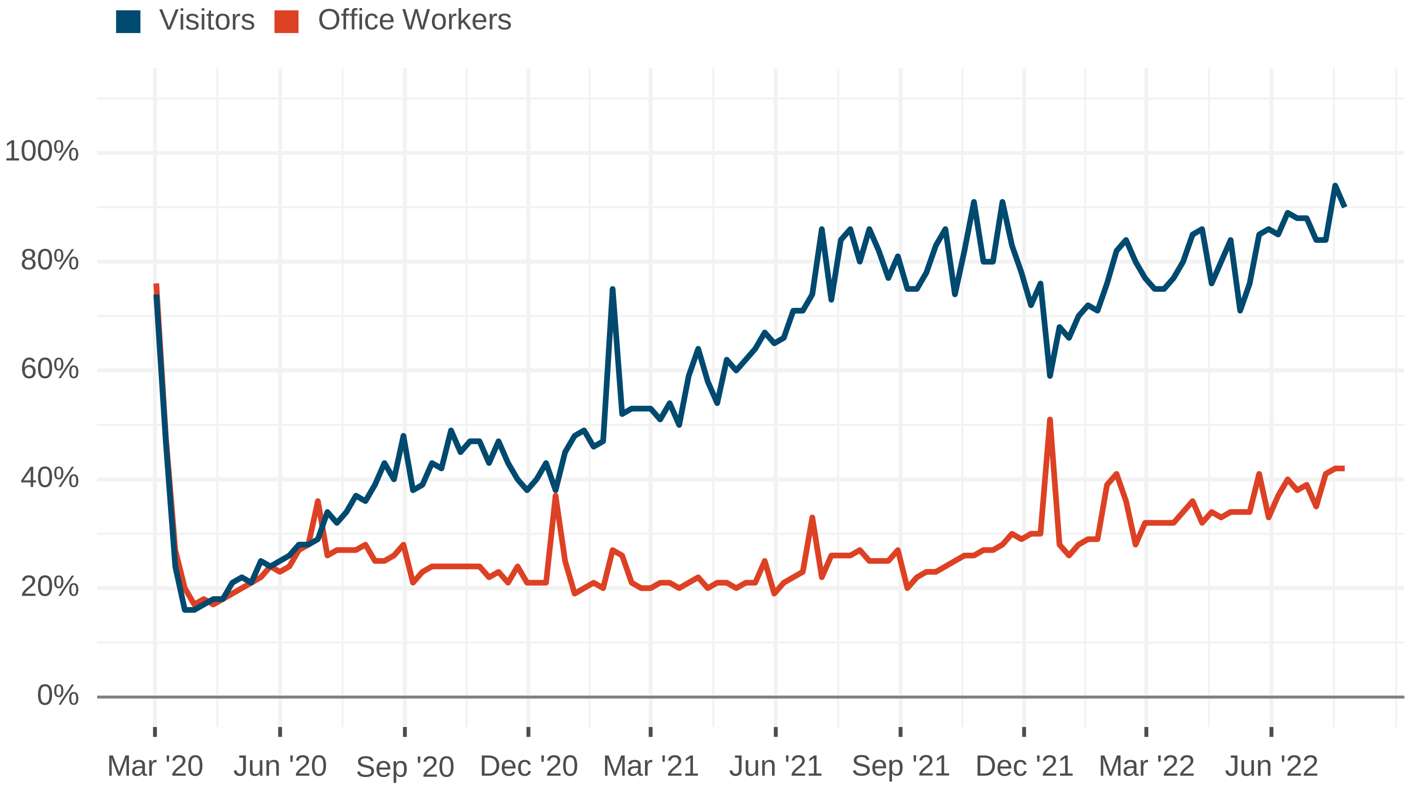
Impacts of the Pandemic Continue to Differ by Sector

- The chart to the right compares downtown foot traffic of visitors and office workers, as measured by aggregate-level cell phone data.
- While not fully recovered to pre-pandemic levels, tourist traffic appears to be relatively strong, and this should help support continued recovery in the local hospitality sector.
- At the same time, office workers have been slow to return to the office, and this persistent impact could represent a long-term shift that will impact other sectors, including construction and real estate, as well as leisure and hospitality.

Downtown Seattle Recovery

Compared to equivalent week in 2019

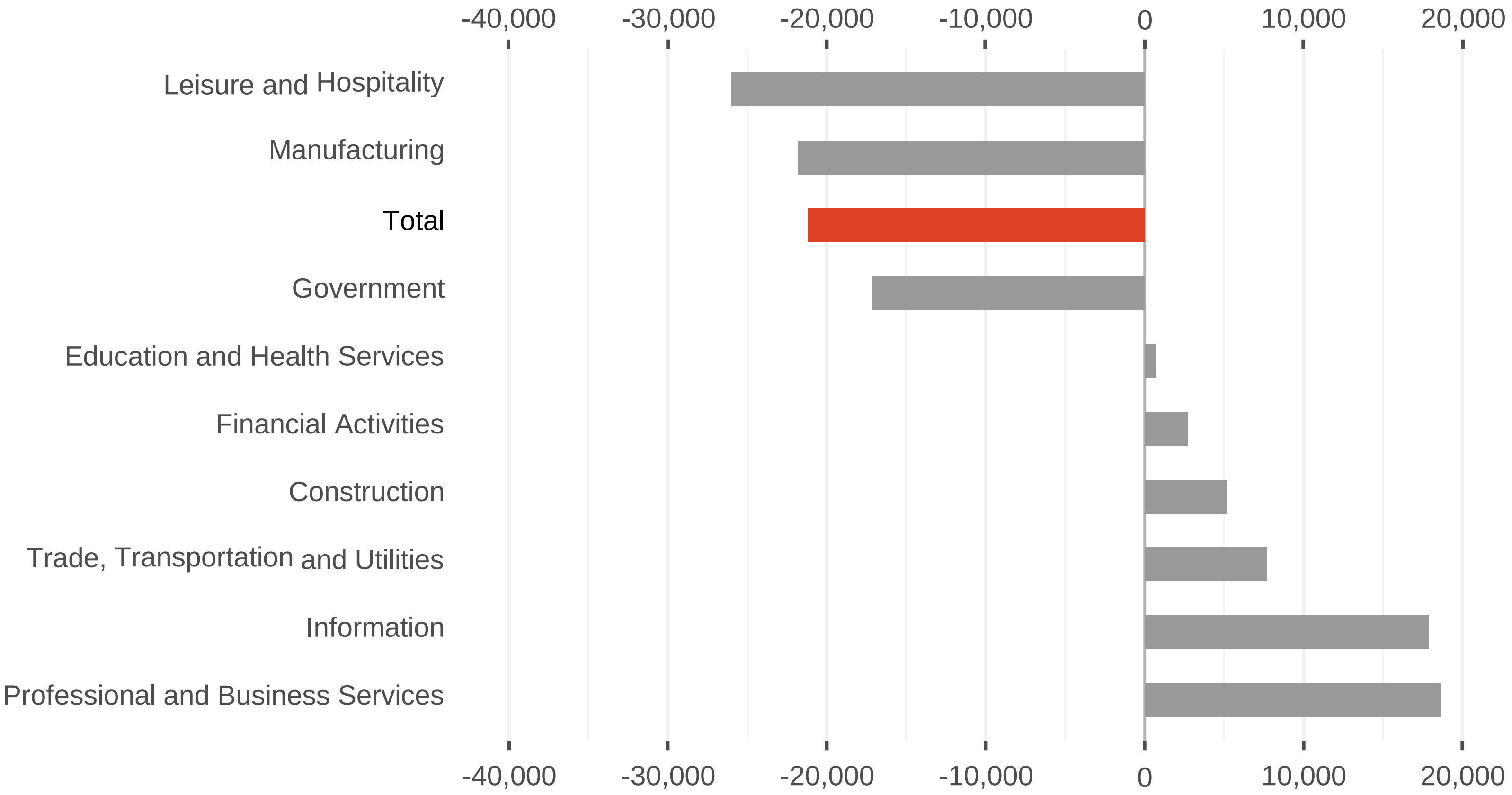


Source: Foot traffic based on cell phone location data by Placer.ai

Employment Recovery Continues to Differ by Sector (cont.)

