

City of Chehalis
Washington

Final Report

**SOUTH INDUSTRIAL
AREA ANNEXATION
FISCAL ANALYSIS**

March, 2009

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March 16, 2009

Mr. Merlin MacReynold
City Manager
350 North Market Blvd. Room 101
Chehalis, Washington 98532

Subject: South Industrial Area Annexation Fiscal Analysis

Dear Mr. MacReynold:

We are pleased to submit our final report summarizing the results of our South Industrial Area Annexation Fiscal Analysis. As noted in our executive summary, the City's expenditures will exceed the revenues from the South Industrial area during the first five years because of payments to Lewis County for the loss of its Road Fund revenues as provided for in an interlocal agreement between the City and the County. Based on the original staffing proposed in 2005, the City would be able to pay for services from the area's revenues after the City stops its payments to the County. However, based on a more recent staffing estimate, the City's expenditures will continue to exceed revenues from the area even after the City stops its payments to the County. Another issue that will need to be resolved if the City annexes the area involves potential payments from Fire District #6 as provided for in the Revised Code of Washington 35A.14.400. We are sending a copy of this report via e-mail, but we will also provide you with hard copy reports and a master copy. If there are any questions, please do not hesitate to contact us (425) 867-1802 ext. 228.

Sincerely,

Peter Moy
Principal

Enclosures

TABLE OF CONTENTS

Executive Summary i

I. Introduction 1

II. Key Assumptions and Methodologies 5

III. Financial Analysis..... 14

IV. Potential Revenue Impacts on Other Jurisdictions 18

EXECUTIVE SUMMARY

The City of Chehalis has been considering whether to annex an area southeast of the City limits that has been known as the South Industrial Area. The South Industrial Area is about 2.2 square miles and is primarily southeast of the City limits, between Interstate 5 and Jackson Highway on the west and east and extending south to Northstar Drive across to the edge of properties on Newaukum Village Drive and up to where Bishop Road meets Jackson Highway. Most of the land is zoned for industrial uses except for the properties that are along Bishop Road and Interstate 5 which are zoned for commercial uses. While there are some large developed properties in the area, as well as smaller developed properties, there are still large amounts of undeveloped property within the annexation area. The residential population is estimated at about 275.

Before determining whether to begin the steps toward annexing the area, the City first wanted to determine the financial viability of the annexation, and it engaged FCS GROUP to conduct a fiscal analysis of the South Industrial Area. The fiscal analysis of the South Industrial Area is focused primarily on the City of Chehalis' General Fund. Based on discussions with City management, the primary services that will be affected by the annexation are police, fire, street, and stormwater services. The City already provides water and sewer service to parts of the area. Municipal Court, planning, and parks and recreation services are not anticipated to be impacted by the annexation.

The fiscal analysis involved forecasting revenues and expenditures for the General Fund and the three utilities: water, wastewater, and stormwater. The forecasts were for a 10 year period starting in 2010 when it would be expected that the City might begin to receive revenue and provide services. There were a number of assumptions used to develop the forecast, and some of the general assumptions and limitations of the forecast include the following:

- ◆ Annual inflation for revenues and most expenditures is estimated at 3%,
- ◆ Because of the uncertainty about what development will take place in the future and what the timing, the type of development, and the real estate sales might be, real estate excise taxes were not forecasted as part of this analysis.
- ◆ It is also assumed that the costs associated with issuing building permits and performing plan reviews will be offset by the fees paid, and these costs and revenues were not included as part of the forecast.
- ◆ The analysis assumes that the personnel will be hired by January 1, 2010, but the City may find that to have the trained staff available by January 1, it may have to hire the staff in mid to late 2009. These costs would have to be supported by the City's current revenues before it starts receiving revenues from the annexation area.
- ◆ The analysis assumes the same level of staffing throughout the ten year forecast period. As development occurs in the South Industrial Area, additional staff might be needed, especially for police services, as development, employment, and traffic increases in the area.

- ◆ Although we have estimated the amount that Lewis County Fire District #6 might need to pay the City, no payments are included in the fiscal analysis.
- ◆ A number of separate assumptions and methodologies were used to develop the ten year forecasts for both revenues and expenditures.

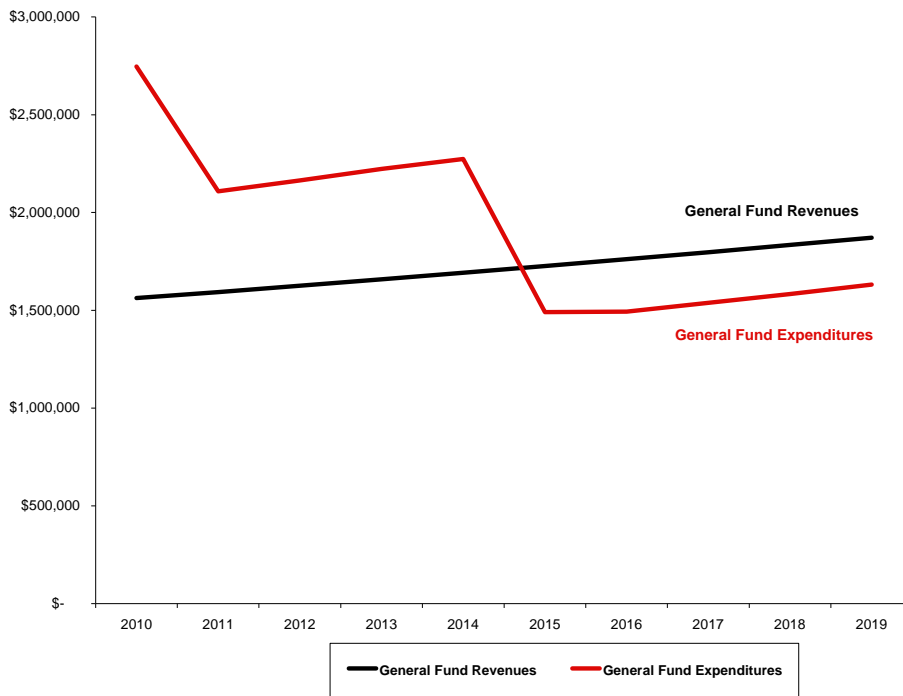
The fiscal analysis involves forecasting the major General Fund revenue sources and expenditures. Revenues include general and EMS property taxes, sales taxes, private utility taxes on electricity, natural gas, and telephone services, public utility taxes on the City's utilities, and some miscellaneous sources such as business licenses and Liquor Control Board profits and taxes. Expenditures include operating and capital costs for police, fire, and street services as well as potential payments to Lewis County per an interlocal agreement to reimburse the County Road Fund for the loss of revenue caused by the annexation. For the City's utilities, the water and sewer analyses forecast the lost revenue from the out of City surcharge, while for the stormwater utility both revenue and expenditures are forecasted.

