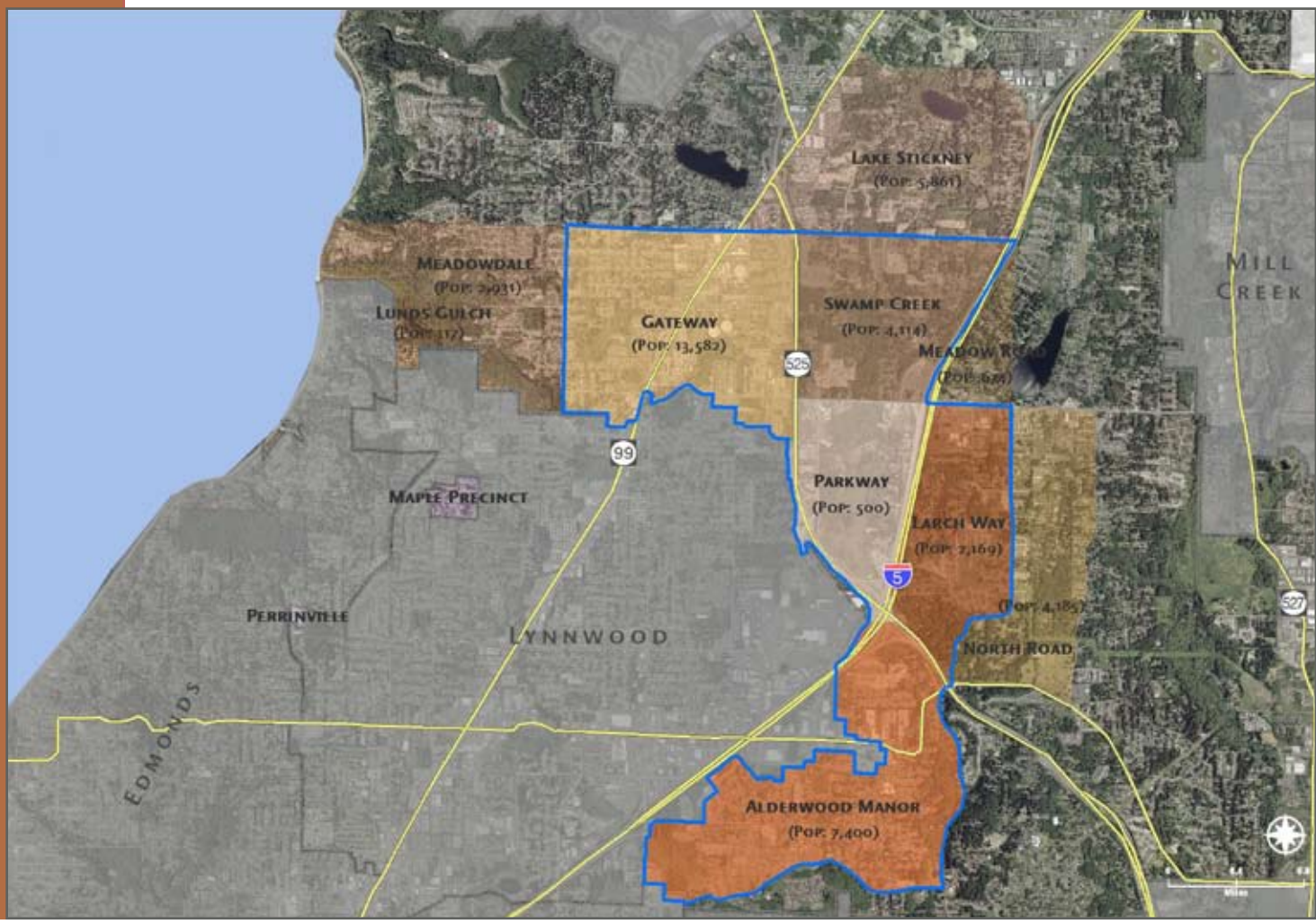
CITY OF Lynnwood

Fiscal Annexation Analysis

FINAL REPORT: January 14, 2009



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CITY OF LYNNWOOD
FISCAL ANNEXATION ANALYSIS

BACKGROUND

This report documents the results of an annexation study conducted by Berk & Associates on behalf of the City of Lynnwood to assess the fiscal, governance and strategic implications of potential large-scale annexations. The annexation analysis was conducted by looking at how each potential annexation might fit within the broader context of the City's long-term fiscal situation. The goal of the analysis is to provide decision-makers at the City and key stakeholders including current Lynnwood residents, residents of the annexation area and other affected jurisdictions, with a more complete understanding of the fiscal implications of annexation, both in terms of the costs the City would bear immediately upon annexation, during the transition period, and in the longer term.

The study included an assessment of nine geographical subareas, most of which are included in the City's Municipal Urban Growth Area (MUGA). These subareas include:

- Gateway
- Swamp Creek
- Parkway
- Larch Way
- Alderwood Manor
- Lake Stickney
- Meadowdale
- Lund's Gulch
- North Road

These nine contemplated annexation subareas were combined into eight annexation "scenarios," based on the following criteria: (1) the areas under consideration must have logical geographical boundaries and be contiguous; and (2) the scenarios must have at least 10,000 population, to ensure receipt of the State sales tax credit. Eight scenarios were studied; however, three scenarios were chosen to be analyzed in more detail:

- **Scenario 1**: Core MUGA West of SR 525 – Gateway; also known as *Lynnwood North annexation area*
- **Scenario 2**: Core MUGA East of SR 525 - Swamp Creek, Parkway, Larch Way, and Alderwood Manor; also known as *Lynnwood East annexation area*
- **Scenario 3**: Core MUGA - Gateway, Swamp Creek, Parkway, Larch Way, and Alderwood Manor (combination of Scenarios 1 and 2)

At the time of writing this report, the City is proceeding with a process for submitting an intent to annex for two concurrent annexations: Scenarios 1 and 2 (Lynnwood North and Lynnwood East annexation areas). To maintain consistency with the City' "recognized" MUGA, the Meadowdale and North Road subareas were deferred to a second phase of annexations. During preparation of this analysis, the Lake Stickney was dropped from further consideration.

STUDY APPROACH

An annexation fiscal model was developed to estimate revenues and expenses for both the existing City and a post-annexation City under different development and policy assumptions. The analysis assumes annexation in 2010 and examines costs and revenues through 2027. Taking the analysis out over time allows the City to see how the fiscal balance in the City might change over time and how annexation might affect the long-term fiscal outlook.

In the model, factors in the land base (such as population, employment, and commercial activity) drive both demand for services and the tax base to support services. Depending on a jurisdiction's scope of services and choices regarding level of service, demand for services leads to costs, and depending on a jurisdiction's choices regarding fiscal and taxing policy (limited by tax laws), its tax base will lead to tax and fee revenues.

It is important to note that this is a financial planning tool and is not a budget development exercise. The analysis is intended to provide a reasonable estimate of potential costs and revenues associated with annexation and to allow for the assessment of the alternative scenarios to test the implications of development assumptions, policy choices and alternative service delivery options. If the City proceeds with an annexation, this analysis provides a basis from which the City can begin the process of meeting the higher service demands of the larger city. However, the actual implementation will be accomplished through the regular biennial budget process where the Mayor and Council will revisit the staffing and service delivery options in light of updated information and the overall budget needs of the City at that time.

Another objective of the model is to factor in the sales tax credit funding. Since this funding is designed to assist eligible cities that commence annexation by 2010 by providing support for up to ten years, the model runs through 2027, several years past the last possible year of sales tax credit funding support. The model estimates the maximum sales tax credit and the eligible annexation deficit to determine the amount of potential revenue from this source, as well as providing information on the fiscal impact of annexation once the tax support is no longer available. While the forecasts in this analysis represent Berk & Associates' best understanding of the application of SSB 6686 to a real-world situation, at this time there is substantial uncertainty about the implementation of those provisions.

KEY FINDINGS

Baseline Outlook for City of Lynnwood

Assuming no annexation, the City of Lynnwood is projected to experience revenue shortfalls in the future. This finding is consistent with the basic fiscal challenge in most other cities in Washington and is principally related to the impact of Initiative 747 (and subsequent legislative action to restore the provisions of the Initiative after it was declared unconstitutional by the Supreme Court in November 2007) which limits growth in property taxes; rising costs of doing business; and additional staffing related to in-city growth needed to maintain existing levels-of-service. In addition, some revenues are projected to decline, such as sales taxes (due to the current economic slow-down).

The impacts of annexation can best be understood in terms of whether annexation would be expected to make this baseline imbalance situation better or worse.

Annexation Scenarios

The analysis suggests that impacts of annexation differ between each of the three scenarios. As discussed above, the City of Lynnwood is currently estimated to experience revenue shortfalls under a "no annexation" scenario (see Section 4.0). A useful approach to evaluating the framework used for each scenario is to determine whether or not a particular annexation scenario contributes to this revenue shortfall or helps lessen it. An annexation may still appear feasible even in a scenario where the incremental fiscal impacts are negative. In this case, the proportionate impact to the City's net deficit is more important than whether the annexation is negative.