- The Leisure and Hospitality sector has been slow to recover, but the strength of the current summer tourist season bodes well.
- By contrast, robust employment growth in the Trade, Information and Professional Services sectors has been a driving force in the region's overall economic recovery.

Change in Seattle Area Employment Since February 2020



Source: Washington State Employment Security Department. Seasonally Adjusted.

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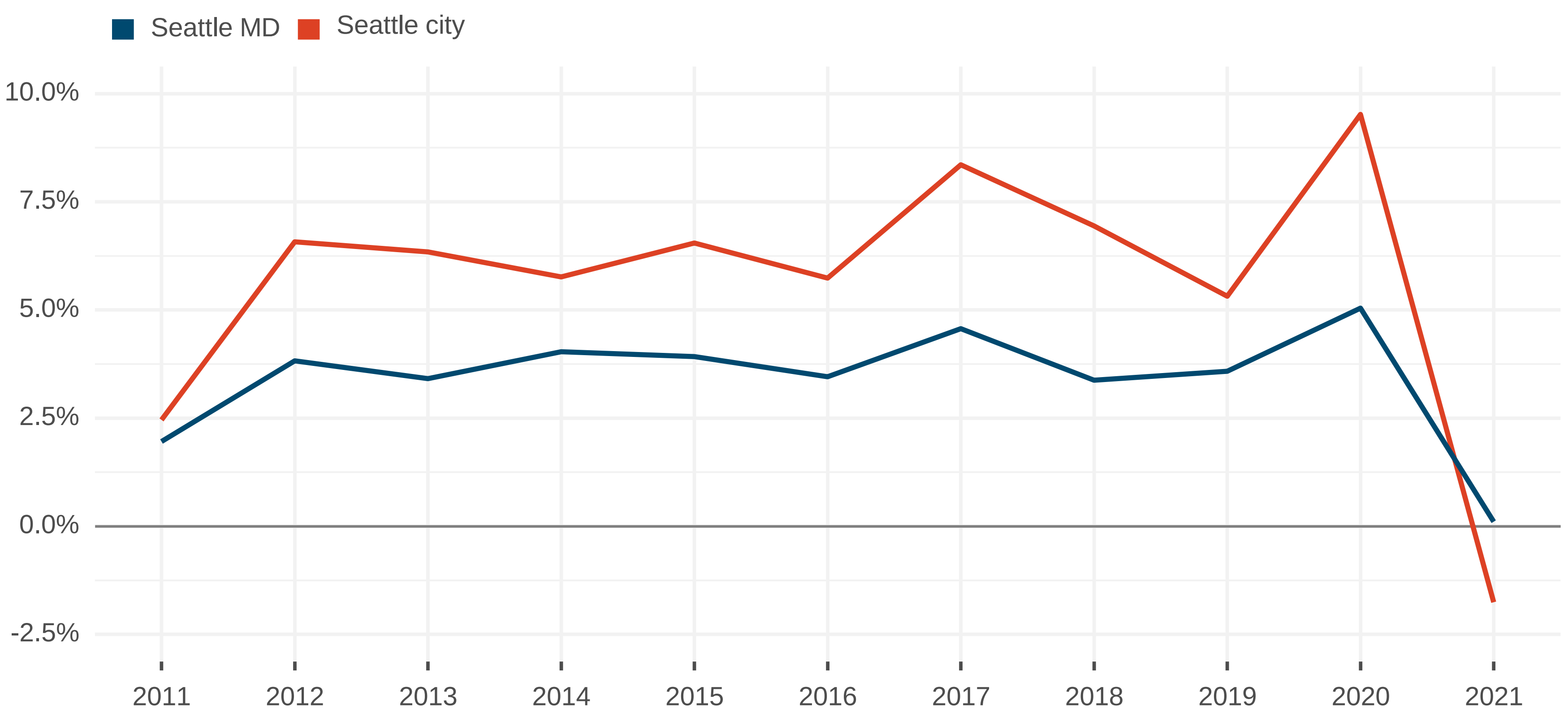
Job Growth in Technology May be Shifting Away from Seattle

Employment growth for trade, information, professional and business services

March 2011 to March 2021



Source: Puget Sound Regional Council, covered employment in month of March

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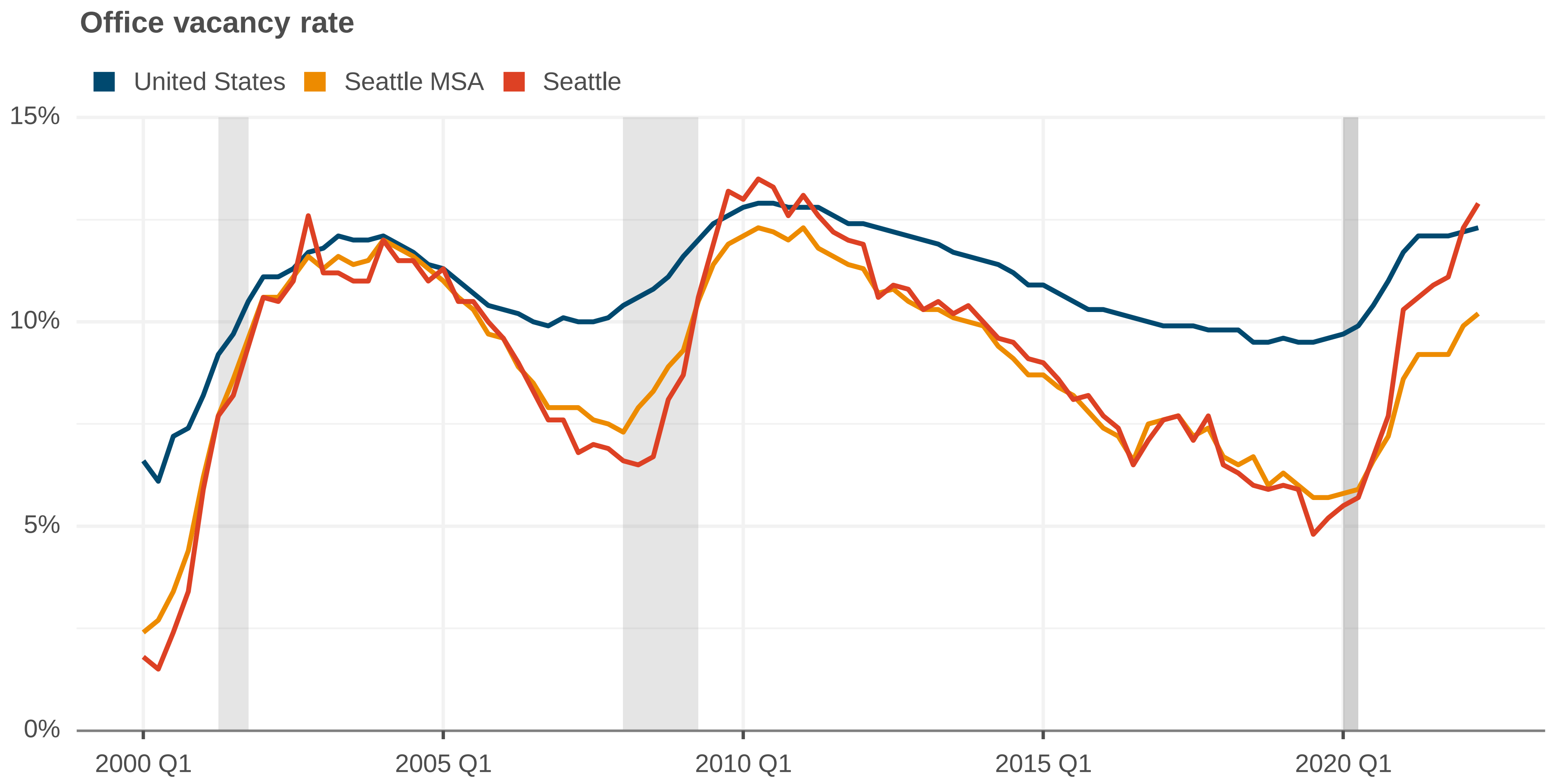
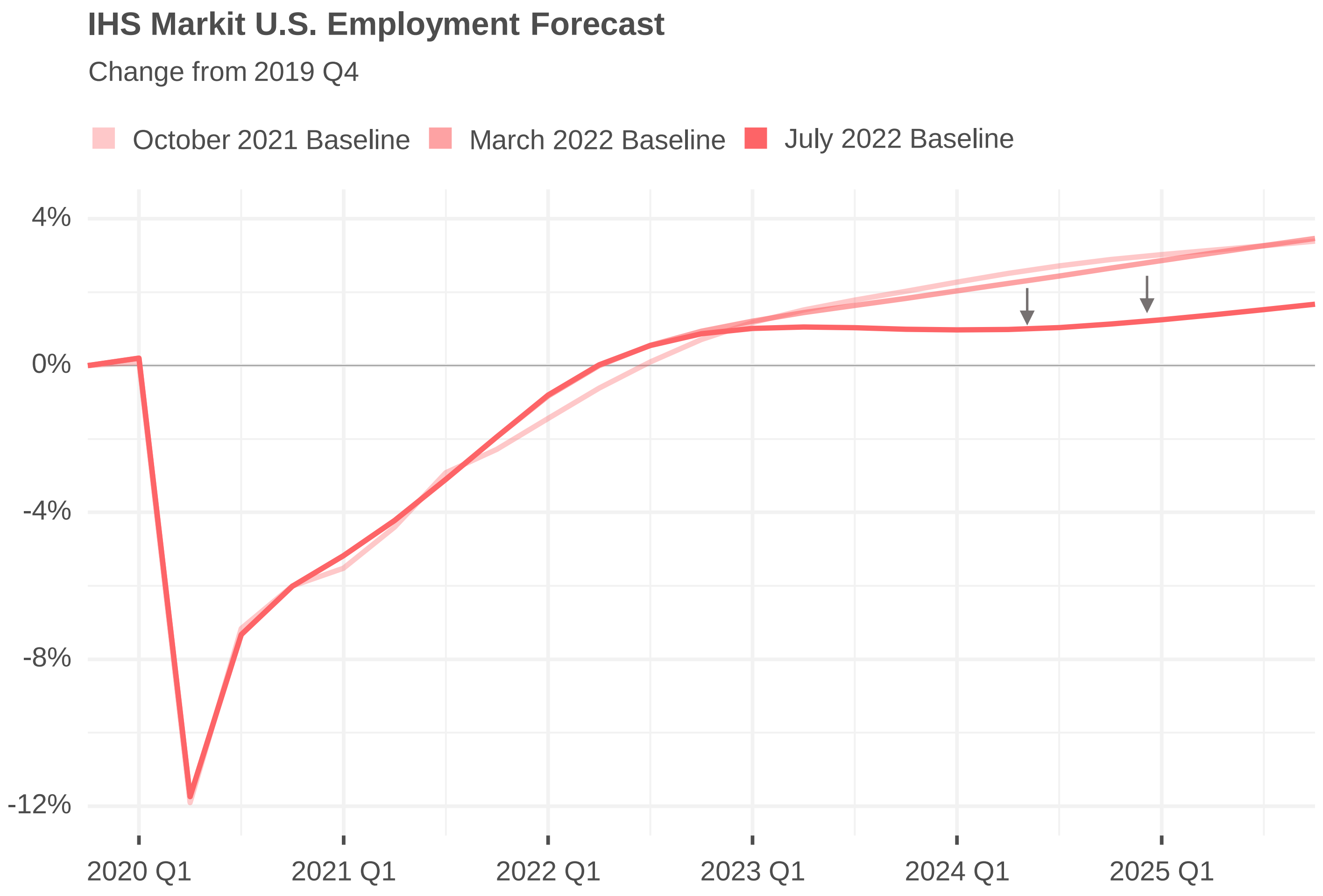
Demand for office space in Seattle is low