Two different forecasts were analyzed because of changing staffing needs for police and fire services. In Scenario A, the police and fire staffing are forecasted as originally discussed in 2005. Police needed three additional police officers, while Fire needed seven additional firefighters. After further reviewing the impacts of these staffing changes, the City believes that the current levels of service provided to City residents and businesses might decline at these staffing levels. To maintain the current service levels within the City, a Scenario B was developed that provided for adding five police officers and eleven firefighters. The forecasts show the following:

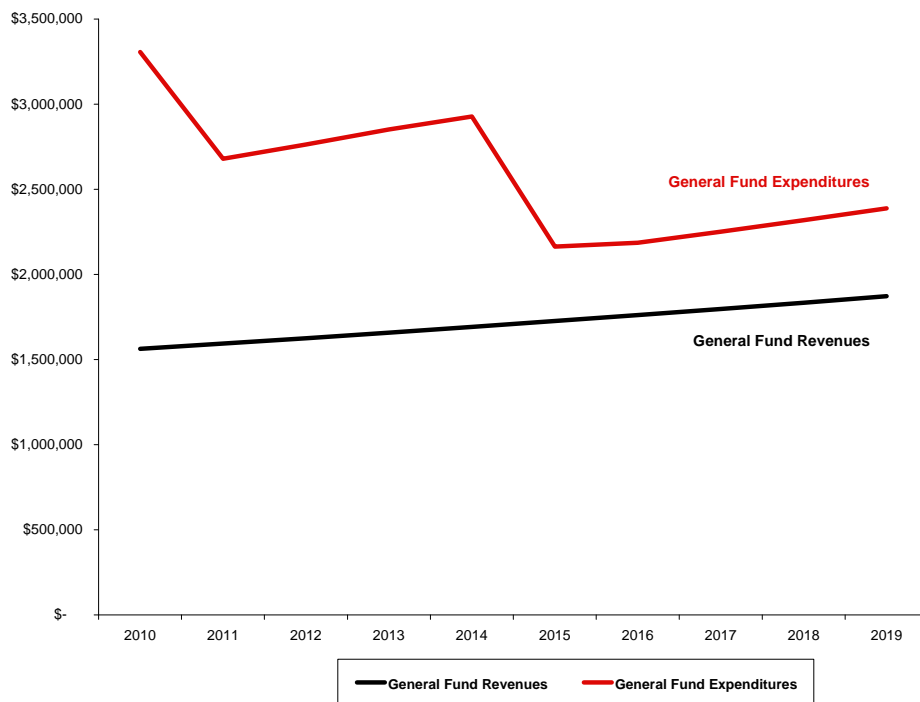
- ◆ The overall General Fund is at a deficit each year for the first five years, but then turns positive in Scenario A after the City eliminates the County Road Fund payments. Scenario A's total deficit for the first five years is almost \$3.7 million.
- ◆ Scenario B has greater costs and as a result, has a much larger deficit in the first five years at almost \$6.7 million. Scenario B also continues to have operating deficits each year, even after the City stops making the County Road Fund payment.

For the City, the amount paid to Lewis County for the lost County Road Fund tax revenue is a critical component in determining the annexation's financial viability. The County Road fund payment is more than the amount the City would receive from its own property taxes in the area. The following charts show the revenues and expenditures for the ten year period between 2010 and 2019.

Scenario A
The Originally Proposed Three Police Officer and Seven Firefighter Staffing



Scenario B
Five Police Officer and Eleven Firefighter Staffing for Maintaining City Service Levels



With the annexation, the City utility customers within the annexation area will pay the City's resident rate instead of the higher out of City rate. As a result, the City will actually lose about \$21,000 per year for the water and wastewater funds. The City will also be providing stormwater services to the annexation area, and based on the revenues and expenditures estimated by the Public Works Department, the City will not recover its costs for providing these services as shown below.

Storm and Surface Water Fund Forecast

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Storm Water Revenue										
Storm Water Charges	\$ 14,180	\$ 14,605	\$ 15,044	\$ 15,495	\$ 15,960	\$ 16,439	\$ 16,932	\$ 17,440	\$ 17,963	\$ 18,502
Total Revenue	\$ 14,180	\$ 14,605	\$ 15,044	\$ 15,495	\$ 15,960	\$ 16,439	\$ 16,932	\$ 17,440	\$ 17,963	\$ 18,502
Expenses										
Storm Water	\$ 99,831	\$ 102,826	\$ 105,910	\$ 109,088	\$ 112,360	\$ 115,731	\$ 119,203	\$ 122,779	\$ 126,463	\$ 130,256
City Utility Tax	\$ 851	\$ 876	\$ 903	\$ 930	\$ 958	\$ 986	\$ 1,016	\$ 1,046	\$ 1,078	\$ 1,110
Total Expenses	\$ 100,681	\$ 103,702	\$ 106,813	\$ 110,017	\$ 113,318	\$ 116,717	\$ 120,219	\$ 123,826	\$ 127,540	\$ 131,367
Net Income	\$ (86,501)	\$ (89,097)	\$ (91,769)	\$ (94,523)	\$ (97,358)	\$ (100,279)	\$ (103,287)	\$ (106,386)	\$ (109,577)	\$ (112,865)

From an overall standpoint, the forecasts show that if the City annexes the South Industrial Area the City faces some major financial challenges and considerations about the level of services that the City can provide to both its current residents and businesses as well as to the new residents and businesses in the annexation area.

I. INTRODUCTION

For several years, the City of Chehalis has been considering whether to annex an area southeast of the City limits that has been known as the South Industrial Area. Before determining whether to begin the steps toward annexing the area, the City first wanted to determine the financial viability of the annexation. In 2005, the City's Finance Director performed an initial financial analysis, and subsequent to that analysis, the City engaged FCS GROUP to review that analysis and to perform an update of the analysis.