For example, since the baseline fiscal outlook forecasts a 7%-8% ongoing structural deficit in core revenues, an annexation area that was estimated to experience a net shortfall of 5% in core revenues would appear to make the situation worse. However, the important concept is that while both areas show negative forecasts, the fact that the problem is more manageable in the annexation area (5% versus 8% deficit) then annexation would marginally improve the overall situation, by reducing the City gap somewhat on a percentage basis. Another way to look at this is since the City cannot operate at a deficit in the long-term, any structural fix to the baseline condition (either higher taxes or lower costs) would likely benefit the annexation in a proportional way. In this case, the effect of these policy choices would likely make the net impacts in the annexation area reverse from a deficit to a surplus.

Scenario 1 Findings. Taken on its own, Scenario 1 is projected to be unbalanced over the analysis time horizon. This scenario does not increase the City's revenue base in proportion to the incremental costs and contributes more than 25% of the City's total net deficit. The City would be eligible for the State sales tax credit, which is designed to offset deficits associated with annexation. However, the credit is still not able to offset all of the incremental costs associated with annexation. At the conclusion of the credit period, the City is projected to be worse off than in the baseline outlook.

Scenario 2 Findings. This scenario significantly increases the revenue base for the City and reduces the overall net deficit. The State sales tax credit assists the City in offsetting some of the initial annexation-related deficits that occur in the first ten years after annexation. After the ten year period the annexed area is still balanced and improves the baseline City outlook.

Scenario 3 Findings. This scenario, which combines the annexed areas in Scenarios 1 and 2, also increases the City's revenue base. The positive impact of the areas included in Scenario 2 has helped offset the deficits associated with Scenario 1. Similar to Scenario 2, the State sales tax credit assists the City in offsetting deficits that occur in the first ten years after annexation. After the ten year period the annexed area is still balanced and improves the structural balance in the City's long-term fiscal outlook.

Lynnwood would likely not need the full amount of State sales tax credit available in all years for Scenarios 2 and 3. In these instances, it is best to think of the potential availability of additional State sales tax credit as an added level of insurance to mitigate potential financial risks associated with annexation.

Potential Fire District Service Contract

Upon annexation, the City will provide fire and EMS services to some portions of Fire District 1 from its newly acquired fire stations: in Scenario 1, Meadowdale Gap and Lunds Gulch; in Scenario 2, a north-south area between new Lynnwood boundaries and Mill Creek; and in Scenario 3, the previously mentioned areas plus portions of Lake Stickney. City and Fire District 1 will need to approve a services

contract for these areas. Lynnwood Fire Department suggested that they would likely not require additional staff and equipment to serve these areas.

The contract terms and payment amount will be determined through negotiation between Lynnwood and FD1; however, based on the analysis of Fire District 1 assessed value, expense and EMS levy rates, and potential revenues, the City of Lynnwood may potentially be able to receive between $500,000 and $600,000 in Scenario 1, $2.4 million and $2.6 million in Scenario 2, and $3.5 million to $3.9 million in Scenario 3. Due to the fact that the terms of any future contract will need to be negotiated with Fire District 1, these potential revenues were excluded from the base evaluation of annexation feasibility.

At the time of writing, discussions regarding alternative options with the Fire District are on-going.

TRANSITION PERIOD ANALYSIS

The timing of the effective date of annexation has a large effect on revenues in the first few years of annexation. However, the existence of the State sales tax credit means that there is more flexibility in selecting an annexation date. The decision to pre-hire positions or to further delay other non-essential positions is also a major timing factor to consider. Staggering or delaying the hiring process will also aid current City staff in the transition and integration of new staff.

Based on the various revenue lags, there are four dates that would maximize the City's cash flow:

- **March 1, 2010.** The advantage of annexing in March would be that the City would be eligible to collect State sales tax credit revenues beginning in July 2010. The City would also take advantage of the large property tax revenue months of May, June, November, and December. However, due to sales tax revenue lags, the City would not receive sales tax revenues until July and would not receive any sales tax revenues for the month of March.
- **April 1, 2010.** Similar to March, an effective annexation date of April 1, 2010 the City would be eligible to receive State sales tax credit revenues beginning in July 2010. The City would also take advantage of the large property tax revenue months of May, June, November, and December. An annexation date of April 1 also minimizes the sales tax revenue lags. The City would receive its first sales tax revenues in July 2010.
- **October 1, 2010.** In this scenario, the City would not receive State sales tax credit revenue until July 2011. The advantage of annexing in October is that the City would receive levied but uncollected county road and fire property taxes for both 2010 and 2011. The City would take advantage of the large property tax collection months of November and December. However, the portion of the levied but uncollected county road tax revenues would have to flow into the City's Street Fund. The uses of these funds would be limited to transportation-related expenses. An annexation date of October 1 also minimizes the sales tax revenue lags. The City would receive its first sales tax revenues in January 2011.
- **November 1, 2010.** Similar to October, the City would not receive State sales tax credit revenue until July 2011. Also, the City would receive levied but uncollected county road and fire taxes for both 2010 and 2011. The portion of the levied but uncollected county road tax revenues would have to flow into the City's Street Fund and would be limited to transportation-related expenses. Due to sales tax revenue lags, the City would receive its first sales tax revenues in April 2011 and would not receive any sales tax revenues for November or December.

CAPITAL FACILITIES ANALYSIS

Major Capital Costs and Needs

In general, upon annexation, as capital needs are better understood, there are likely to be more needs than there are resources coming from the annexation area. This situation is comparable to the base City situation, which has unfunded portions of its current capital needs, thus the long-term funding situation is unlikely to be dramatically different than the status quo. In the absence of a full capital assessment, available data on capital needs is limited to projects identified as part of Snohomish County's Transportation Improvement Program (TIP), Transportation Needs Report (TNR), Comprehensive Plan, and Drainage Needs Report. This analysis reviewed these documents and presents summary information.

There are approximately $15.7 million identified roads projects for Scenario 1, $150.5 million for Scenario 2 and $166.2 for Scenario 3. One large project of note in Scenarios 2 and 3 is the improvement of SR 524 from I-5 to 204th Street SE (JP-8) – at $105.4 million. The project was initially going to be funded through a regional transportation improvement district as part of Proposition 1 in 2007, with the County partially matching the funding. The proposition failed and the Washington Department of Transportation (WSDOT) currently has no plans to do the project in the near future. Overall, a funding disparity exists between identified project needs and projects slated for construction in the six-year TIP for each scenario. It is not clear how much responsibility the City would have for improving the road if the project was slated for construction sometime in the future.

Currently, each scenario has considerable stormwater facility needs and minimal dedicated funding. Scenario 1 has an estimated cost of a little over $2.0 million with $478,000 in known funding. Scenario 2 has an estimated cost of over $8.1 million with $481,000 in funding, and Scenario 3 has an estimated cost of over $10.2 million with only $959,000 in known funding.

The City's comprehensive plan includes an inventory of the existing parks and facilities and existing park needs, if any, based on the City's level-of-service (LOS) standards. Overall, upon annexing any of the scenarios, the City would lack enough total park acreage, Core Park acreage, Special Use acreage, and trail miles to meets its LOS standards. The City would also need to increase the amount of open space in every scenario, with the exception of Scenario 2. Scenario 2 also had the least need with only 34.9 total additional acres needed.

Capital Revenues

Our analysis provides estimates of the revenues from the Real Estate Excise Tax and the capital portion of the Gas Tax, which are held aside as available funding for capital infrastructure needs in the contemplated annexation areas. For annexation areas only, Scenario 1 amounts to an estimated $11.2 million over the next 20 years in present value terms, Scenario 2 to $21.3 million, and Scenario 3 results in an estimated $32.4 million.

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1.0 INTRODUCTION

1.1 Study Purpose

This report documents the results of an annexation study conducted by Berk & Associates on behalf of the City of Lynnwood to assess the fiscal, governance, and strategic implications of potential large-scale annexations. The annexation analysis was conducted by looking at how each potential annexation might fit within the broader context of the City's long-term fiscal situation. The goal of the analysis is to provide decision-makers at the City and key stakeholders, including current Lynnwood residents, residents of the annexation area, and other affected jurisdictions, with a more complete understanding of the fiscal implications of annexation, both in terms of the costs the City would bear immediately upon annexation, during the transition period, and in the longer term.

The study includes an assessment of nine geographical subareas, some of which are included in the City's Municipal Urban Growth Area (MUGA). These subareas include:

- Gateway
- Swamp Creek
- Parkway
- Larch Way
- Alderwood Manor
- Lake Stickney
- Meadowdale
- Lund's Gulch
- North Road

This analysis combines these subareas into scenarios that meet the eligibility criteria for annexation sales tax credit (population over 10,000 and 20,000). The analysis explores different annexation scenarios, including full annexation of the City's MUGA and annexation options that are based on logical combinations of the subareas.