Source: CoStar. Shaded areas denote recessions.

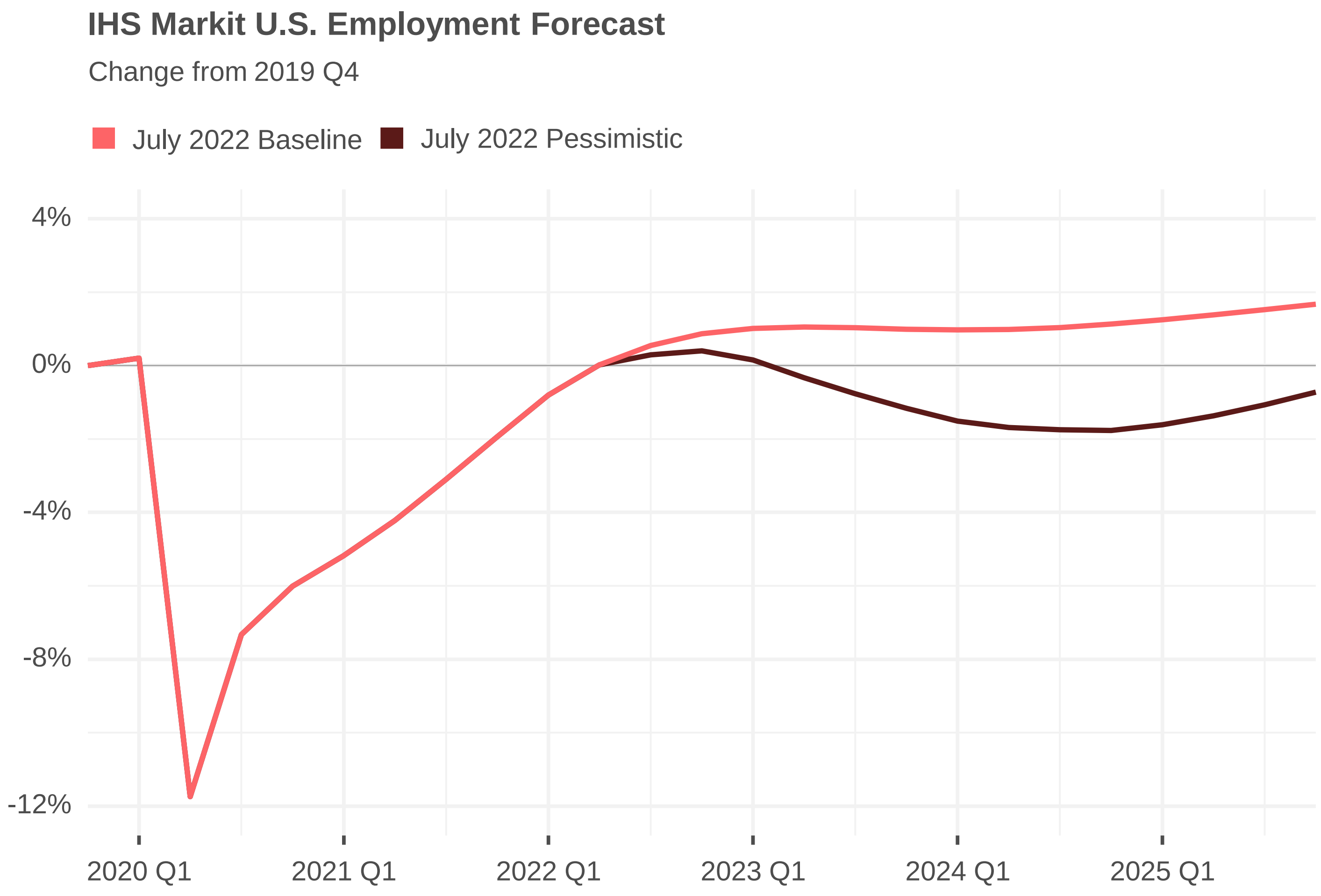
National and Regional Economic Forecasts

Inflation and Fed Response Has Cooled The Overall Economic Outlook



- The graph to the left focuses on changes in employment to capture the general trend of the national economy. Other high-level measures of economic activity would show a comparable pattern.
- Between Fall and Spring, there was only a small change in overall economic projections.
- By contrast, the most recent national forecasts anticipate an extended period of relatively slow growth, both in employment and the overall economy.