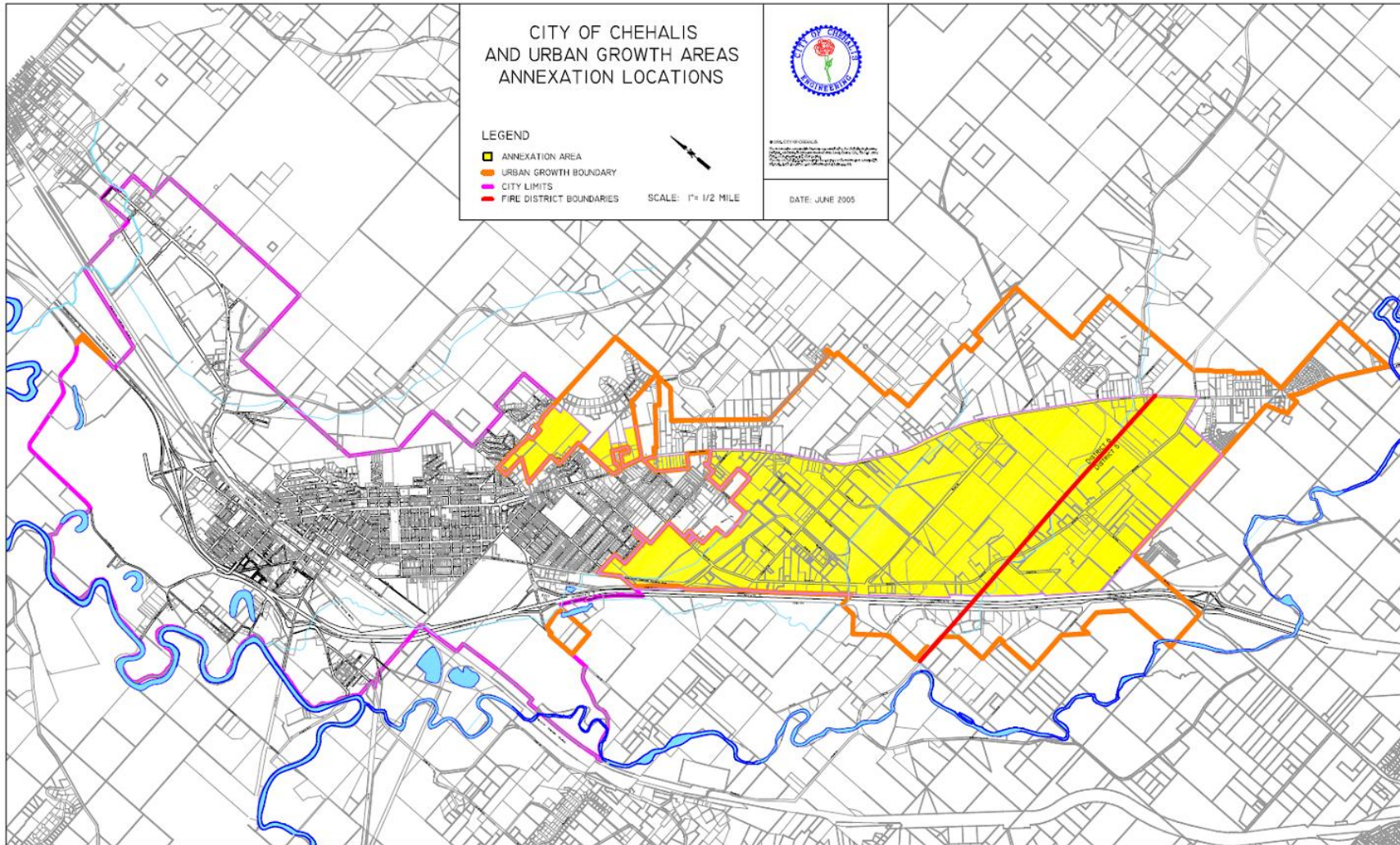
The approach used to conduct the analysis involved the following:

- ◆ Reviewing previous City documentation and data related to the prior analysis and other documents (e.g. Letter from Lewis County Fire District #6 about its concerns),
- ◆ Identifying key assumptions and data needed to conduct the fiscal analysis,
- ◆ Working with the various City department directors and City staff to collect data and to identify the potential impacts on their operations and costs,
- ◆ Working with the City staff and the Lewis County Assessor's Office to obtain updated assessed values for properties located in the annexation area, as well as other related data associated with the properties,
- ◆ Contacting other governmental agencies such as the Washington State Department of Revenue and the Lewis County Public Utility District to collect additional data related to the annexation area,
- ◆ Using a financial model to perform the fiscal analysis, and
- ◆ Reviewing the preliminary results with City management to resolve any issues concerning any assumptions, analytical issues, and data.

The South Industrial Area

The South Industrial Area is about 2.2 square miles and is primarily southeast of the City limits, between Interstate 5 and Jackson Highway on the west and east and extending south to Northstar Drive across to the edge of properties on Newaukum Village Drive and northward to where Bishop Road meets Jackson Highway. Most of the land is zoned for industrial uses, except for the properties that are along Bishop Road and Interstate 5 which are zoned for commercial uses. Exhibit 1 shows a map of the annexation area, while Exhibit 2 shows the zoning for the area.

Exhibit 1 South Industrial Area Annexation Map



Based on the data provided by the Lewis County Assessor's Office, the 2008 assessed values for the area totaled about \$458.5 million which includes personal property, machinery, and equipment, as well as real property. Over half the area's assessed value is related to Chehalis Power, and other businesses with high assessed values include FM Retail Services and Hardell Mutual Plywood Corporation. The largest land owner is the Port of Chehalis, and other large landowners include the three previously mentioned companies, as well as Community Partners and Legend Oaks. Based on the Assessor's use descriptions for each property, Exhibit 3 shows how the land is currently classified.

Exhibit 3
South Industrial Area Property Characteristics

Use Description	Acres	% of Total Acres	Assessed Value*	% of Total Assessed Value
Single Unit Residential	213	16.1%	\$19,550,137	4.3%
Mobile Home	11	0.8%	1,291,136	0.3%
Other Residential	27	2.0%	2,985,750	0.7%
Manufacturing	219	16.6%	91,284,371	19.9%
Transportation	17	1.3%	2,315,300	0.5%
Wholesale and Retail	7	0.5%	4,248,139	0.9%
Services	124	9.4%	61,016,429	13.3%
Utilities	19	1.4%	837,050	0.2%
Agricultural Not Cultivated	114	8.6%	9,140,817	2.0%
Current Agricultural Use	109	8.2%	3,376,492	0.7%
Residential Land Undivided	234	17.7%	10,294,770	2.3%
Commercial/Industrial	229	17.3%	251,477,101	54.9%
Total	1,323	100.0%	\$458,476,642	100.0%

*Includes assessed values of publicly owned property

Based on the land use descriptions, there are an estimated 103 single family residences. According to Lewis County's draft comprehensive plan, the average household size in the County is 2.67 persons. Assuming that all these units are occupied, there would be about 275 people living in the annexation area. The South Industrial Area is served by Lewis County Fire Districts #5 and #6. The taxable assessed values for these two districts are about \$19.3 million and \$421.6 million, respectively. The City already provides water and wastewater service to portions of the area.

II. KEY ASSUMPTIONS AND METHODOLOGIES

The fiscal analysis of the South Industrial Area is based primarily on the annexation's impact on the City of Chehalis's General Fund. Based on discussions with City management, the primary service impacts will involve Police, Fire, Streets, and Utilities. City management also believes that other services involving the Municipal Court, planning, and parks and recreation services would not be significantly affected by the annexation.

The fiscal analysis involved forecasting revenues and expenditures for the General Fund and the three utilities: water, wastewater, and storm water. The forecasts were for a 10 year period starting in 2010 when it would be expected that the City might begin to receive revenue and provide services. There were a number of assumptions used to develop the forecast, and some of the general assumptions and limitations of the forecast include the following:

- ◆ Annual inflation for revenues and most expenditures is estimated at 3%,
- ◆ Because of the uncertainty about what development will take place in the future and what the timing, the type of development, and the real estate sales might be, real estate excise taxes were not forecasted as part of this analysis.
- ◆ It is also assumed that the costs associated with issuing building permits and performing plan reviews will be offset by the fees paid, and these costs and revenues were not included as part of the forecast.
- ◆ The analysis assumes that the personnel will be hired by January 1, 2010, but the City may find that to have the trained staff available by January 1, it may have to hire the staff in mid to late 2009. These costs would have to be supported by the City's current revenues before it starts receiving revenues from the annexation area.
- ◆ The analysis assumes the same level of staffing throughout the ten-year forecast period. As development occurs in the South Industrial Area, additional staff might be needed, especially for police services, as development, employment, and traffic increases in the area.