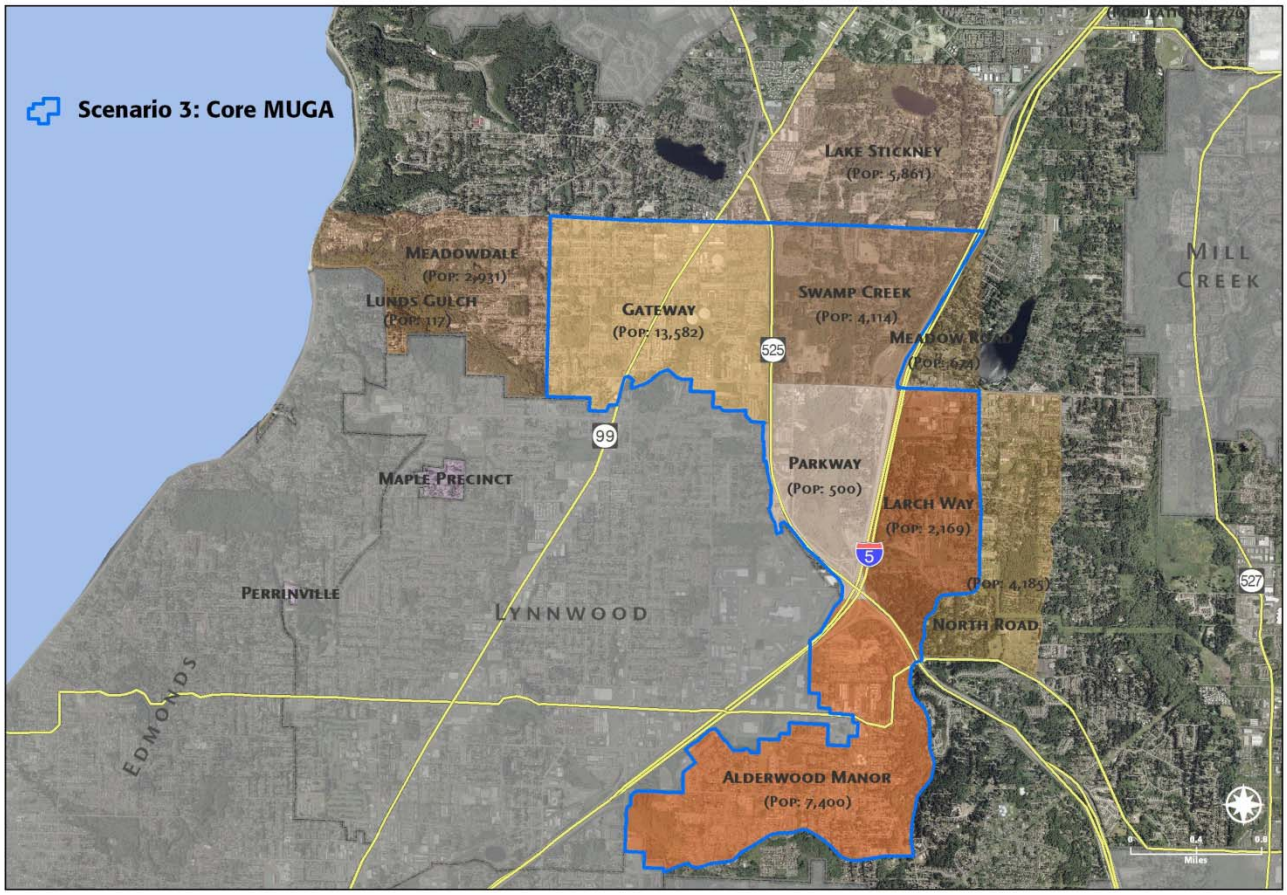
This report summarizes Berk & Associates' analysis of potential fiscal impacts of annexation. This assessment addresses the following key issues:

1. **Scenario Combinations:** What annexation area or combination of subareas would make most fiscal sense to pursue in the near-term?
2. **Near-Term Operating Impacts:** What new operating costs and revenues would Lynnwood likely face if it were to annex the study areas and provide levels of service consistent with current services in existing City neighborhoods?
3. **Long-Term Fiscal Outlook:** How would the City's fiscal future look with and without annexation?
4. **State Sales Tax Credit Potential:** What role might the state sales tax credit play in the decision about annexation and the long-term fiscal implications?

5. **Transition Period:** What are the near-term timing and cash flow considerations during the transition period (immediately prior to, and two to three years after annexation)?
6. **Capital Infrastructure Assessment:** What are the major existing infrastructure deficiencies in the annexation area and what is the availability of capital funding?

The map in **Exhibit 1** shows the annexation subareas included in the study, which lie to the north and east of the current City boundaries.

Exhibit 1
Lynnwood Annexation Subareas



Source: City of Lynnwood, 2008; Berk & Associates, 2008

1.2 Planning-Level Study

This study is a planning-level study with financial projections 20 years into the future. The analysis has been constructed to assist the City with decisions regarding potential annexations and as such the key financial elements focus on the revenue and cost areas where annexation is likely to have the greatest impact. The financial projections presented in this report should not be confused with a budget, as there are several financial elements excluded from this analysis which would be integrated into a budget forecast. The most significant of these are the various fund balances, which are very important from a budget perspective, but which are largely irrelevant to an annexation decision.

1.3 Overview of State Sales Tax Credit

Because of the fiscal challenges posed by most large annexations, in March 2006, the Washington State Legislature passed Substitute Senate Bill (SSB) 6686 (now codified as *RCW 82.14.415*), which added a new funding mechanism to provide transitional funding to annexing cities. The Legislature passed a bill authorizing a *local sales tax* to assist the cities with negative cost impacts resulting from the provision of municipal services to areas with a population of at least 10,000. The revenue is a credit against the State share of the sales tax; hence "state sales tax credit".

The funding assists eligible cities by providing support for up to ten years, and gives communities time to integrate the new areas and implement policies designed to address the long-term fiscal impacts of annexations. In addition to the revenues from existing City taxes and fees, the analysis considers the implications of alternative annexation scenarios in terms of eligibility for the State sales tax credit. It is important to explore different annexation scenarios, including full annexation of all areas and partial annexation options, based on logical combinations of the study areas.

Key stipulations:

- **Population.** To be eligible for the State sales tax credit, the city must have a population of less than 400,000 and be located in a county with a population of more than 600,000. The annexed areas must have a population of at least 10,000.
- **Net Deficit.** All revenue from the tax must be used to provide, maintain, and operate municipal services for the annexation area. The sales tax credit revenues may not exceed the difference between that which the City deems necessary to provide services for the annexation area and the general revenue received from the annexation. If the revenues do exceed that which is needed to provide the services, the tax must be suspended for the remainder of the fiscal year.
- **Ten Year Limit.** To be eligible, an annexation must have commenced prior to January 1, 2010. The tax credit is available for no more than ten years.
- **The Maximum Tax Rate.**
  - 0.1 percent for each annexation area (up to two) with a population over 10,000 and
  - 0.2 percent for an annexation area over 20,000
- **Threshold Amount.** Threshold amount is the estimated annual net deficit associated with the annexation area. This is the maximum amount of sales tax credit revenues that the City is eligible to receive each fiscal year. The City would provide this annual threshold amount to the Department of Revenue by March 1 each year. Actual revenues will be determined as the lower of the threshold amount or the available sales tax credit revenues at either the 0.1 percent or 0.2 percent rate.

1.4 Annexation Scenarios

It is generally not practical or reasonable to evaluate each of the potential annexation subareas in isolation; there is a logical order of annexing the closest subareas first and then the outlying ones. Moreover, there could be economies of scale benefits from annexing several subareas at once. For these reasons, the nine contemplated annexation subareas were combined into eight annexation "scenarios," based on the following criteria: (1) the subareas under consideration must have logical

geographical boundaries and be contiguous; and (2) the scenarios must have at least 10,000 population, to ensure receipt of the State sales tax credit.

These eight annexation scenarios were reviewed and divided into two phases:

Phase 1: Lynnwood's Core MUGA

- SCENARIO 1: Core[1] MUGA West of SR 525 - Gateway
- SCENARIO 2: Core MUGA East of SR 525 - Swamp Creek, Parkway, Larch Way, and Alderwood Manor
- SCENARIO 3: Core MUGA - Gateway, Swamp Creek, Parkway, Larch Way, and Alderwood Manor (Scenarios 1 and 2 combined)

Phase 2: Areas Outside the City's Core MUGA

- SCENARIO 4: Core MUGA, plus Meadowdale and Lunds Gulch
- SCENARIO 5: Core MUGA, plus Lake Stickney
- SCENARIO 6: Core MUGA, with Meadow Road
- SCENARIO 7: Core MUGA, plus North Road
- SCENARIO 8: All annexation subareas

Exhibit 2 presents the 2007 estimates of population, housing units, and other key statistics for Lynnwood and each of the potential annexation scenarios.