The Revised National Forecast Also Includes Increased Risk of a Recession



- Focusing again on employment as a measure of the overall economy, this graph compares the Baseline and Pessimistic forecast for the national economy.
- The baseline forecast shown here anticipated recent Fed actions and the second quarter GDP decline. Looking forward, the baseline forecast projects a return to GDP growth in the third quarter of this year.
- But the updated pessimistic scenario is consistent with a true recession and would be associated with job losses over the next 2 years.
- The probability assigned to this pessimistic scenario now stands at 45%, compared to 35% in the spring. The probability of the baseline forecast remains at 50%. (And the optimistic scenario at just 5%.)

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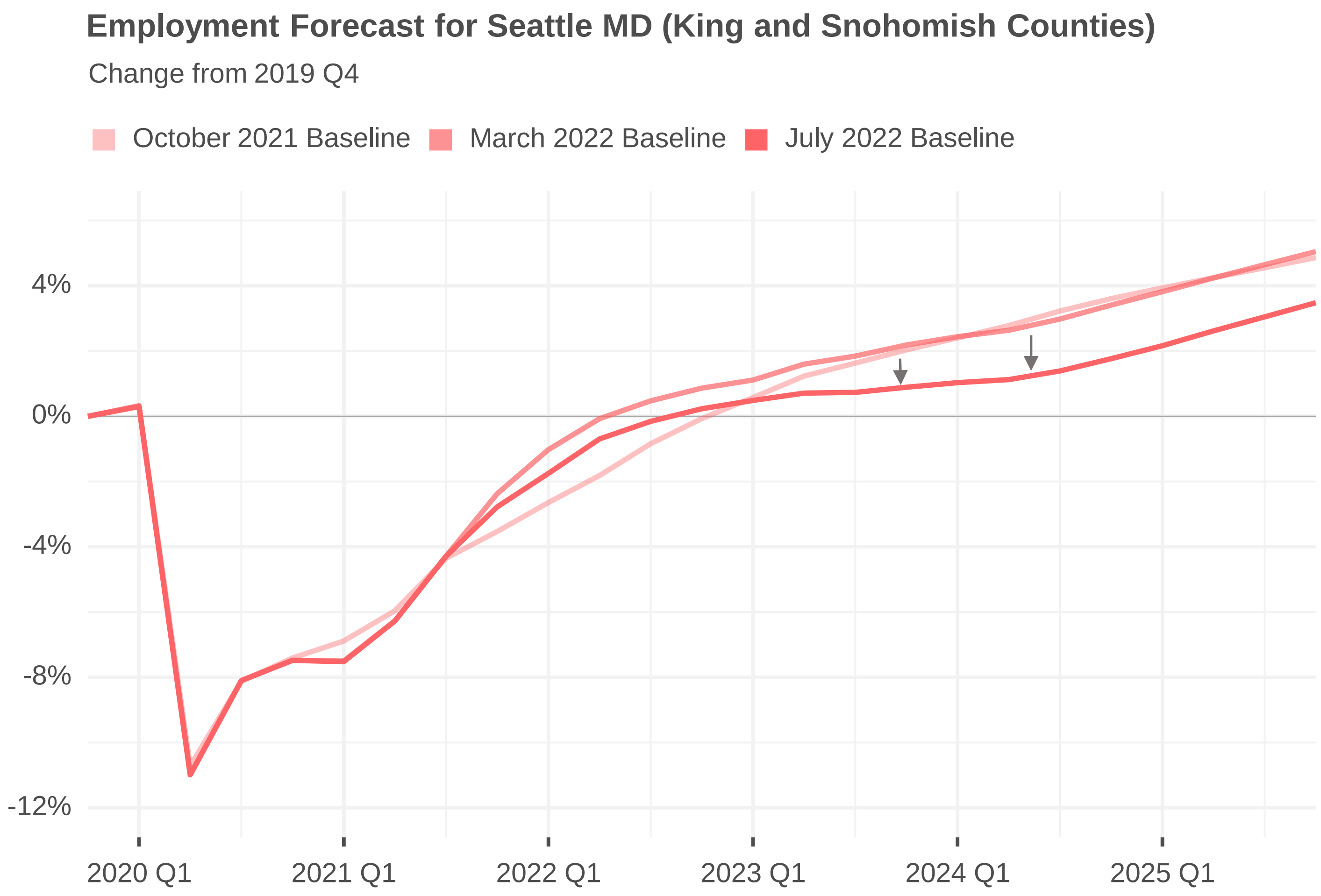
The Shift in Economic Outlook is Also Seen in the Regional Forecast



- Focusing again on employment, we can see that he current regional forecast anticipates notably slower job growth than projected in April. And the pattern seen here is also reflected in other measures of regional economic activity.
- Both the general economic uncertainty created by increasing inflation and the Fed's direct steps to control escalating prices are expected to slow the overall level of real economic growth within the region.
- Recent announcements regarding near-term hiring slowdowns at major technology firms are consistent with this expectation.

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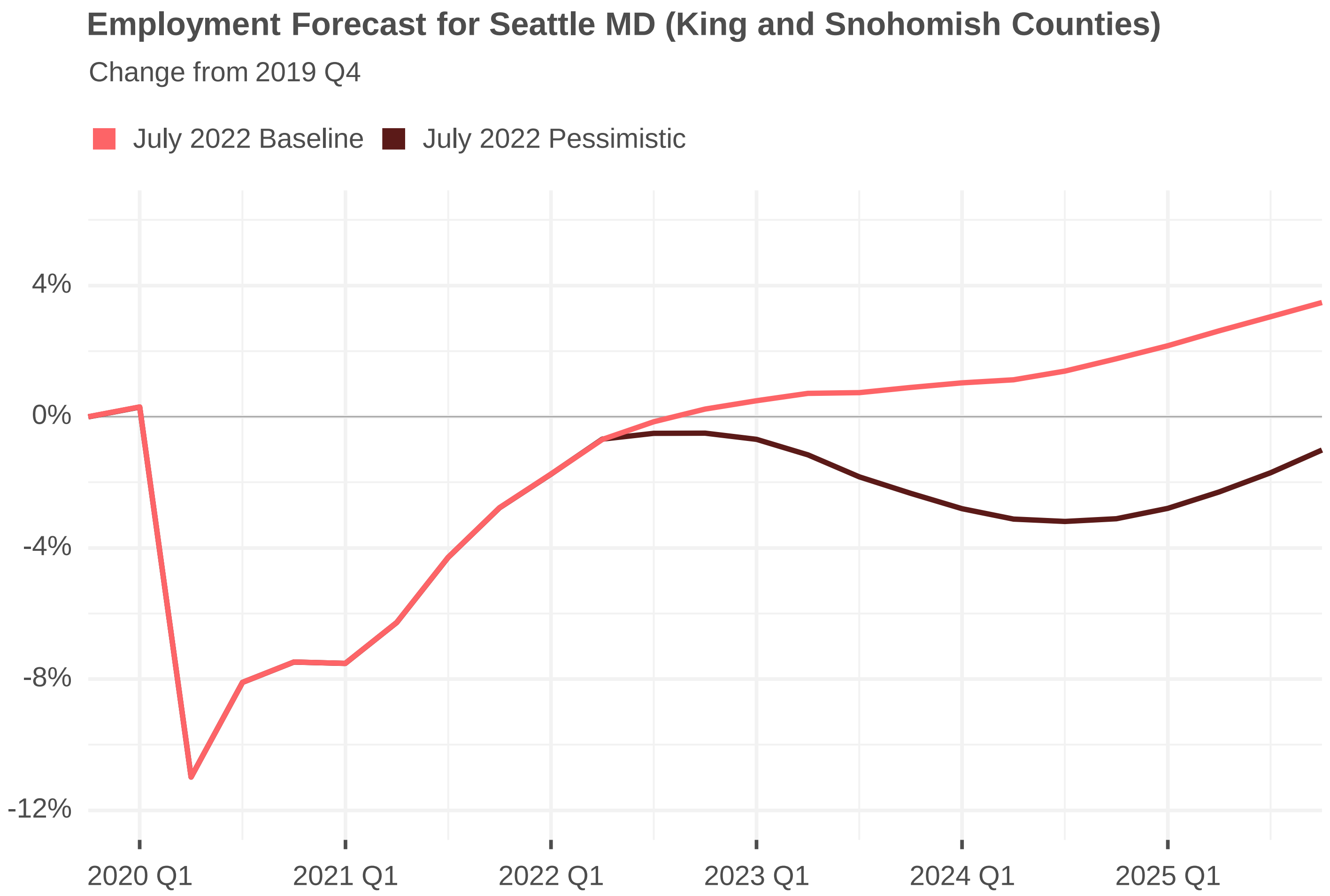
Pessimistic Forecast Reflects Deeper Decline than Comparable April Projections



- The revised pessimistic scenario projects a regional downturn that would result in the loss of almost 48,000 jobs over the next two years.
- In the April forecast, the potential job losses associated with the pessimistic scenario totaled just over 14,000.
- While job growth under the new pessimistic scenario would return in the middle of 2024, the recovery would be slow and current employment levels would not be restored until early 2026.