The following sections discuss the revenue and expenditure assumptions and data used in the fiscal analysis.

General Fund and Utility Revenues

The primary revenue sources for the General Fund involve property taxes, sales taxes, and utility taxes, while rate revenues are the primary revenue source for the City's utilities.

Property Taxes

The Lewis County Assessor's Office provided the parcels and assessed values of the properties within the annexation area. The Assessor's Office identified the parcels based on maps previously provided

to the Assessor for the City's previous study. The South Industrial Area's total assessed value, including public properties, is about \$458.5 million, and the taxable assessed value is about \$440.8 million. The assessed value also includes personal property, machinery, and equipment associated with the properties. This data was obtained by using the addresses from the Assessor's data and by searching the Assessor's Parcel Assessment and Tax System available on the Assessor's web site.

The forecast uses the 2008 property tax rates (General Fund and EMS Levy) as a starting point. The property tax rates for the subsequent years are then forecasted based on adding the South Industrial Area's assessed value to the City's current property tax base, with the forecasted annual increase in the assessed value based on the City's average growth in assessed value plus a base of annual new construction. The annexation area's property tax growth and new construction is related to the City's current and past growth instead of the County's or Fire District #6's growth. The property tax revenues are then calculated based only on the revenues added from new construction. The growth factors used in the analysis are the following:

- ◆ The annual increase in assessed value is at 2%, which is about the average increase from 2004 to 2007. The percentage change in assessed value from 2007 to 2008 was 35%, and thus we have used the more conservative growth factor for both the City's current assessed value and the annexation area's assessed value.
- ◆ The annual new construction for the annexation area is based on Chehalis' most recent experience for 2008 which is at 1.45% of the total assessed value, while the added assessed value for new construction in the City is based on the same amount used in 2008.

Sales Taxes

To estimate the sales tax revenue, the Department of Revenue (DOR) provided a taxable sales figure for 2007 from businesses within the annexation area. An electronic map of the area was provided by the Public Works Department and given to the Department of Revenue to identify the businesses and the taxable sales within the area. According to DOR, 67 businesses generated \$22,868,123 in taxable sales in 2007. The forecast uses this base number and adds inflation each year. One outstanding issue concerning sales taxes is the new sales tax streamlining legislation that changed the sales tax calculations from an origin-based system to a destination delivery-based system. The first quarter results under the legislation are currently being compiled. Depending on the portion of sales where delivery is made outside the area, the future sales tax revenues could be lower than forecasted at this time. In addition, the recent slowdown in the economy might also make it more difficult to determine the impact of the streamlining legislation because sales activity may also be declining. Once the sales tax data is analyzed for the first and second quarter of the state's current fiscal year, adjustments to the sales tax forecast might be necessary.

City Utility Revenue and Utility Taxes

The City applies utility taxes to both private and City-owned utilities. The major private utilities are electricity and natural gas. As part of the annexation petition, the petition includes changes to the utility taxes on electricity and natural gas for manufacturing, food processing, electrical generation, and wholesale distribution businesses. Instead of a flat rate of 6%, which is currently applied to all revenue within the City charged by an electric or natural gas utility, the petition calls for an individual customer tax rate of 6% for a tax liability of up to \$10,000 (charges up to \$166,667), with a 1% rate applied thereafter for a tax liability above \$10,000 and a maximum tax liability of \$75,000. For electricity, Lewis County Public Utility District provided the total 2007 electricity charges based on the addresses in the Assessor's property data used to determine the assessed value of the area. The total 2007 electricity charges for the area totaled \$4,058,750. Because the electricity charges were not available by customer, the City's previous estimates were used to calculate the difference between revenues from a flat rate tax of 6% and the adjusted tax rates. The difference showed that the adjusted tax revenue would be about 50% less. For the natural gas charges and telephone charges, the City's previous estimates were used.

For the City's water and wastewater utilities, the City provided the 2007 annual water and wastewater charges for properties that use City utilities within the South Industrial Area. The City's total water charges for the area were \$215,337, while the total wastewater charges were \$226,667. The charges include a 10% surcharge for out of City customers, and if the area is annexed, the customers will pay a lower rate, thus reducing the City's 6% utility tax revenue by about \$1,175 for water and \$1,236 for wastewater. Although there will be a loss in revenue for the water and wastewater utilities, the City will collect revenue for its stormwater utility. The Public Works Department has estimated that the stormwater charges for the major commercial properties in the annexation area would generate about \$7,322 in 2008 revenues if the City did not charge property owners within the Flood District. The residential units would add another \$6,044 in revenue if none of the homes are in the Flood District for a 2008 total of \$13,366. The 2008 utility taxes from this revenue source would be about \$802. If the property owners in the Flood District also had to pay the City's stormwater fee, the revenues would increase to \$22,452. The forecast assumes that the Flood District customers do not have to pay the City's stormwater charge as conditioned in the annexation petition.

Other Miscellaneous General Fund Revenues

There are a couple of miscellaneous General Fund revenues that might be affected by the South Industrial Area annexation. These revenue sources include state revenues from the Washington State Liquor Board and additional business license fees. The distribution of Liquor Board taxes and profits is based on population and the estimated amount per capita is based on the City's current population and the 2008 budgeted revenues. The budgeted per capita revenue for the Liquor Control Board is \$11.20. As previously noted, it is estimated that about 275 additional residents will be added through the annexation. For the South Industrial Area's businesses, business license

revenue is based on the number of businesses (67) that were reported as part of the Department of Revenue's taxable sales research. This figure is probably a conservative number because any business that does not have taxable sales (e.g. a professional service business) is not included. However, the revenue impacts are not significant since a new business license costs \$35 and renewals are \$15 per year.

Fire District Revenues

According to RCW 35A.14.400, the City is entitled to receive payments from the fire protection district. The RCW states the following when a city annexes less than sixty percent of a fire protection district:

"... the district shall pay to the code city within one year or within such period of time as the district continues to collect taxes in such incorporated or annexed areas, in cash, properties or contracts for fire protection services, a percentage of the value of said assets equal to the percentage value of the real property in the entire district lying within the area so incorporated or annexed ..."