Exhibit 2
Key Estimated Statistics for Contemplated Annexation Scenarios, 2007

	City of Lynnwood	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5	Scenario 6	Scenario 7	Scenario 8
		Core MUGA West of SR 525 *: Gateway*	***Core MUGA East of SR 525*** *: Swamp Creek, Parkway, Larch Way, Alderwood Manor*	***Core MUGA*** *: Gateway, Swamp Creek, Parkway, Larch Way, Alderwood Manor*	*Core MUGA, plus Meadowdale, Lunds Gulch*	*Core MUGA, plus Lake Stickney*	*Core MUGA, plus Meadow Road*	*Core MUGA, plus North Road*	*All annexation areas*
Land Area (Sq Miles)	7.81	1.5	4.2	5.7	6.7	7.1	5.9	6.5	9.27
Housing Units (2006)	14,629	5,348	4,845	10,193	11,093	12,510	10,393	11,973	15,444
Population (2007)	35,490	13,582	14,182	27,764	30,695	33,625	28,438	31,949	41,532
Taxable AV (2008)	$5,056 M	$1,168 M	$1,905 M	$3,073 M	$3,500 M	$3,918 M	$3,184 M	$3,457 M	$4,838 M
Taxable Retail Sales (2007)	$2,240 M	$64 M	$108 M	$172 M	$174 M	$185 M	$180 M	$182 M	$206 M

Source: City of Lynnwood, 2008; Snohomish County Assessor's Office, 2008; Berk & Associates, 2008

The analysis of annexation scenarios was conducted in a two-step process: (1) an initial screening of all eight annexation scenarios to assess the relative fiscal impacts of each; and (2) a more detailed feasibility assessment of the most promising options.

Upon identifying the eight annexation scenarios, a series of meetings was conducted with City staff to document existing service levels, department positions, and their demand drivers. This piece of analysis provided baseline information to determine how City staffing might be expected to change in

[1] Lynnwood MUGA as recognized by Snohomish County Tomorrow, excluding Lunds Gulch.

response to increased demand associated with annexation. At the same time, operating revenue estimates were generated, including all sources of the City's general government funding.

Based on these initial operating expense and revenue estimates for all scenarios, an initial screening of the scenarios was conducted to establish which scenarios warranted the full detailed analysis of annexation impacts. Berk discussed potential scenarios with City staff and determined specific alternatives that provided the best opportunities for leveraging existing City resources, utilizing economies of scale, and minimizing the potential costs of annexation, while still delivering an urban level of service to these areas. The consensus was that three scenarios should be fully developed:

- Scenario 1: Core MUGA West of SR 525 – Gateway; also known as Lynnwood North annexation area
- Scenario 2: Core MUGA East of SR 525 - Swamp Creek, Parkway, Larch Way, and Alderwood Manor; also known as Lynnwood East annexation area
- Scenario 3: Core MUGA - Gateway, Swamp Creek, Parkway, Larch Way, and Alderwood Manor (combination of Scenarios 1 and 2)

Scenarios 1, 2, and 3 were selected for further analysis and consideration for these primary reasons:

- The subareas that comprise these scenarios (Gateway, Swamp Creek, Parkway, Larch Way, and Alderwood Manor) are within the City's Municipal Urban Growth Area, as recognized by Snohomish County Tomorrow. Recently, the City of Mukilteo submitted an annexation plan to the Boundary Review Board that contained areas outside of their MUGA. The Board denied the annexation and required Mukilteo to resubmit an annexation plan to include only those areas within the City's MUGA. Therefore, it would make sense to Lynnwood to concentrate on first determining feasibility of annexing its core MUGA and then other subareas.
- The sales tax credit is targeted to cities annexing contiguous areas containing 10,000 or 20,000 residents. Therefore, annexing any areas or combination of areas with greater than 20,000 residents may potentially add to the cost of annexation with no additional state sales tax credit benefit. Scenarios 1 and 2 are over 10,000 population, while Scenario 3 (the combination of Scenarios 1 and 2) is over 20,000.
- The Lynnwood City Council directed the study of the Lynnwood Core MUGA – Lynnwood North and Lynnwood East annexation areas.

Upon narrowing down to three "most probable" scenarios, a much more detailed feasibility assessment was undertaken. During this portion of the analysis, additional work was done with most City departments in terms of both operational implications and magnitude of cost impacts.

At the time of writing this report, the City is proceeding with a process for submitting an intent to annex for two concurrent annexations included in Phase 1: Scenarios 1 and 2 (Lynnwood North and Lynnwood East annexation areas). These scenarios are discussed in more detail further in the report, as well as Scenario 3, which is a combination of Scenarios 1 and 2.

1.5 Data Sources

Estimates of current population and housing units are based on information provided by the City of Lynnwood. Estimates of assessed values in the annexation areas are based on Geographic Information System (GIS) analysis of Snohomish County Assessor's data extracts and Snohomish County parcel shapefiles. Current retail sales tax estimates in the annexation subareas are based on

Berk & Associates' analysis of the Washington State Department of Revenue's spatial assessment of taxpayers in the area. In addition to taxable sales generated on-site by businesses, Berk & Associates also estimated sales taxes on the construction activity anticipated in the subareas. Other revenues were estimated using a combination of existing City of Lynnwood experience and actual experience in other comparable jurisdictions.

Costs and staffing information for the current City were provided by the City of Lynnwood and represent actual expenditures in the most recent fiscal years, plus expected 2009 and 2010 expenditure levels as presented during the budget process in the fall of 2008.

1.6 Report Organization

This report presents the results of the annexation study for the City of Lynnwood. It includes the following sections:

- Section 2.0 provides an overview of the study's approach, including review of the land-based development model, role of development assumptions, economies of scale, budget structure, and overarching assumptions
- Section 3.0 describes land-based development assumptions, based on Snohomish County's Buildable Lands analysis
- Sections 4.0 discusses the long-term baseline outlook for the City of Lynnwood without annexation
- Section 5.0 presents detailed analysis of findings for Scenarios 1, 2, and 3, including operating costs and revenues, sales tax credit, potential Fire Service contracts, one-time costs, and facility costs. The analysis presented in this section is for *steady-state operation*, i.e. as though the annexation areas were already fully integrated into the City
- Section 6.0 discusses transitional costs and revenues, and how each annexation scenario would look given different effective dates of annexation. This section presents information to allow for a decision regarding the best timing for annexation in terms of cash flows to the City
- Section 7.0 contains a high-level Capital Facilities Analysis, including potential capital costs and needs for roads, surface water management, and parks. In addition, major capital revenue sources, such as REET and gas tax, are discussed

2.0 APPROACH

2.1 Land-Based Fiscal Model

An annexation fiscal model was developed to estimate revenues and expenses for both the existing City and a post-annexation City under different development and policy assumptions. The analysis assumes annexation in 2010 and examines costs and revenues in the annexation area through 2027. Taking the analysis out over time allows the City to see how the fiscal balance in the City might change over time and how annexation might affect the long-term fiscal outlook. **Exhibit 3** is a schematic representation of the model.

It is important to note that this is a financial planning tool and is not a budget development exercise. The analysis is intended to provide a reasonable estimate of potential costs and revenues associated with annexation, and to allow for the assessment of the alternative scenarios to test the implications of

development assumptions, policy choices, and alternative service delivery options. If the City proceeds with an annexation, this analysis provides a basis from which the City can begin the process of meeting the higher service demands of the larger city. However, the actual implementation will be accomplished through the regular biennial budget process where the Mayor and Council will revisit the staffing and service delivery options in light of updated information and the overall budget needs of the City at that time.

Another objective of the model is to factor in the sales tax credit funding. Since this funding is designed to assist eligible cities that annex by 2010 by providing support for up to ten years, the model runs through 2027, several years past the last possible year of sales tax credit funding support. The model estimates the maximum sales tax credit and the eligible annexation deficit to determine the amount of potential revenue from this source, as well as providing information on the fiscal impact of annexation once the tax support is no longer available.

Development Assumptions

In the model, factors in the land base (such as population, employment, and commercial activity) drive both demand for services and the tax base to support services. Depending on a jurisdiction's scope of services and choices regarding level of service, demand for services leads to costs; and depending on a jurisdiction's choices regarding fiscal and taxing policy (limited by tax laws), its tax base will lead to tax and fee revenues.

The Berk model is flexible and captures anticipated development in the City and annexation areas over time, and how these changes affect the underlying local tax base. In particular, the following elements are explicitly specified: (1) development assumptions including type, scale, and timing of new development; (2) type and mix of tenants, associated employment and business income levels; (3) housing mix (single-family and multi-family) and density; and (4) productivity of new retail activity.

Look at City With and Without Annexation

The model looks not just at the annexation areas alone, but instead analyzes the impacts of annexation by comparing the fiscal outlook for the City of Lynnwood under two alternative futures: (1) the future of the current City with boundaries unchanged and (2) the future of a larger version of the City that includes one of the annexation scenarios. Analysis of these two alternative City futures provides a comprehensive look at the annexation impacts: it is possible that a City-with-annexation scenario could have a structural fiscal deficit, but annexation could actually improve the City's fiscal future by narrowing the potential fiscal deficit for the entire City when compared to the no-annexation scenario.