Economic Scenario Recommendation

- The economy is at currently at a delicate balance. Inflation has proven more persistent than initially expected and it is unclear whether prices can be stabilized while the job market remains strong. The increased probability assigned to the pessimistic scenario forecast reflects this uncertainty.

- The Federal Reserve has made reducing inflation its prime policy target and is ready to prioritize controlling long-term price escalation over the potential short-term impacts on employment and economic growth.

- That said, the current baseline forecast is consistent with recent economic developments. Prepared before the GDP announcement and Federal Reserve rate increases, the current baseline forecast predicted a second quarter annualized GDP decline of 1.3%. The actual annualized decline was "just" 0.9%. The baseline forecast also correctly anticipated July's 0.75% increase in the Federal Fund's rate, and the baseline projection also anticipates further increases going forward.

- The 500,000+ jobs added to the national economy in July demonstrates the continued strength of the labor market.

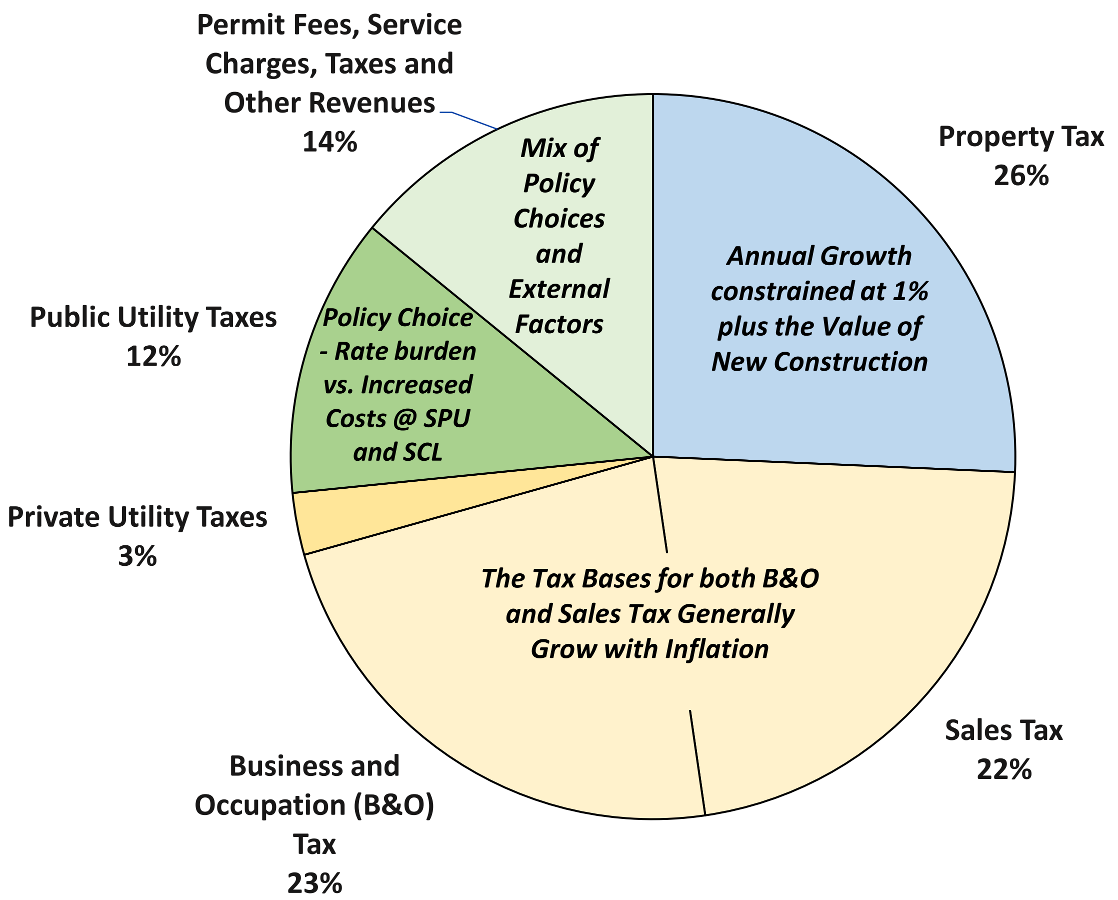
- Given all this, the Forecast Office recommends using the baseline economic scenario for the August Forecast. We will continue to closely monitor economic developments and will not wait until the November forecast to raise issues, if conditions should warrant.

Revenue Update

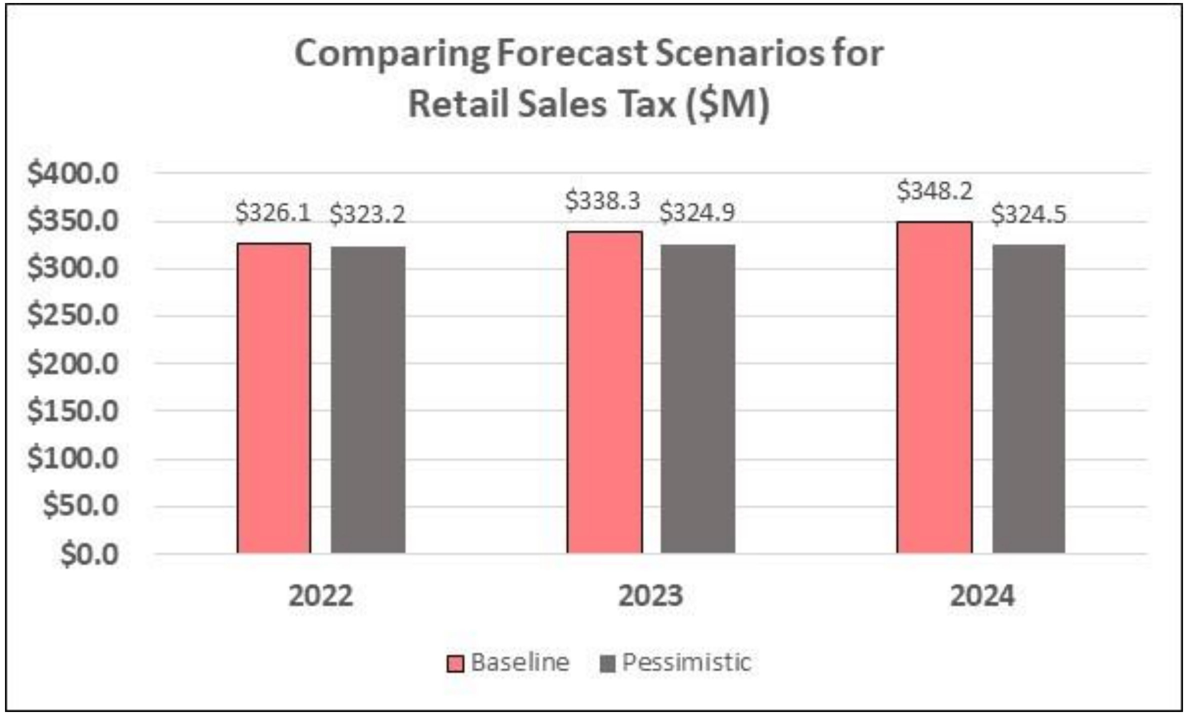
A High-Inflation Environment Creates Structural Challenges for City Revenues