The South Industrial Area represents about 41% of the assessed value of Fire District #6 and about 3% of Fire District #5's assessed value. Based on data provided by the Fire District, the current assessed value of the buildings in Fire District #6 total \$2,472,100, while trucks total \$3,399,276 (based on their insured value), resulting in a total asset value of \$5,871,376. Based on the RCW, the Fire District would pay the City 41% (the percentage of the District within the South Industrial Area) of the value of its assets, which is equal to \$2,407,264. Based on a review of the District's 2007 actual expenditures, the District does not have sufficient fund balances in its accounts to make such a payment. At the end of 2007, it appeared that the District had about \$850,000 in available fund balances in its accounts. It should be noted that the area's residents must still help the District pay off the bonds that were used to purchase trucks and build the headquarters station even after the annexation. Because of the uncertainty about the District's ability to pay the City, payments from the District have not been included as part of the revenue and expenditure forecasts.

General Fund Expenditures

The primary General Fund expenditures involve police, fire, and street services. Fire service is the most expensive service of the three services. The following briefly describes the costs involved and some of the issues that have been highlighted by the different departments.

Police Expenditures

The Police Department initially estimated in 2005 that an additional three officers would be needed to provide services in the annexation area and maintain services in the City. According to the Department, there were 423 calls for service in the annexation area in 2007. Based on the 2007

figures, the Department expects to see a 6% increase in calls for service with the annexation. The Department also determined that over 40% of all activity in the industrial park area required at least a two-officer response, compared to the City where a two officer City response was required 32% of the time. Based on an analysis of the calls for service, preventative patrol, and response times, the Department believes that by adding three additional officers, it can reduce the number of shifts having only 2 officers from 80.8% to 20.5% and while not ideal, this would allow an increase in manpower on high-activity or high-risk shifts, maximizing its efforts on preventive patrol. Additionally, by designating patrol areas, the Department's response times to calls for service and to back-up other officers would offset the issues with the size of the increased patrol area. The Department believes that it does not need to add additional records or detective personnel. Concerning preventative patrol and response time, the Department, however, anticipates the following impacts if three officers were hired:

- ◆ Other parts of the City would see an estimated 15% decrease in preventive patrol during the day up to an estimated 30% decrease at night. The night time percentage reflects increased security checks on closed businesses in the industrial area.
- ◆ The calculated average time for an officer to respond to an emergency within the current city limits is 3 minutes, 29 seconds with the longest emergency response time (the time to travel from one end of the city to the other) being 6 minutes, 39 seconds. With the proposed annexation, the calculated average time for an emergency response increases to 5 minutes, 57 seconds.

To assure that the City residents and businesses do not see a decrease in preventive patrol and emergency response times, the Department re-evaluated its staffing needs in 2008 and determined that five officers would be necessary to maintain the City's current level of service. Thus, there are two potential police service scenarios. The salaries used are near the top step of the Police Officer salary range and Exhibit 4 shows the 2008 base expenditures for each scenario.

**Exhibit 4
 Police Expenditures**

Budget Category	3 Officers 2008 Cost	5 Officers 2008 Cost
Police Officer Salaries and Benefits	\$247,788	\$412,980
Operating costs – training, equipment, fuel etc.	\$8,500	\$8,500
Start-up costs – Uniforms/Equipment	\$10,500	\$17,500
Annual contribution to equipment fund	\$6,200	\$6,200
Capital Cost – Patrol Car with Equipment*	\$33,000	\$33,000
Total	\$305,988	\$427,680

*Replacement every 5 years

Fire Expenditures

In 2006 there were only 68 fire calls and 77 EMS calls in the annexation area. In terms of mutual and automatic aid, the District responded to 149 EMS and 15 fire calls in the City in 2007 (A majority of the EMS calls were from an assisted living complex in South Chehalis.). In contrast, the City provided aid to the District for only 12 EMS and 29 fire calls. The Fire Department estimated in 2005 that another seven firefighters will be needed to staff a second station in the South Industrial Area. The salary and benefits costs shown in Exhibit 5 are based on the first year's beginning 2008 pay for a firefighter. In addition to the benefits, the Department also estimated that a firefighter would also earn \$15,000 in overtime. The forecasted salary costs are based on the current labor agreement's salary steps and account for annual step increases and the estimated increase in base pay according to the current labor agreement. Additional costs that were calculated include the fuel, insurance, and repair and maintenance costs for the new fire truck, facilities costs of about \$30,000 for utilities and maintenance costs based on the current 2008 facilities budget, and training and other general operating supply costs per firefighter. In addition, the Department also estimated that specialized technical rescue training would be needed at a cost of \$5,000 for equipment and \$12,000 for overtime pay to attend the training. The costs also include a new fire truck.

Like the Police Department, another potential issue is the level of service staffing at the station in the South Industrial Area, and in 2008, the Department estimated that additional firefighters might be needed. The use of seven firefighters, as estimated in 2005, presumes that there will be two firefighters always on duty. Currently, the City often has only a minimum of two firefighters on duty at its current station, but many times it also has three or more available given a staff of 13 positions (i.e. 4 captains, 9 firefighters). There may be times when the Department will only have a minimum of four firefighters on duty, two at each station. According to the Department, adding 11 firefighters would provide the Department with a minimum staffing level of five firefighters always on duty rather than a minimum of four. An additional scenario in the financial analysis shows the impact of this higher staffing level. Exhibit 5 shows the total 2008 annual and one time costs for both scenarios.

Exhibit 5
Fire Expenditures

Budget Category	7 Firefighters 2008 Cost	11 Firefighters 2008 Cost
Firefighter Salaries, Benefits, Overtime	\$579,614	\$910,822
Technical Rescue Training (One time cost)	\$17,000	\$26,714
Training, Office & Operating Supplies	\$17,850	\$28,050
Facilities	\$30,000	\$30,000
Engine Operating Costs (Fuel, ins, repairs)	\$10,000	\$10,000
Capital equipment costs – Fire Engine	\$500,000	\$500,000
Total	\$1,154,464	\$1,505,586

One of the key issues concerning the annexation is whether the City will need to construct a new fire station to serve the South Industrial Area. The Department's initial proposed costs included a new 4,000 square foot station at a cost of \$500,000 or \$125 per square foot. Based on discussions with another fire department that is building stations, the City's cost per square foot might be appropriate for a prefabricated structure, but for a custom built station the cost could be as high as \$300 per square foot or \$1.2 million. Because the annexation area includes Lewis County Fire District #6's recently built headquarters fire station, there may be an opportunity to avoid the cost of a new station if the City can negotiate an agreement with the Fire District to use the station in lieu of having the District pay the City for a share of its assets. It should be noted that even though the City annexes property within the District, the property owners in the annexation area are still obligated to pay for any outstanding debt service (RCW 35A.14.500). Since the annexation area's property owners will still be paying a portion of the debt service for District #6's station, using District #6's station might be a viable alternative and would save the annexation area's taxpayers from paying for two stations in the area. If the City built a new fire station and issued Councilmanic bonds to pay for the station, the annual debt service on \$500,000 over 20 years at 5% interest would be \$40,121. The forecast does not include the cost of a new station and assumes that an agreement can be made with the District.

Street Expenditures

The Public Works Department estimates that an additional 12 miles of roadway will be added to the Department's workload. Exhibit 6 shows the Department's cost estimate for staffing, operating supplies, start-up equipment costs, and an annual capital contribution. The salaries used are near the top step of the maintenance staff salary range. It is assumed that the City will use cash to pay for the equipment rather than use debt.