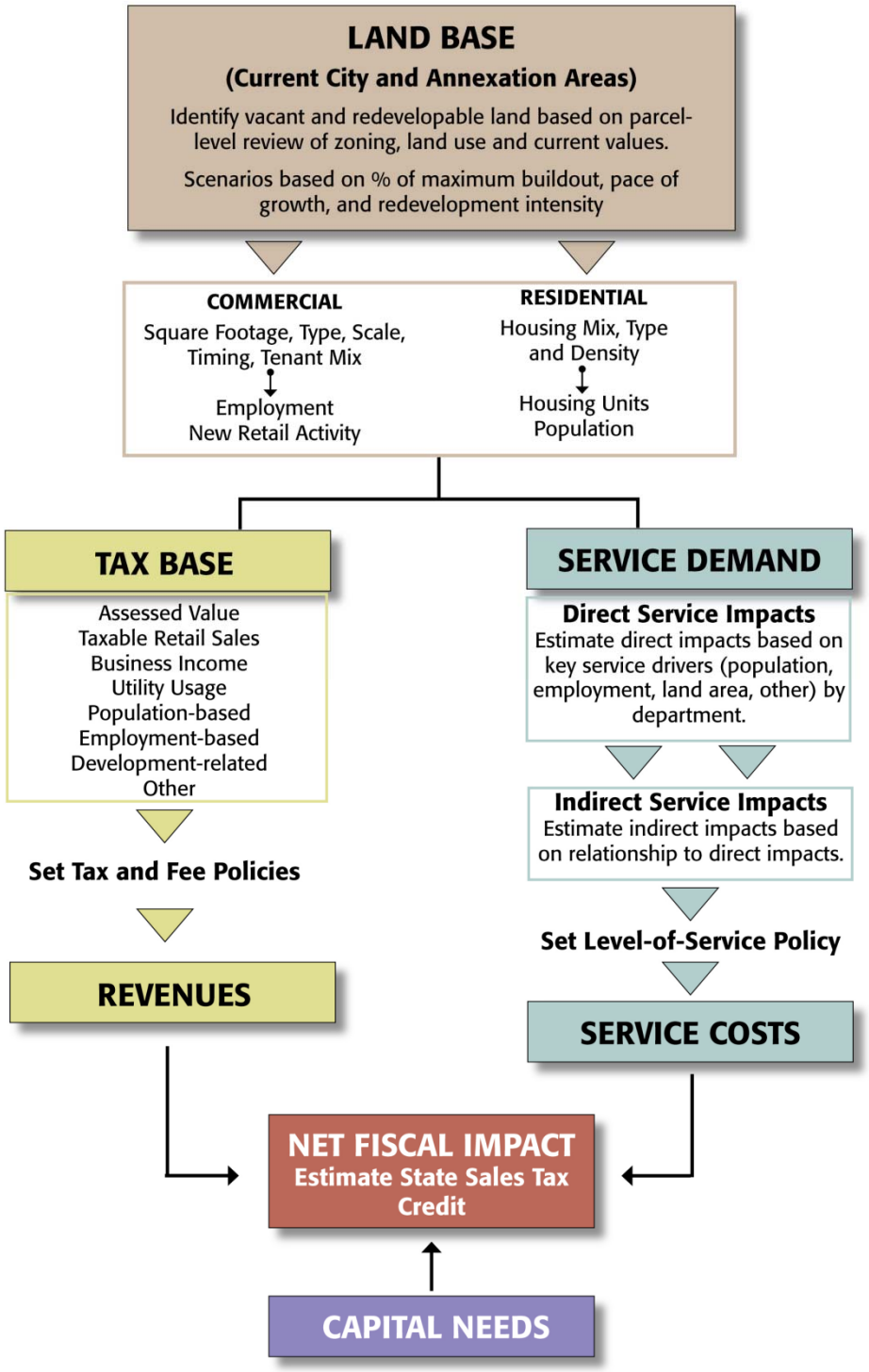
2.2 Economies of Scale

When thinking about annexation, it is likely that the City of Lynnwood will enjoy certain economies of scale in delivering City services. The City will not be required, for example, to hire a second Police or Fire Chief upon annexation. These savings mean that the average cost-per-resident of providing many City services will tend to decrease as the City of Lynnwood becomes larger.

In practical terms, Berk & Associates' model reflects economies of scale in two ways:

- The model identifies positions that will not be affected by annexation (e.g. annexation will not trigger the need to hire a new Fire Chief).
- For certain direct positions (those positions that are directly affected by increased demand for services from annexation or growth) the *"elasticity"* of the position with regard to the new source of demand (demand-driver) may be less than 100%. Elasticities in relation to a given demand-driver may be set at, say, 60%, which means that for every 10% change in demand introduced by the annexation, the need to expand staffing for the position will increase by 6%.

Exhibit 3
Long-Term Fiscal Model Schematic



Source: Berk & Associates, 2008

Budget Structure

While the model is not fund-based, it does isolate the components of the City's budget that are funded through general tax and fee revenues, which in the case of Lynnwood includes functions and departments within the City's General, Criminal Justice Reserve, and Street funds. The model does not include utility enterprise funds (such as water, sewer, or stormwater management), as these funds are self-supporting through utility revenues.

In Lynnwood's actual operations, the City uses a more extensive accounting system of funds to facilitate provision of services. To the extent that these funds are used for core City operations and would be affected by annexation, the costs and revenues are included within the model framework of estimating *core* costs of service, or capital costs and revenues (including all funds listed above). In instances when these funds are not used for core operational expenditures and are not expected to be affected by annexation, no cost impact of annexation is estimated.

Capital costs include the following three categories: (1) equipment and fleet costs necessary to support the increased staff levels associated with annexation, (2) facilities related to housing the increased staff, and (3) capital infrastructure needs for roadways, stormwater, and parks. In addition, a high-level estimate of the future capital-restricted revenues for the annexation area is provided.

Overarching Assumptions

The analysis summarized in this report is shaped by the following *key overarching assumptions:*

- The current level of service, staffing, and expenditures in Lynnwood (as defined in the 2007-08 budget) are the benchmarks for projecting comparable levels of service, staffing, and costs in the annexation area. This study does not evaluate whether Lynnwood's existing levels of service, staffing, or expenditures are acceptable or sustainable within existing resources and staffing.
- This fiscal analysis excludes local services that are assumed to be unaffected by the annexation decision, including water and sewer services (provided by Alderwood Water & Sewer), public schools (Edmonds School District), health services (Stephens Hospital), and transit (Community Transit).
- While the model is not fund-based, it does isolate the components of the City's budget that are funded through general tax and fee revenues, as discussed above. The model does not include utility enterprise funds, since these funds are not tax-supported.
- The future changes in service demands and City revenues are a function of explicit assumptions regarding growth and development, inflation factors, and the assumptions of maintaining current levels of service and continuation of current tax and fee policies.
- The voter-approved EMS levy is assumed to be renewed every five years at the full $0.50 rate.

3.0 LAND-BASED DEVELOPMENT ASSUMPTIONS

Development assumptions within the City of Lynnwood and potential annexation subareas are based on *Snohomish County Buildable Lands Inventory*[2], updated in 2007. This assessment of buildable lands provides estimates of future population and employment capacity for all cities and urban growth areas in the County. In general, these classifications of parcels indicate the potential for growth:

- Vacant parcels
- Redevelopable parcels – these parcels with low-value structures are assumed to have potential for redevelopment; they are identified according to the ratio of land value to improvement value
- Partially-used parcels – these parcels with existing structures that use only a portion of the site are assumed to have potential for additional development without demolition of the existing buildings
- Pending parcels – parcels with development already planned or permitted by Snohomish County

If the parcels are identified as vacant, redevelopable, or partially used, they are assumed to be available for development. A portion of this land is set aside for wetlands and other critical areas, as well as roads, right-of-ways, churches, schools, and parks. In residential areas, future development density is assumed to mirror historical development in areas with the same future land use designation. In terms of commercial and industrial development, the estimated land capacity was converted to capacity for building structures by applying specific density assumptions. Floor Area Ratios (FAR) of 0.3 for commercial, 0.3 for industrial, and 1.5 for mixed use were used to reflect the current character as well as current zoning of the commercially-zoned land. For example, at an FAR of 0.33, a 100,000 square foot industrial building would require 300,000 square feet (sf) of land (approximately 6.9 acres).

For each zoning category of buildable land, an estimate was made of how much of the development capacity is likely to be consumed over the next 20 years. The percent of buildout assumption is based on the total capacity in the pending (permitted) category plus a review of historic trends for development in the City and annexation subareas.

Additionally, due to reduced development activity resulting from current economic conditions, the analysis assumes that development in the City and most annexation subareas will be "backloaded" by using a development curve that assumes less development will happen in the early years, and more in the later years. For some subareas where there was specific knowledge of development coming on-line, such as the Ash Way Transit-Pedestrian Village, the analysis frontloaded these buildout assumptions.