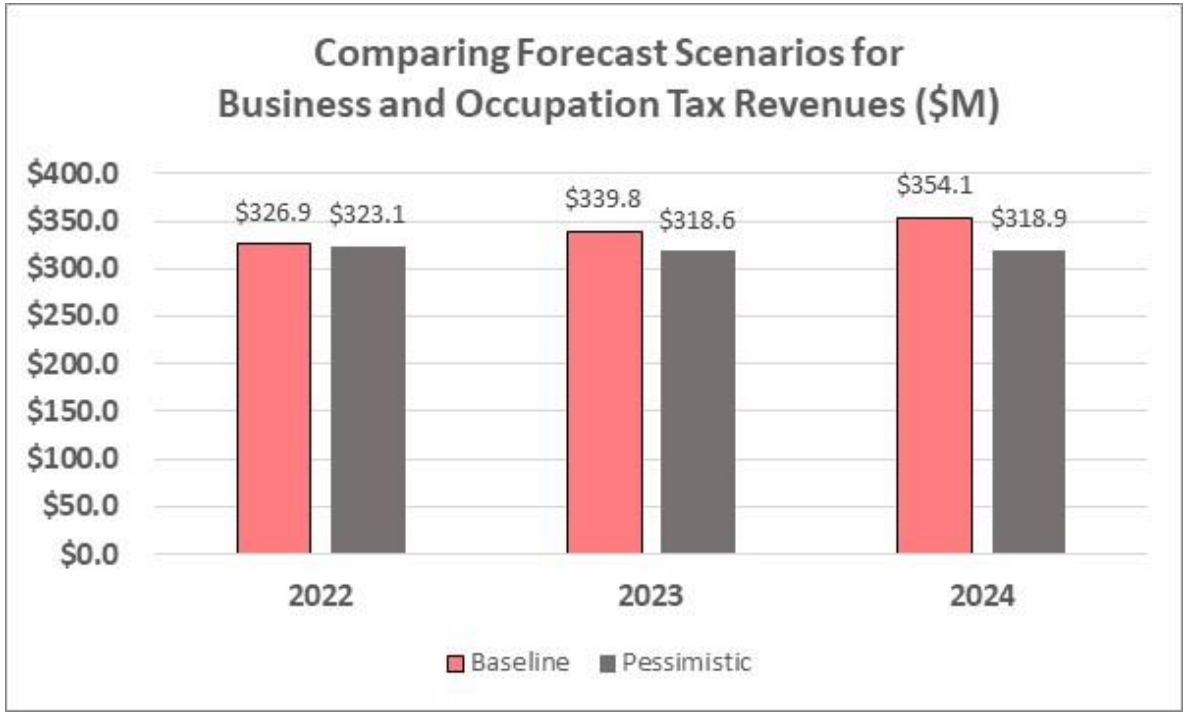
- Setting aside whether fighting inflation will slow economic growth, the direct impacts of inflation will systematically weaken the purchasing power of General Fund revenues.
- While one might assume that City revenues will generally grow as the prices of goods and services increase, that is not true for all the City's revenue streams.
- Property tax revenues are statutorily constrained to grow at just 1% plus the value of new construction. They represent 25%+ of total General Fund revenues.
- Furthermore, policy choices about public utility rates and the fees charged for City services could also constrain overall revenue growth.
- And at the same time, inflation will be driving up the costs of all the goods and services the City purchases.

General Fund Revenue and the Impacts of Inflation



How Do Forecasts Vary Across Economic Scenarios?





- The divergence between the baseline and pessimistic scenarios grows over time, as the predicated paths of economic growth diverge.
- The cumulative 3-year difference for Retail Sales tax is $40 million and B&O Taxes it is $60 million; implying a cumulative $100 million difference over this year and the coming biennium.

Summary of Revised General Fund Forecast for 2022

Revenue Source	2021 Actuals	2022 - Adopted Budget	2022 - April Forecast	2022 - August Forecast	Diff: August vs. April
Property Tax (Including Medic One Levy)	$363,690	$373,770	$371,600	$371,630	$30
Retail Sales Tax	$299,410	$303,930	$318,470	$326,080	$7,610
Business & Occupation Tax	$315,390	$317,430	$331,860	$326,900	($4,960)
Utility Tax - Private	$44,720	$38,960	$40,040	$41,660	$1,620
Utility Tax - Public	$169,610	$178,100	$180,530	$179,480	($1,050)
Other City Taxes	$16,880	$23,380	$21,230	$19,240	($1,990)
Parking Meters	$16,510	$25,600	$22,330	$23,850	$1,520
Court Fines	$18,610	$16,090	$18,430	$12,810	($5,620)
Revenue from Other Public Entities	$20,880	$15,550	$17,050	$18,360	$1,310
Grants	$69,420	$12,840	$13,490	$44,050	$30,560
Fund Balance Transfers	$44,680	$159,590	$159,590	$155,230	($4,360)
Service Charges & Reimbursements	$42,840	$109,810	$103,350	$101,630	($1,720)
Licenses, Permits, Interest Income and Other	$72,130	$70,830	$73,420	$73,380	($40)
Carry-forward Grants and Legislated Change excluded from April F'cast		$0	$40,700	NA	---
Payroll Tax - Late 2021 Payments	N/A	N/A	N/A	$41,900	$41,900
Total	**$1,494,770**	**$1,645,880**	**$1,712,090**	**$1,736,200**	**$24,110**
Annual Growth		10.1%	14.54%	16.2%	

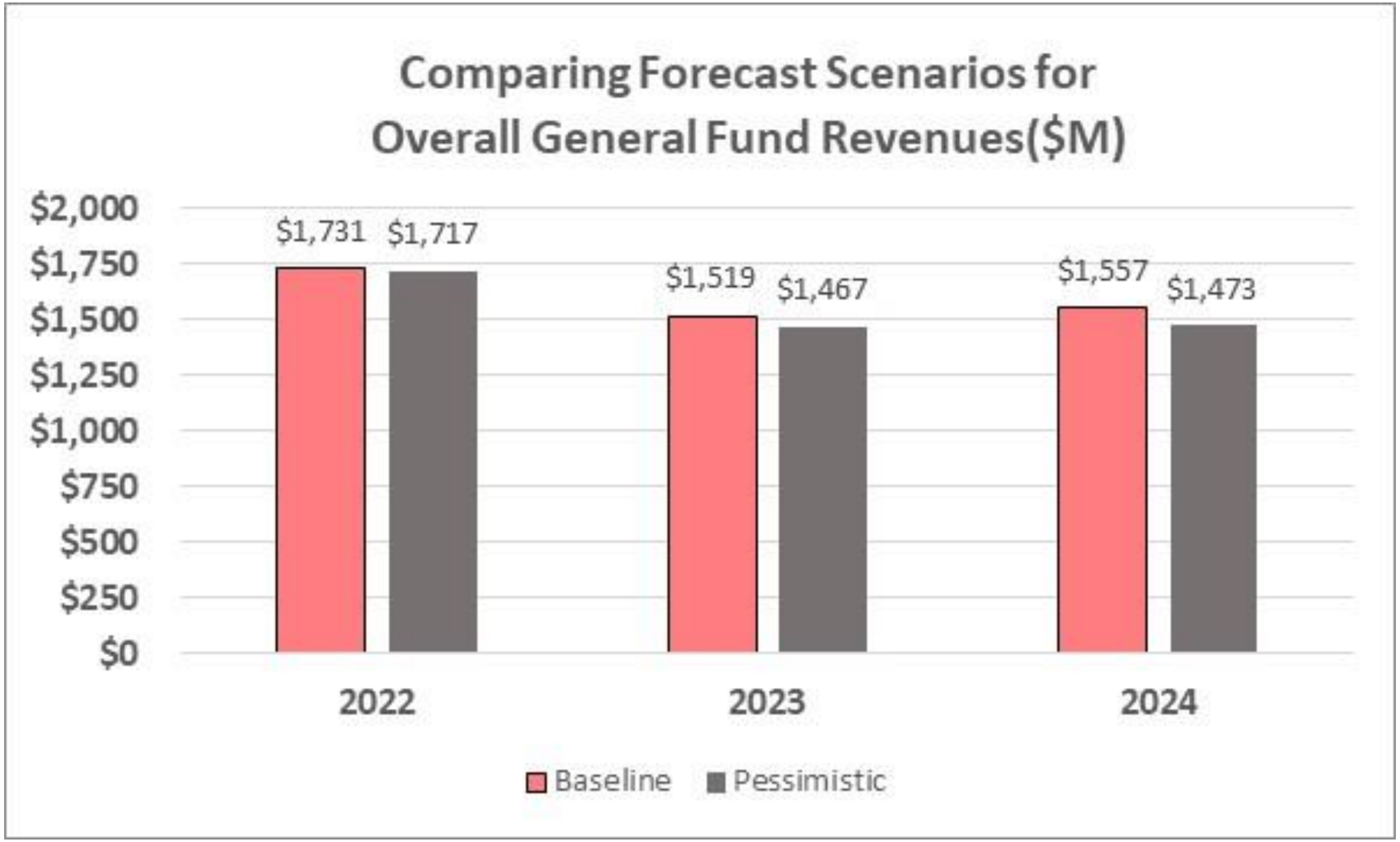
Summary of Revised General Fund Forecasts for 2023 & 2024