Exhibit 6 Street Expenditures

Budget Category	2008 Cost
Two (2) Street Maintenance staff	\$131,200
Street operating costs - painting, signage, asphalt, gravel, fuel etc.	\$76,500
Capital equipment costs – Power Sweeper, Pick-up Truck	\$95,000
Annual capital contribution to capital funds	\$20,000
Total	\$322,700

One major street cost is the cost of any new street improvements that have been made by Lewis County and payment to the County for the lost County Road Fund taxes. An inter-local agreement provides that the City reimburse the County for capital investments that were made within the annexation area using local funds. The basis for cost recovery is the County's portion of the cost based on a straight line depreciation calculation based on the useful life of the improvement. Based on a request to the Lewis County Public Works Department, only two projects were identified, the Rush Road Extension and a realignment of Bishop and Sturdivant. Since these projects are not completed, no specific County costs are available. According to the County, local funding so far for the Rush Road Extension is about \$325,927, excluding any reimbursements from the Port of Chehalis or the City of Chehalis. For the realignment of Bishop and Sturdivant, the County estimates that the local funding for the project will be about \$74,000. Because the projects are not completed, the actual local costs are not available. As a result, no City reimbursement costs are included in the forecast. If the City owed the County for the entire local share on these two projects, the City would then owe the County about \$400,000.

The inter-local agreement also provides that the City and County agree to negotiate appropriate revenue sharing for lost County Road Fund revenues. The revenue sharing will last until a regional transportation improvement plan is adopted by the City and the County. For the forecast we have assumed that the City would pay the County for the full loss of revenues for only five years and that there would be an agreement about a regional transportation plan after five years. The estimated 2008 County Road tax revenue for the annexation area is \$867,271. This amount increases at 1% per year.

Utility Expenditures

Since the City already provides water and wastewater service to the South Industrial Area, it is anticipated that the City will not have any increased costs if the area is annexed. If new development occurs with City service, the City will then receive additional revenues through its rate revenues to help offset any additional costs caused by additional development. In addition, water and wastewater rates can be adjusted to reflect increased costs.

For stormwater, however, the City will be providing a new service to the area. The Public Works Department estimates that the additional operating costs will include the following as shown in Exhibit 7. In addition, it is assumed that the stormwater utility will also pay the 6% utility tax to the General Fund.

Exhibit 7
Stormwater Expenditures

Budget Category	2008 Cost
One (1) Storm/surface water staff	\$65,600
Miscellaneous supplies, culverts, pipe, etc	\$28,500
Total	\$94,100

III. FINANCIAL ANALYSIS

Based on the previous assumptions and methodologies discussed in Chapter II, the General Fund and the utility revenues and expenditures were analyzed and forecasted for the ten year period from 2010 to 2019. To help understand the impacts of different forecasted costs, two scenarios were developed for the General Fund based on potential changes in the staffing needs for police and fire services. The first General Fund scenario, Scenario A, is based on the City's initial 2005 staffing estimates of adding three police officers and seven firefighters. Scenario B is based on the revised staffing estimates of adding five police officers and eleven firefighters.

One of the key factors in the forecasts is the amount paid to the County for its loss of revenue from the County Road Fund taxes. If the City pays the County an amount equivalent to the 2008 County Road Fund revenues adjusted for an increase of 1% per year, the City will have significant losses in the first five years after the annexation. Because the County Road Fund property tax has a higher levy rate than the City's General Fund property tax levy, the City will be paying more money to the County than it is receiving from the annexation area's property taxes. Thus, all the other taxes must support the full cost of providing services to the annexation area as well as help pay the County.

In addition to the County Road Fund tax revenues, the City will need to make a substantial capital investment in equipment for Fire and Public Works. A new police car, a fire truck, and assorted heavy trucks and equipment will mean the City needs to invest about \$666,245 in 2010. The forecast assumes that the City will pay for these in cash and will not use debt to finance these purchases. If debt is used, the annual debt service on a 20 year bond at 5% interest is about \$53,500.

Scenario A provides a minimum number of police and fire staff, but keeps the annexation area costs low. Service levels for existing City residents, however, might decrease as previously mentioned in the Police and Fire Department assumptions and discussion. With Scenario B, the City adds sufficient staff to maintain existing City service levels, but the annexation area costs are much higher. The forecasts show the following:

- ◆ The overall General Fund is at a deficit each year for the first five years, but then turns positive in Scenario A after the City eliminates the County Road Fund payments. Scenario A's total deficit for the first five years is almost \$3.7 million.
- ◆ Scenario B has greater costs and as a result, has a much larger deficit in the first five years at almost \$6.7 million. Scenario B also continues to have operating deficits each year, even after the City stops making the County Road Fund payment.

Exhibits 8 and 9 show the ten year forecasts for Scenario A and Scenario B.

Exhibit 8
Scenario A with the Original Proposed Police Officer and Firefighter Staffing*

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenues										
Property Tax	\$ 854,270	\$ 866,904	\$ 879,726	\$ 892,737	\$ 905,940	\$ 919,339	\$ 932,935	\$ 946,732	\$ 960,734	\$ 974,942
EMS Levy	\$ 160,121	\$ 162,523	\$ 164,960	\$ 167,434	\$ 169,944	\$ 172,491	\$ 175,076	\$ 177,699	\$ 180,360	\$ 183,061
Sales Tax	\$ 208,643	\$ 214,902	\$ 221,349	\$ 227,990	\$ 234,829	\$ 241,874	\$ 249,130	\$ 256,604	\$ 264,302	\$ 272,232
Electricity Tax	\$ 129,178	\$ 133,053	\$ 137,045	\$ 141,156	\$ 145,391	\$ 149,753	\$ 154,245	\$ 158,872	\$ 163,639	\$ 168,548
Natural Gas Tax	\$ 188,766	\$ 194,429	\$ 200,262	\$ 206,270	\$ 212,458	\$ 218,831	\$ 225,396	\$ 232,158	\$ 239,123	\$ 246,297
Telephone Tax	\$ 18,017	\$ 18,558	\$ 19,115	\$ 19,688	\$ 20,279	\$ 20,887	\$ 21,514	\$ 22,159	\$ 22,824	\$ 23,508
Public Utility Tax	\$ (1,707)	\$ (1,758)	\$ (1,811)	\$ (1,865)	\$ (1,921)	\$ (1,979)	\$ (2,038)	\$ (2,099)	\$ (2,162)	\$ (2,227)
Other GF Revenues	\$ 5,612	\$ 4,370	\$ 4,471	\$ 4,575	\$ 4,682	\$ 4,793	\$ 4,906	\$ 5,023	\$ 5,144	\$ 5,268
Total Revenues	\$ 1,562,900	\$ 1,592,981	\$ 1,625,117	\$ 1,657,984	\$ 1,691,602	\$ 1,725,989	\$ 1,761,164	\$ 1,797,149	\$ 1,833,963	\$ 1,871,628
Operating Expenditures										
Police	\$ 289,613	\$ 286,828	\$ 295,433	\$ 304,296	\$ 313,424	\$ 322,827	\$ 332,512	\$ 342,487	\$ 352,762	\$ 363,345
Fire	\$ 702,787	\$ 727,412	\$ 767,761	\$ 810,788	\$ 845,591	\$ 870,959	\$ 897,088	\$ 924,000	\$ 951,720	\$ 980,272
Streets	\$ 220,349	\$ 226,959	\$ 233,768	\$ 240,781	\$ 248,005	\$ 255,445	\$ 263,108	\$ 271,001	\$ 279,131	\$ 287,505
Total Operating Expenditures	\$ 1,212,749	\$ 1,241,199	\$ 1,296,962	\$ 1,355,865	\$ 1,407,020	\$ 1,449,231	\$ 1,492,708	\$ 1,537,489	\$ 1,583,614	\$ 1,631,122
Capital Expenditures	\$ 666,245	\$ -	\$ -	\$ -	\$ -	\$ 40,586	\$ -	\$ -	\$ -	\$ -
Debt Service General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
County Road Fund Payments	\$ 867,271	\$ 867,271	\$ 867,271	\$ 867,271	\$ 867,271	\$ -	\$ -	\$ -	\$ -	\$ -
County Road Improvement Payments										
Total Expenditures	\$ 2,746,265	\$ 2,108,469	\$ 2,164,233	\$ 2,223,135	\$ 2,274,291	\$ 1,489,817	\$ 1,492,708	\$ 1,537,489	\$ 1,583,614	\$ 1,631,122
Net Contribution to Fund Balance	\$ (1,183,365)	\$ (515,488)	\$ (539,116)	\$ (565,151)	\$ (582,689)	\$ 236,172	\$ 268,457	\$ 259,660	\$ 250,350	\$ 240,506