In addition, some of Lynnwood's potential projects, including City Center and Lynnwood High School development, were directly included in the model based on current development forecasts included in Environmental Impact Statements. The City Center development assumptions are based on the medium density alternative as approved by the City Council, and include the development of approximately 3 million sf of new office, redevelopment of 1.5 million sf of retail, and construction of

[2] City of Lynnwood requested Buildable Lands GIS files from Snohomish County, and Berk & Associates used these files to generate buildable lands figures based on contemplated annexation area boundaries. For more detailed data for Lynnwood, its MUGAs, and other subareas, see *Snohomish County Tomorrow 2007 Buildable Lands Report* on the County's web site.

approximately 2,900 multi-family units. This development process is now forecast to commence in 2012, with build-out to preferred alternative levels to be achieved over 20 years. Another project, redevelopment of the Lynnwood High School[3] site, is planned to include 58,000 sf of office, 300,000 sf of retail, a 125-room hotel, and about 715 multi-family housing units. The development is expected to begin in 2011 and be completed in four years.

The estimate of development capacity for residential lands and the baseline assumptions for 20-year growth are shown in **Exhibit 4**, where housing is presented in terms of single- and multi-family housing units. Approximately 1,400 single-family units and 6,300 multi-family units are estimated to be built through 2027 in the annexation areas.

[3] Lynnwood High School redevelopment project is currently undergoing environmental review (draft EIS in February 2009), and action by the City Council on the project may change these projections.

Exhibit 4
Major Development Assumptions:
Housing Unit (HU) Capacity and Assumed Pace of Development

	Total HU Capacity	% Build-out	Development Curve	Total HU through 2028	Net Units Added
Current City of Lynnwood *					
SF Housing Units - Added	900	80%	2.5%	720	**441**
SF Housing Units - Subtracted	349	80%	2.5%	279	
MF Housing Units - Added	1,067	50%	2.5%	3,690	**3,612**
MF Housing Units - Subtracted	155	50%	2.5%	78	
Gateway					
SF Housing Units - Added	618	70%	2.5%	433	**305**
SF Housing Units - Subtracted	182	70%	2.5%	127	
MF Housing Units - Added	2,754	75%	2.5%	2,066	**2,006**
MF Housing Units - Subtracted	79	75%	2.5%	59	
Swamp Creek					
SF Housing Units - Added	644	70%	2.5%	451	**391**
SF Housing Units - Subtracted	85	70%	2.5%	60	
MF Housing Units - Added	3,035	70%	-5.0%	2,125	**2,119**
MF Housing Units - Subtracted	8	70%	-5.0%	6	
Parkway					
SF Housing Units - Added	151	100%	2.5%	151	**60**
SF Housing Units - Subtracted	91	100%	2.5%	91	
MF Housing Units - Added	2,425	50%	2.5%	1,213	**1,213**
MF Housing Units - Subtracted	0	50%	2.5%	0	
Alderwood Manor					
SF Housing Units - Added	610	60%	2.5%	366	**322**
SF Housing Units - Subtracted	73	60%	2.5%	44	
MF Housing Units - Added	1,323	60%	2.5%	794	**768**
MF Housing Units - Subtracted	43	60%	2.5%	26	
Larch Way					
SF Housing Units - Added	552	60%	2.5%	331	**306**
SF Housing Units - Subtracted	42	60%	2.5%	25	
MF Housing Units - Added	346	60%	2.5%	208	**208**
MF Housing Units - Subtracted	0	60%	2.5%	0	

Source: Snohomish County Buildable Lands Inventory, 2007; City of Lynnwood, 2008; Berk & Associates analysis, 2008

* For Current City, large planned development projects are assumed at 100% buildout. Remaining development is assumed at level listed in table. Total Capacity does not include units in planned developments, while net units added do. **Note:** "Housing units – Subtracted" represent existing structures to be demolished for redevelopment projects.

The estimate of development capacity for commercial lands and the baseline assumptions for 20-year growth are shown in **Exhibit 5.** Employment uses are presented in terms of total commercial and industrial square footage by subarea. There is significant capacity for commercial development in the annexation areas, with estimated net new retail totaling 2.2 million sf, office-based development 2.4 million sf, and about 225,000 sf of industrial being brought on-line through 2027.

For current City of Lynnwood, the estimated new building square feet are allocated 45% to retail, 35% to office-type uses, 5% to hotel, and 5% to auto retail, based upon the approximate current distribution in the City. In the annexation study subareas, these distributions are 45% to retail, 45% to office-type uses, and 5% to hotel. The rest of the commercial allocation is assumed to be for non-local revenue-generating governmental uses (in order to be conservative in this analysis, the development of these uses is not assumed to generate the construction sales tax).

Exhibit 5
Commercial Building Capacity and Assumed Pace of Development

	Total Capacity (SF)	% Build-out	Development Curve	Total Comm SF 2007 through 2028	Net SF Added
Current City of Lynnwood *					
Retail Non-Auto - Added	2,480,022	75%	2.5%	2,413,124	**1,471,971**
Retail Non-Auto - Subtracted	914,871	75%	2.5%	941,153	
Retail Auto Added	183,705	45%	2.5%	82,667	**52,172**
Retail -Auto Subtracted	67,768	45%	2.5%	30,496	
Accomodations Added	275,558	80%	2.5%	315,446	**234,125**
Accomodations Subtracted	101,652	80%	2.5%	81,322	
Office - Added	1,928,906	75%	2.5%	4,054,680	**3,521,005**
Office - Subtracted	711,566	75%	2.5%	533,675	
Industrial - Added	784,280	70%	2.5%	548,996	**266,641**
Industrial - Subtracted	403,364	70%	2.5%	282,355	
Gateway					
Retail - Added	858,970	50%	2.5%	429,485	**350,415**
Retail - Subtracted	158,141	50%	2.5%	79,071	
Office - Added	858,970	50%	2.5%	429,485	**350,415**
Office - Subtracted	158,141	50%	2.5%	79,071	
Industrial - Added	0	50%	2.5%	0	**0**
Industrial - Subtracted	0	50%	2.5%	0	
Swamp Creek					
Retail - Added	1,145,384	50%	2.5%	572,692	**568,080**
Retail - Subtracted	9,225	50%	2.5%	4,613	
Office - Added	1,145,384	70%	2.5%	801,769	**795,311**
Office - Subtracted	9,225	70%	2.5%	6,458	
Industrial - Added	0	50%	2.5%	0	**0**
Industrial - Subtracted	0	50%	2.5%	0	
Parkway					
Retail - Added	1,406,361	50%	-5.0%	703,180	**696,382**
Retail - Subtracted	13,598	50%	-5.0%	6,799	
Office - Added	1,406,361	50%	2.5%	703,180	**696,382**
Office - Subtracted	13,598	50%	2.5%	6,799	
Industrial - Added	449,467	50%	2.5%	224,734	**224,734**
Industrial - Subtracted	0	50%	2.5%	0	
Alderwood Manor					
Retail - Added	154,926	50%	10.0%	77,463	**39,993**
Retail - Subtracted	74,941	50%	10.0%	37,471	
Office - Added	154,926	50%	10.0%	77,463	**39,993**
Office - Subtracted	74,941	50%	10.0%	37,471	
Industrial - Added	0	50%	2.5%	0	**0**
Industrial - Subtracted	0	50%	2.5%	0	
Larch Way					
Retail - Added	1,114,867	50%	2.5%	557,433	**547,855**
Retail - Subtracted	19,157	50%	2.5%	9,579	
Office - Added	1,114,867	50%	2.5%	557,433	**547,855**
Office - Subtracted	19,157	50%	2.5%	9,579	
Industrial - Added	0	50%	2.5%	0	**0**
Industrial - Subtracted	0	50%	2.5%	0	

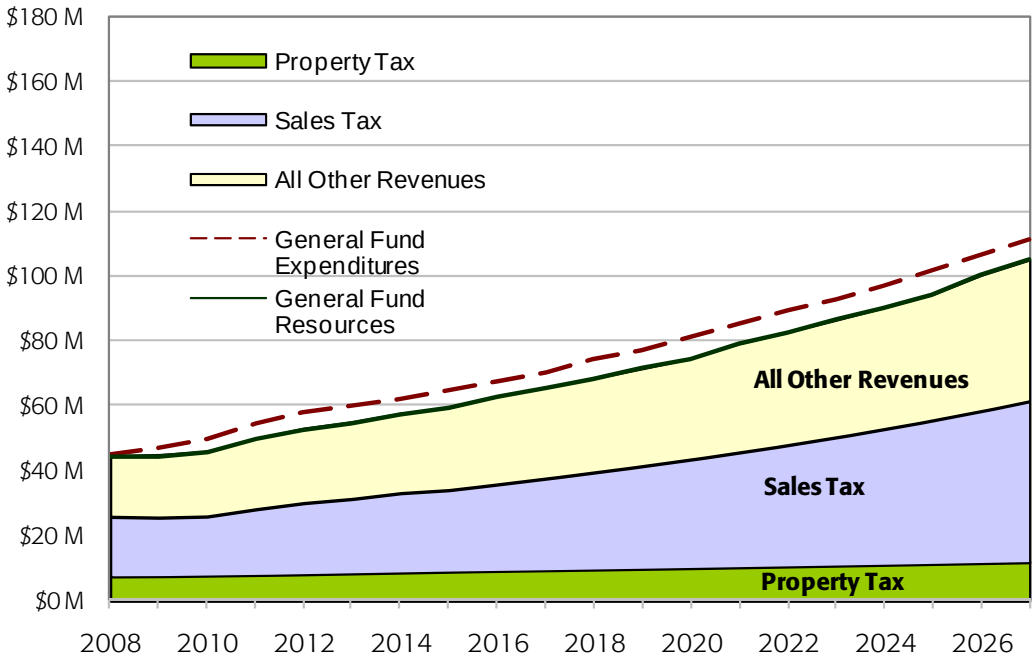
Source: Snohomish County Buildable Lands Inventory, 2007; City of Lynnwood, 2008; Berk & Associates analysis, 2008
* For Current City, large planned development projects are assumed at 100% buildout at levels shown in the EIS. Remaining development is assumed at level listed in table. Total Capacity does not include area in planned developments, while net sf added does.
Note: "Subtracted" represent existing structures to be demolished for redevelopment projects.