Revenue Source	2022 - August Forecast		2023 - April Forecast	2023 - August Forecast	Diff: August vs. April		2024 - April Forecast	2024 - August Forecast	Diff: August vs. April
Property Tax (Including Medic One Levy)	$371,630		$382,130	$381,800	($330)		$387,010	$388,750	$1,740
Retail Sales Tax	$326,080		$331,740	$337,480	$5,740		$349,720	$346,230	($3,490)
Business & Occupation Tax	$326,900		$348,980	$339,800	($9,180)		$366,980	$354,110	($12,870)
Utility Tax - Private	$41,660		$36,050	$40,750	$4,700		$34,110	$38,050	$3,940
Utility Tax - Public	$179,480		$186,720	$186,180	($540)		$191,140	$191,890	$750
Other City Taxes	$19,240		$21,660	$20,570	($1,090)		$22,640	$21,530	($1,110)
Parking Meters	$23,850		$29,460	$34,630	$5,170		$37,220	$42,120	$4,900
Court Fines	$12,810		$24,080	$19,760	($4,320)		$28,630	$24,340	($4,290)
Revenue from Other Public Entities	$18,360		$18,070	$18,270	$200		$18,210	$18,540	$330
Grants	$44,050		$28,520	$22,340	($6,180)		$10,440	$10,520	$80
Fund Balance Transfers	$155,230		$0	$2,500	$2,500		$0	$2,500	$2,500
Service Charges & Reimbursements	$101,630		$40,970	$41,030	$60		$43,000	$42,630	($370)
Licenses, Permits, Interest Income & Other	$73,380		$77,340	$74,010	($3,330)		$79,410	$76,100	($3,310)
Payroll Tax - Late 2021 Payments	$41,900		N/A	N/A	N/A		N/A	N/A	N/A
Total	**$1,736,200**		**$1,525,720**	**$1,519,120**	**($6,600)**		**$1,568,510**	**$1,557,310**	**($11,200)**
Annual Growth			(12.1%)	(12.5%)			2.8%	2.5%	

Understanding the Forecast Changes for Individual GF Revenues

- **Retail Sales Tax:** Relative to 2021 actual levels, the revised 2022 forecast represents an annual increase of 8.9%, which is largely consistent with the impacts of inflation, indicating that the overall level of taxable activity is expected to be stable, even as the value of individual transactions change. Growth is forecast to slow in 2023 and 2024, as inflation cools, and the impact of increasing interest rates leads to modest overall economic growth.
- **B&O Tax:** The downward revision of the forecast for 2022 reflects primarily the lower than predicted receipts for 2022 Q1 current obligations and for the 2021 annual obligations received since February. This adjusted to the current base level of B&O revenues then lowers the "starting point" for the projections for all subsequent years. In addition, predicted growth for 2023 and 2024 is lower as well, just like in the case of the sales tax. The net impact is to lower the annual B&O forecast for all three years (2022, 2023 and 2024) relative to the April forecast.
- **Utility Taxes – Private:** The decline in demand for telephone services has again accelerated, and a downward adjustment has been for the 2022 forecast to reflect a change in the timing of cable-related tax payments (which are also in long-term decline).
- **Utility Taxes – Public:** Water is the driver of the 2022 decline and is highly dependent on weather. As it was cooler than usual through the second quarter, revenues came in lower than expected. The full picture may change given the recent high temperatures.
- **Court Fines:** Parking citation volume is comparable to pre-pandemic levels, but all other citation categories remain significantly lower. Revenue adjusted down reflecting refunds and voiding of 200,000 citations related to certification issue, the elimination of a non-cash, balance sheet revenue accounting requirement, and an adjustment of the payment rate on citations.
- **Grants:** Grant carryforwards represent a large share of the 2022 increase. The 2023 change represents a drop in expected FEMA reimbursements due to payments shifting from 2023 to 2022 and a submission being deemed ineligible.
- **Fund Balance Transfers:** Since April, a portion of CRF transfers was redirected straight to Human Services and Housing, rather than the GF.
- **Licenses, Permits, Interest & Other:** Main drivers of 2023-24 reductions are Business Licenses (-$1.4m) and Police Dept. Emergency Services - Alarm fees (-$1.3m).

Comparing General Fund Totals – Baseline vs. Pessimistic



- The cumulative difference between the Baseline and Pessimistic scenarios over this year and the following biennium (2022,2023, and 2024) is ~$150 million.

Summary of Selected General Government Revenues for 2022

Revenue Source	2021 Actuals	2022 - Adopted Budget		2022 - April Forecast	2022 - August Forecast	Diff: August vs. April
General Government Revenues:						
Payroll Tax	$248,100	$233,870		$277,490	$279,640	$2,150
Admission Tax	$9,450	$20,050		$20,050	$20,350	$300
Sweetened Beverage Tax	$21,240	$20,380		$22,190	$21,770	($420)
Short-Term Rental Tax	$6,050	$9,810		$7,920	$9,050	$1,130
REET	$112,180	$88,040		$99,720	$106,600	$6,880
Transportation-Specific Revenues:						
Trans. Ben. Dist. - Sales & Use Tax	$37,330	$47,750		$49,200	$51,030	$1,830
Trans. Ben. Dist. - Vehicle License Fee	$13,350	$16,010		$15,480	$15,480	$0
Commercial Parking Tax	$28,550	$36,540		$38,440	$37,870	($570)
SSTPI - Parking Infraction Penalties	$8,080	$15,210		$13,410	$12,820	($590)

Summary of Select General Government Revenue Forecasts for 2023 & 2024

Revenue Source	2022 - August Forecast		2023 - April Forecast	2023 - August Forecast	Diff: August vs. April		2024 - April Forecast	2024 - August Forecast	Diff: August vs. April
General Government Revenues:									
Payroll Tax	$279,640		$296,250	$294,120	($2,130)		$311,970	$311,470	($500)
Admission Tax	$20,350		$21,400	$21,430	$30		$22,040	$22,150	$110
Sweetened Beverage Tax	$21,770		$22,860	$21,980	($880)		$23,310	$22,530	($780)
Short-Term Rental Tax	$9,050		$8,370	$9,310	$940		$8,750	$9,950	$1,200
REET	$106,600		$87,810	$94,760	$6,950		$82,550	$94,660	$12,110
Transportation-Specific Revenues:									
Trans. Ben. Dist. - Sales & Use Tax	$51,030		$49,420	$52,910	$3,490		$50,310	$54,350	$4,040
Trans. Ben. Dist. - Vehicle License Fee	$15,480		$15,690	$15,690	$0		$15,910	$15,910	$0
Commercial Parking Tax	$37,870		$50,340	$46,110	($4,230)		$52,620	$49,130	($3,490)
SSTPI - Parking Infraction Penalties	$12,820		$14,990	$14,990	$0		$14,120	$14,120	$0