*Excludes Fire District payments, which might be negotiated

Exhibit 9
Scenario B with Additional Police Officer and Firefighter Staffing*

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenues										
Property Tax	\$ 854,270	\$ 866,904	\$ 879,726	\$ 892,737	\$ 905,940	\$ 919,339	\$ 932,935	\$ 946,732	\$ 960,734	\$ 974,942
EMS Levy	\$ 160,121	\$ 162,523	\$ 164,960	\$ 167,434	\$ 169,944	\$ 172,491	\$ 175,076	\$ 177,699	\$ 180,360	\$ 183,061
Sales Tax	\$ 208,643	\$ 214,902	\$ 221,349	\$ 227,990	\$ 234,829	\$ 241,874	\$ 249,130	\$ 256,604	\$ 264,302	\$ 272,232
Electricity Tax	\$ 129,178	\$ 133,053	\$ 137,045	\$ 141,156	\$ 145,391	\$ 149,753	\$ 154,245	\$ 158,872	\$ 163,639	\$ 168,548
Natural Gas Tax	\$ 188,766	\$ 194,429	\$ 200,262	\$ 206,270	\$ 212,458	\$ 218,831	\$ 225,396	\$ 232,158	\$ 239,123	\$ 246,297
Telephone Tax	\$ 18,017	\$ 18,558	\$ 19,115	\$ 19,688	\$ 20,279	\$ 20,887	\$ 21,514	\$ 22,159	\$ 22,824	\$ 23,508
Public Utility Tax	\$ (1,707)	\$ (1,758)	\$ (1,811)	\$ (1,865)	\$ (1,921)	\$ (1,979)	\$ (2,038)	\$ (2,099)	\$ (2,162)	\$ (2,227)
Other GF Revenues	\$ 5,612	\$ 4,370	\$ 4,471	\$ 4,575	\$ 4,682	\$ 4,793	\$ 4,906	\$ 5,023	\$ 5,144	\$ 5,268
Total Revenues	\$ 1,562,900	\$ 1,592,981	\$ 1,625,117	\$ 1,657,984	\$ 1,691,602	\$ 1,725,989	\$ 1,761,164	\$ 1,797,149	\$ 1,833,963	\$ 1,871,628
Operating Expenditures										
Police	\$ 472,291	\$ 467,337	\$ 481,358	\$ 495,798	\$ 510,672	\$ 525,992	\$ 541,772	\$ 558,025	\$ 574,766	\$ 592,009
Fire	\$ 1,080,130	\$ 1,118,099	\$ 1,180,756	\$ 1,247,598	\$ 1,301,494	\$ 1,340,538	\$ 1,380,755	\$ 1,422,177	\$ 1,464,842	\$ 1,508,788
Streets	\$ 220,349	\$ 226,959	\$ 233,768	\$ 240,781	\$ 248,005	\$ 255,445	\$ 263,108	\$ 271,001	\$ 279,131	\$ 287,505
Total Operating Expenditures	\$ 1,772,771	\$ 1,812,396	\$ 1,895,882	\$ 1,984,178	\$ 2,060,171	\$ 2,121,976	\$ 2,185,635	\$ 2,251,204	\$ 2,318,740	\$ 2,388,302
Capital Expenditures	\$ 666,245	\$ -	\$ -	\$ -	\$ -	\$ 40,586	\$ -	\$ -	\$ -	\$ -
Debt Service General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
County Road Fund Payments	\$ 867,271	\$ 867,271	\$ 867,271	\$ 867,271	\$ 867,271	\$ -	\$ -	\$ -	\$ -	\$ -
County Road Improvement Payments										
Total Expenditures	\$ 3,306,286	\$ 2,679,666	\$ 2,763,152	\$ 2,851,448	\$ 2,927,441	\$ 2,162,561	\$ 2,185,635	\$ 2,251,204	\$ 2,318,740	\$ 2,388,302
Net Contribution to Fund Balance	\$ (1,743,387)	\$ (1,086,685)	\$ (1,138,036)	\$ (1,193,464)	\$ (1,235,839)	\$ (436,573)	\$ (424,470)	\$ (454,055)	\$ (484,777)	\$ (516,674)

*Excludes Fire District payments which might be negotiated

The two scenarios provide City officials with a framework to discuss options that affect the quality and level of services that might be provided to current City residents and businesses and to the South Industrial Area. The key policy issue concerns how services provided to the South Industrial Area will affect the services provided to and the financial burden on the City's current residents and businesses. From an overall standpoint, the forecasts show that if the City annexes the South Industrial Area, the City faces some major financial challenges and considerations about the level of services that the City can provide to both its current residents and businesses, as well as to the new residents and businesses in the annexation area.

Utility Fund Forecasts

As previously mentioned, the City already provides water and wastewater service in the annexation area and charges rates that are 10% higher than the in-city rates. With the annexation, the customers within the annexation area will pay the City's resident rate. As a result, the City will actually lose about \$21,000 per year for the water and wastewater funds. Exhibits 10 and 11 show the losses for these funds based on average rate increases equal to inflation. According to the 2008 budget, both funds have sufficient fund balances to absorb the loss of revenue until rates are updated.