4.0 BASELINE OUTLOOK FOR CITY OF LYNNWOOD

Assuming no annexation, the City of Lynnwood is projected to experience revenue shortfalls in the future. This finding is consistent with the basic fiscal challenge in most other cities in Washington and is principally related to the impact of Initiative 747 (and subsequent legislative action to restore the provisions of the Initiative after it was declared unconstitutional by the Supreme Court in November 2007) which limits growth in property taxes; rising costs of doing business; and additional staffing related to in-city growth needed to maintain existing levels-of-service. In addition, some revenues are projected to decline, such as sales taxes (due to the current economic slow-down).

Exhibit 6 shows the City's estimated core revenues and expenditures through 2027. **Technical Appendix B** provides detailed annual revenue and expense projections for the City over the study period; however, it is once again important to note that these estimates are for planning purposes only, not for budgeting.

Exhibit 6
Estimated Core Revenues and Expenditures for City of Lynnwood, No Annexation (2008-2027)



Source: Berk & Associates analysis, 2008

Exhibit 7 shows the estimated costs and revenues for the City without annexation over the study period (2008 through 2027).

Exhibit 7
Estimated Core Revenues and Expenditures for City of Lynnwood, No Annexation (2010-2027)

Current City	2010	2015	2020	2025
Core Expenditures	49,707,007	64,874,742	81,315,797	102,030,368
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**49,707,007**	**64,874,742**	**81,315,797**	**102,030,368**
Core Resources	45,976,365	59,432,351	74,649,177	94,427,916
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**45,976,365**	**59,432,351**	**74,649,177**	**94,427,916**
Net Resources (000's)	(3,730,642)	(5,442,391)	(6,666,621)	(7,602,451)
Deficit/Surplus as % of Expenditures	-8%	-8%	-8%	-7%

Increment from Annexation Areas	2010	2015	2020	2025
Core Expenditures	0	0	0	0
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**0**	**0**	**0**	**0**
Core Resources	0	0	0	0
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**0**	**0**	**0**	**0**
Net Resources (000's)	0	0	0	0
Deficit/Surplus as % of Expenditures	0%	0%	0%	0%

Entire City with Annexation	2010	2015	2020	2025
Core Expenditures	49,707,007	64,874,742	81,315,797	102,030,368
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**49,707,007**	**64,874,742**	**81,315,797**	**102,030,368**
Core Resources	45,976,365	59,432,351	74,649,177	94,427,916
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**45,976,365**	**59,432,351**	**74,649,177**	**94,427,916**
Net Resources (000's)	(3,730,642)	(5,442,391)	(6,666,621)	(7,602,451)
Deficit/Surplus as % of Core Expenditures	-8%	-8%	-8%	-7%

Source: Berk & Associates analysis, 2008

The provisions of Initiative 747 cap the allowed increases in property tax revenue at 1% per year (plus levies on new construction). To exceed the 1% allowed increase, municipalities must seek voter approval. With this major revenue source capped at 1% increase per year, and with costs that tend to escalate at levels at least equivalent to inflation (and in cases of labor, health care costs and employee benefits, more than inflation), cities across the state are facing the reality of costs, that grow faster than their revenues. To address this challenge, local governments must either increase their tax base through growth or cut costs to maintain fiscal balance.

It is important to put this ongoing 8% funding shortfall into an appropriate planning context. As discussed previously, this analysis is designed to provide the necessary information to support a decision regarding annexation. Thus the approach focuses on how annexation might change the annual revenues and expenditures of the City of Lynnwood. While this provides a comprehensive look at the potential incremental impacts on the City's financial picture, it does not provide a full accounting of the City's projected sources and uses of funds. In particular, the analysis does not include reserve funds or the balance carryforward in the City's major funds or the interest earned on these funds.

As a result, the deficits projected in the baseline outlook should be viewed as an indication of the structural imbalance between new and ongoing revenues and expenditures assuming continuation of existing levels-of-service. It should not be viewed as an estimate of the near term cash flow situation for the City. This is another example of how this is a planning tool and not a budget document.

A key component of this structural imbalance going forward is the expected impact of the sales tax streamlining which is estimated to reduce City of Lynnwood sales tax collections by approximately $2 million per year. While there is expected to be some state funded mitigation in the short term, this is a long-term structural change that will need to be addressed. Potential mitigation revenues are not included in the financial analysis for annexation.

While the City can manage these projected deficits in the near term, a persistent long term deficit would require policy decisions that would either increase revenues or reduce costs to bring the annual inflows and outflows in line. Since the City cannot operate at a deficit, the Council will need to make appropriate policy adjustments to close the fiscal gap in the future ***with or without annexation***. These could include:

- Tax policy changes, including levy lid lifts, changes in utility tax rates, or new taxes (such as utility or Business & Occupation taxes), which would increase revenues to meet rising service costs
- Slower hiring rate or changes in other cost variables, such as the growth in salary and benefit costs, to bring the cost of services in line with available resources
- Decreases in levels of service

It is important to note that however the City might choose to address any baseline operating deficits, these policy changes would have an impact on the potential impacts of annexation. For example, if the City were to consider raising taxes to close the gap, the higher tax rates would increase the revenues that would be expected from the annexation area. If the approach were to reduce costs by modifying levels of service, then these revised levels of service would likely reduce costs associated with annexation.

Since the City is not required to make these choices at this time, the annexation analysis assumes a continuation of existing policies, even though they are estimated to lead to future budget shortfalls. As a result, *the impacts of annexation can best be understood in terms of whether annexation would be expected to make this baseline imbalance situation better or worse*.

Sales Tax Streamlining

In recent years, the Washington State Department of Revenue has engaged in a cooperative effort among states and private industries to create more uniform sales tax structures, referred to as the Streamlined Sales Tax Project. The Project's mission is to simplify the rules surrounding the levying of sales taxes, with a goal to pave the way for taxation of delivered goods (such as catalog and Internet sales) whose sales originate out-of-state. This project represents a potential impact to the City of Lynnwood.

States participating in the project have been changing their sales tax laws to be consistent with provisions of the Streamlined Sales and Use Tax Agreement (SSTA), a set of provisions developed by participants in the Streamlined Sales Tax Project. Washington has implemented the sourcing rule to comply with the model agreement and to become a member of the governing board, which will decide the rules for future streamlined sales tax provisions. As a member, Washington State will

receive additional sales taxes from remote sellers who have agreed to voluntarily comply with the SSTA, in part to benefit from its tax liability protections. Under the terms of the SSTA, those retailers will collect sales taxes for every member state that has implemented the model agreement. The rule change took effect in Washington State in July 2008.

What this means for Washington cities is that under the sourcing provisions of the agreement, the "source" of most delivered goods will shift local sales taxes to the place of delivery, and the potential exists for substantial shifts in revenues from jurisdictions with businesses that involve delivery of goods to customers in other areas (such as software sales and warehouses that deliver goods like furniture to retail customers outside the jurisdiction).

The analysis done for this study did not assume any change in revenues resulting from the implementation of sales tax streamlining. However, the Washington State Department of Revenue is estimating that the City of Lynnwood will see a loss in sales tax revenues from this rule change of approximately $2 million for State fiscal year 2009. The State offers a temporary mitigation to jurisdictions that suffer revenue loss. Beginning December 31, 2008, the State will make quarterly distributions to negatively impacted local jurisdictions. These mitigation payments are not included in the baseline fiscal outlook.

Considering that the annexation areas are primarily residential in character, these areas are generally going to be net winners in terms of the changes due to streamlining and may help offset some of the City's losses. It is unlikely that the potential streamlining benefits from these areas will be sufficient to materially reduce the expected losses in the City (however, the State's mitigation program will help offset these losses). In addition, modeling the impacts of SSTA is beyond the scope of this project.

5.0 DETAILED FEASIBILITY ANALYSIS: SCENARIOS 1, 2, & 3

5.1 Analysis Findings

The analysis suggests that impacts of annexation differ between each of the three scenarios. As discussed above, the City of Lynnwood is currently estimated to experience revenue shortfalls under a "no annexation" scenario (see Section 4.0). A useful approach to evaluating the framework used for each scenario is to determine whether or not a particular annexation scenario contributes to this revenue shortfall or helps lessen it. An annexation may still appear feasible even in a scenario where the incremental fiscal impacts are negative. In this case, the proportionate impact to the City's net deficit is more important than whether the annexation is negative.