Understanding the Forecast Changes for Other Individual Revenues

- **Admission Tax:** Slightly higher forecast is motivated by a somewhat faster than previously expected recovery so far this year.
- **Sweetened Beverage Tax:** Growth in concentrate (fountain drink) consumption not occurring as fast as assumed in April. Slower return-to-office, inflationary effects on household spending and potential job concerns led to downward forecast revision.
- **Short-term Rental Tax:** Revisions to these revenues for 2022 and beyond are driven by a stronger than anticipated recovery so far this year – with revenues nearly comparable to 2019 levels – and the expectation that summer tourism will be robust.
- **Real Estate Excise Tax (REET):** Through June, REET revenue totaled $54.8 million, slightly ahead of the April forecast of $99.9 million. The forecast has thus been revised up for 2022 to 2027. Rising mortgages rates are however expected to cool the housing market, as a result, the revenue is expected to decline somewhat in the coming years.
- **Transportation Benefit District (TBD) Sales Tax:** This revenue source in general tracks the regular retail sales tax. The increase in the forecast relative to April reflects the year-to-date actuals and increasing inflation.
- **Commercial Parking Tax:** As growth in the regional economy is projected to slow relative to April, with the gap widening in 2023, commercial parking activity is expected to undergo a weaker recovery to pre-pandemic levels, though the rate increase effective July will give revenues a boost. In addition, office parking activity – typically a strong share of the tax base – has eroded substantially and the share of workers returning to the office has remained low in Seattle.
- **Payroll Expense Tax:** The revised 2022 baseline forecast is lower than the final 2021 payments of $290 million because payments for the first half of this year are not on pace to match this level of revenue. It appears that declining stock values, which are an important component of compensation in the sectors that drive these revenues, are leading to lower tax obligations. The projections for 2023 and 2024 have been adjusted to be consistent with the new forecast of the 2022 base, and an overall slowing of projected growth in the regional economy, including the technology sector. Additional details are provided on the slides that follow.

Payroll Expense Tax (PET) – What We Know So Far

Who Pays the Tax

- Trade, Information and Professional & Business Services account for more than 88% of the tax receipts for 2021 obligations. This means that revenues are heavily dependent on just three sectors, rather than a diversified tax base.
- For 2021, the tax applied progressively to compensation above $150,000 paid to employees at businesses with gross receipts of more than $7 million. In 2022, the comparable figures are $158,000 and $7.4 million. The thresholds will increase by 10.1% for next year.
- The measure of the tax is the payroll awarded to employees who work in the City, whether that be from home, or at a Seattle location. Thus, a robust return-to-office would increase the total tax base and we had generally anticipated a faster return.

Payments to Date

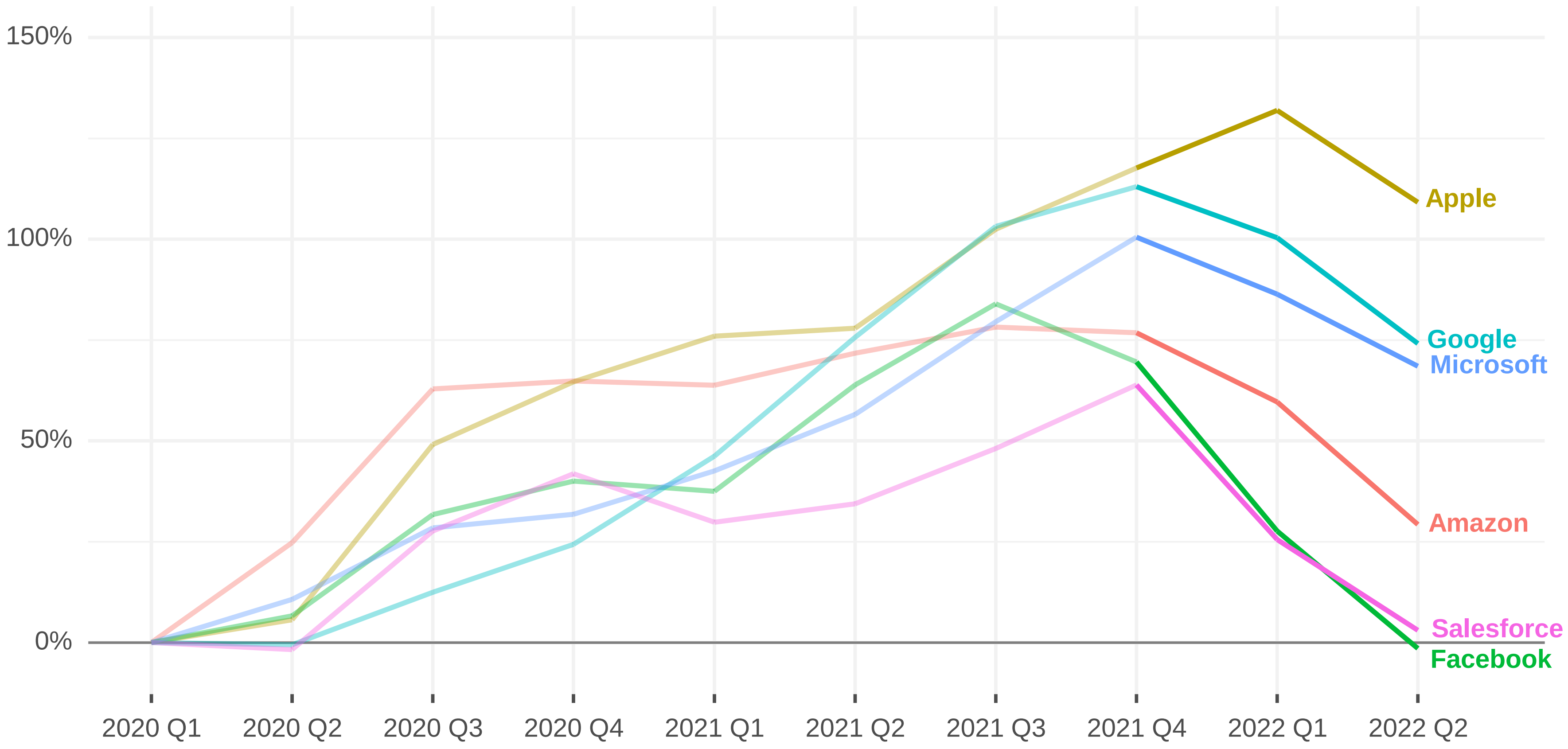
- Total taxes paid for 2021 are now expected to reach $290 million. More than $40 million in delayed 2021 payments have been collected since February of this year.
- For 2021, payments were made one-time, at year end. For 2022, estimated quarterly payments are now required.
- Year-to-date quarterly payments show a pattern of lower estimated tax obligations for many employers. Based on these preliminary second quarter results, some of the larger taxpayers from last year are not on pace to reach their 2021 totals.
- Current payment rates extrapolate to approximately $260 million in annual revenue, which is below the April 2022 forecast of $277 million. At the same, historical patterns in payroll data from ESD indicate that more than 50% of total compensation is paid in the second half of the year. Thus, there is good reason to expect that the final total will exceed the a simple "straight-line" extrapolation of current receipts. The final 2022 forecast of just under $280 reflects that expectation.
- Looking forward to 2023 and beyond, we are forecasting somewhat slower growth in the coming years anticipating that less of the overall regional job growth in the technology and related sector will be concentrated specifically in the city.

Potential Explanations for Lower PET 2022 Payments

- A significant share of compensation at many technology firms comes as stock grants.
- PET is thus likely to be much more volatile than sales tax or B&O tax.
- Tech stock prices have declined significantly in 2022, after a strong performance in 2021.

	2021	2022 YTD
Amazon	24.7%	-18.2%
Microsoft	44.3%	3.1%
Facebook	36.9%	-33.7%
Google	69.5%	-0.5%

Change in stock prices since 2020 Q1



Source: Yahoo Finance

Potential Explanations for Lower PET 2022 Payments

- Workplace presence is trending up, but slowly.
- Firms choose one of two methodologies in determining tax obligations: (i) where workers are "primarily assigned"; or (ii) the share of hours worked in Seattle.
- More firms are using the hours worked approach this year, which may reflect expectation that work from home will continue.