Exhibit 10 Water Fund Forecast

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Water										
Revenue										
Water Charges	\$ (20,768)	\$ (21,391)	\$ (22,033)	\$ (22,694)	\$ (23,375)	\$ (24,076)	\$ (24,798)	\$ (25,542)	\$ (26,309)	\$ (27,098)
Total Revenue	\$ (20,768)	\$ (21,391)	\$ (22,033)	\$ (22,694)	\$ (23,375)	\$ (24,076)	\$ (24,798)	\$ (25,542)	\$ (26,309)	\$ (27,098)
Expenses										
Water Distribution	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Water Treatment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
City Utility Tax	\$ (1,246)	\$ (1,283)	\$ (1,322)	\$ (1,362)	\$ (1,402)	\$ (1,445)	\$ (1,488)	\$ (1,533)	\$ (1,579)	\$ (1,626)
Total Expenses	\$ (1,246)	\$ (1,283)	\$ (1,322)	\$ (1,362)	\$ (1,402)	\$ (1,445)	\$ (1,488)	\$ (1,533)	\$ (1,579)	\$ (1,626)
Net Income	\$ (19,522)	\$ (20,108)	\$ (20,711)	\$ (21,332)	\$ (21,972)	\$ (22,632)	\$ (23,311)	\$ (24,010)	\$ (24,730)	\$ (25,472)

Exhibit 11 Wastewater Fund Forecast

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Wastewater										
Revenue										
Sewer Charges	\$ (21,861)	\$ (22,517)	\$ (23,192)	\$ (23,888)	\$ (24,605)	\$ (25,343)	\$ (26,103)	\$ (26,886)	\$ (27,693)	\$ (28,524)
Total Revenue	\$ (21,861)	\$ (22,517)	\$ (23,192)	\$ (23,888)	\$ (24,605)	\$ (25,343)	\$ (26,103)	\$ (26,886)	\$ (27,693)	\$ (28,524)
Expenses										
City Utility Tax	\$ (1,312)	\$ (1,351)	\$ (1,392)	\$ (1,433)	\$ (1,476)	\$ (1,521)	\$ (1,566)	\$ (1,613)	\$ (1,662)	\$ (1,711)
Total Expenses	\$ (1,312)	\$ (1,351)	\$ (1,392)	\$ (1,433)	\$ (1,476)	\$ (1,521)	\$ (1,566)	\$ (1,613)	\$ (1,662)	\$ (1,711)
Net Income	\$ (20,549)	\$ (21,166)	\$ (21,801)	\$ (22,455)	\$ (23,128)	\$ (23,822)	\$ (24,537)	\$ (25,273)	\$ (26,031)	\$ (26,812)

The City will also be providing stormwater services to the annexation area, and based on the revenues and expenditures estimated by the Public Works Department, the City will not recover its costs for providing these services. A recent rate study showed that the City had a beginning fund

balance for its operating fund of only \$150,000. Without either reducing costs or implementing a rate increase, the potential losses would consume such a fund balance within two to three years after the annexation occurs. To avoid having existing City residents pay higher rates, the City might want to determine if a separate rate is appropriate for the annexation area given the costs and the potential operations and maintenance needs in the area. Exhibit 12 shows the results of the forecast.

Exhibit 12
Storm and Surface Water Fund Forecast

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Storm Water Revenue										
Storm Water Charges	\$ 14,180	\$ 14,605	\$ 15,044	\$ 15,495	\$ 15,960	\$ 16,439	\$ 16,932	\$ 17,440	\$ 17,963	\$ 18,502
Total Revenue	\$ 14,180	\$ 14,605	\$ 15,044	\$ 15,495	\$ 15,960	\$ 16,439	\$ 16,932	\$ 17,440	\$ 17,963	\$ 18,502
Expenses										
Storm Water	\$ 99,831	\$ 102,826	\$ 105,910	\$ 109,088	\$ 112,360	\$ 115,731	\$ 119,203	\$ 122,779	\$ 126,463	\$ 130,256
City Utility Tax	\$ 851	\$ 876	\$ 903	\$ 930	\$ 958	\$ 986	\$ 1,016	\$ 1,046	\$ 1,078	\$ 1,110
Total Expenses	\$ 100,681	\$ 103,702	\$ 106,813	\$ 110,017	\$ 113,318	\$ 116,717	\$ 120,219	\$ 123,826	\$ 127,540	\$ 131,367
Net Income	\$ (86,501)	\$ (89,097)	\$ (91,769)	\$ (94,523)	\$ (97,358)	\$ (100,279)	\$ (103,287)	\$ (106,386)	\$ (109,577)	\$ (112,865)

For the City's utilities, the South Industrial Area annexation will also create some financial challenges, and utility rates might have to be raised to offset revenue losses and the costs of providing services to the annexation area.

IV. POTENTIAL REVENUE IMPACTS ON OTHER JURISDICTIONS

If the South Industrial Area is annexed by the City, there will be several impacts on the existing jurisdictions that generate revenue from and provide services to the area. There are three major service providers: Lewis County and Lewis County Fire Districts #5 and #6. All three jurisdictions will lose property tax revenues, and the County will also lose some sales tax revenues. Exhibit 13 shows the potential changes in revenue.

Exhibit 13
Revenue Impacts on Other Jurisdictions

Jurisdiction	Equivalent 2008 Revenue Loss
Lewis County Road Fund	\$867,271 – Property Taxes
Lewis County General Fund	\$196,666 – Sales Taxes
Lewis County Fire District #5	\$15,029 – Property Taxes
Lewis County Fire District #6	\$477,101– Property Taxes

As previously discussed, the forecasts assume that the City will pay Lewis County for the County Road Fund losses for a five year period. The five year period provides sufficient time for the County to begin planning and decreasing its future Road Fund expenditures. Another payment alternative for the City is to pay a decreasing share of the Road Fund losses over the five year period, such as reducing the payment amount by 20% per year. Such negotiations should take place before the annexation is approved so the City can plan for the expenditures.

For Lewis County Fire District #6, the impact will be substantial since the District will lose about 41% of its assessed value. In 2008, the District received about \$1.2 million for property taxes, and the potential property tax loss is equal to about 40% of the property tax revenues. However, the property tax loss represents only 33% of the \$1.4 million 2008 budgeted expenditures (About \$455,200 is for capital outlay). As discussed in Chapter II, it should also be noted that if the District has any debt service obligations, the property owners within the annexation area will still be obligated to pay their percentage share of the debt service (i.e. about 41%) even though the area is annexed into the City. Thus, property owners might still pay some District taxes even though the City provides the services. As a result, the revenue loss amount shown in Exhibit 13 might be lower, depending on how much debt service the District has. As also discussed in Chapter II, the District might owe the City about \$2.5 million as part of the annexation for the City's share of the District's assets. How such a payment or equivalent value is transferred to the City is not known at this time, and to obtain agreement on this issue, the City might need to negotiate with the District.