For example, since the baseline fiscal outlook assumes a 7%-8% ongoing structural deficit in core revenues, an annexation area that was estimated to experience a net shortfall of 5% in core revenues would appear to make the situation worse. However, the important concept is that while both areas show negative outlooks, the fact that the problem is more manageable in the annexation area (5% versus 8% deficit) then annexation would marginally improve the overall situation, by reducing the City gap somewhat on a percentage basis. Another way to look at this is since the City cannot operate at a deficit in the long-term, any structural fix to the baseline condition (either higher taxes or lower costs) would likely benefit the annexation in a proportional way. In this case, the effect of these policy choices would likely make the net impacts in the annexation area reverse from a deficit to a surplus.

Exhibit 8 presents the chart of estimated core revenues and expenditures for Scenarios 1, 2, and 3, while **Exhibit 9** shows the estimated costs and revenues for Lynnwood, annexation scenarios, and the total combined area every five years over the study period. The charts and tables present data in

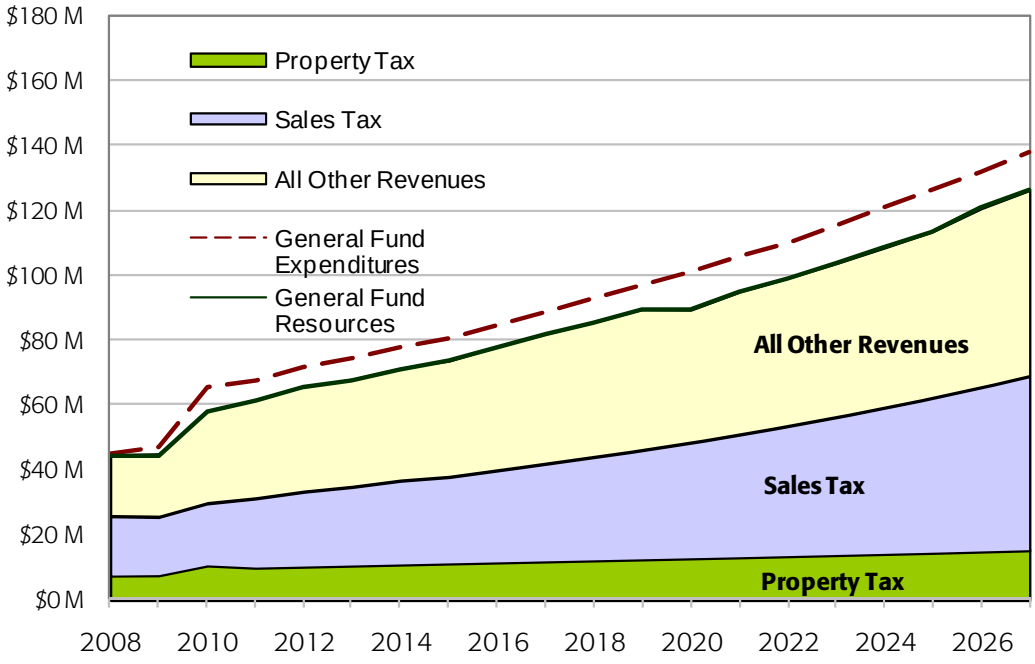
the *steady-state period* – assuming that the annexation areas are in the City in 2010. **Technical Appendix C** provides detailed annual revenue and expense projections for the three annexation scenarios over the study period.

Scenario 1 Findings. Taken on its own, Scenario 1 is projected to be unbalanced over the analysis time horizon. This scenario does not increase the City's revenue base in proportion to the incremental costs, and contributes to more than 25% of the City's total net deficit. The City would be eligible for the State sales tax credit, which is designed to offset deficits associated with annexation. However, the credit is still not able to offset all of the incremental costs associated with annexation. At the conclusion of the credit period, the City is projected to be worse off than in the baseline outlook.

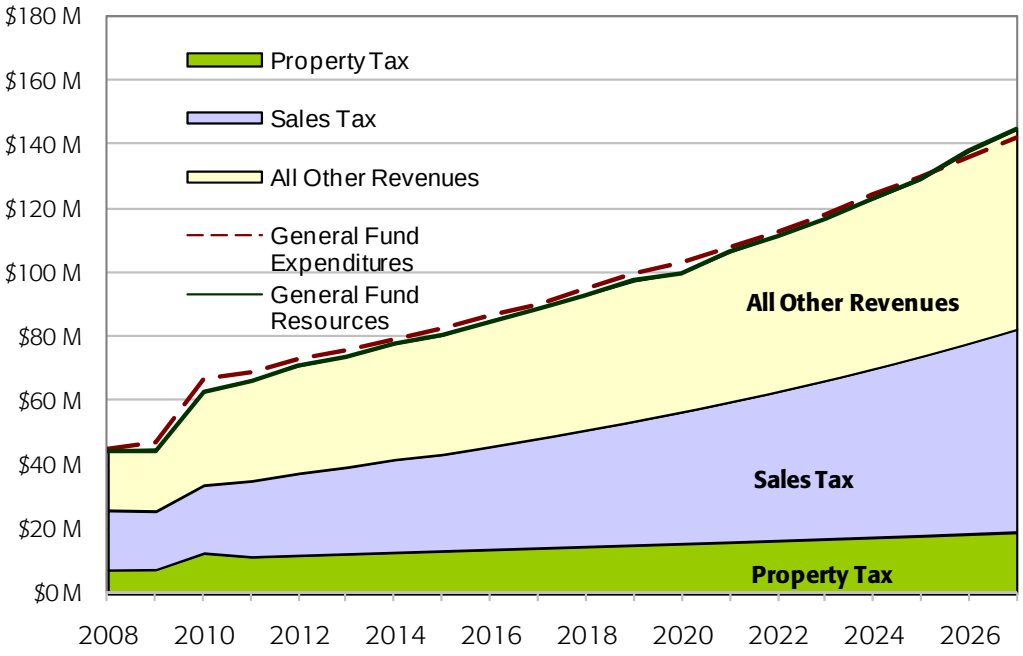
Scenario 2 Findings. This scenario significantly increases the revenue base for the City and reduces the overall net deficit. The State sales tax credit assists the City in offsetting some of the initial annexation-related deficits that occur in the first ten years after annexation. After the ten year period, the annexed area is still balanced and improves the baseline City outlook.

Scenario 3 Findings. This scenario, which combines the annexed areas in Scenarios 1 and 2, also increases the City's revenue base. The positive impact of the areas included in Scenario 2 has helped offset the deficits associated with Scenario 1. Similar to Scenario 2, the State sales tax credit assists the City in offsetting deficits that occur in the first ten years after annexation. After the ten year period the annexed area is still balanced and improves the structural balance in the City's long-term fiscal outlook.

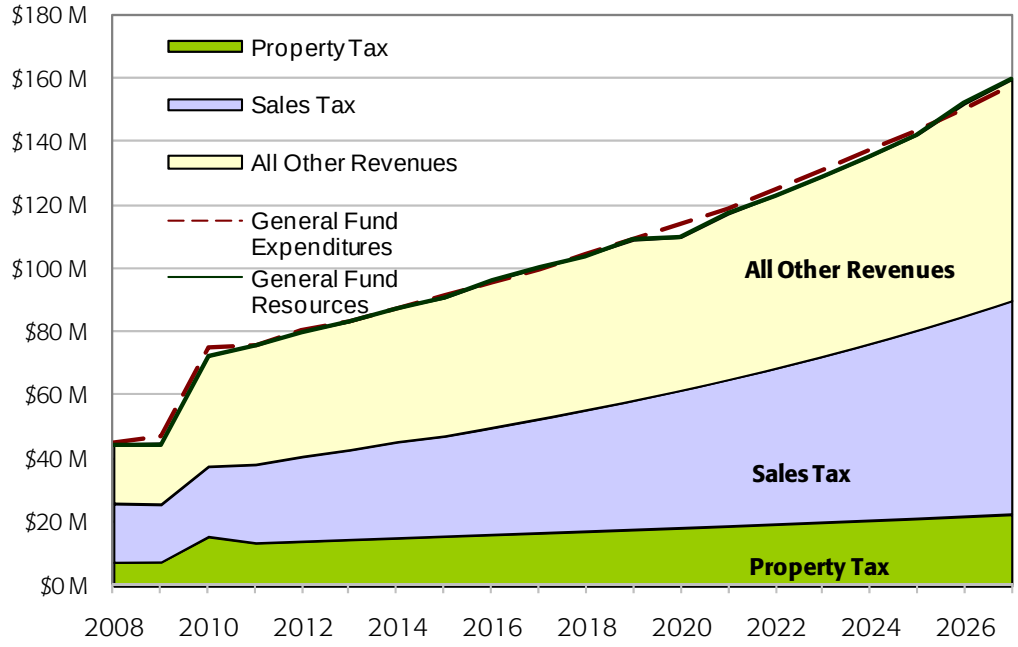
Exhibit 8
Estimated Core Revenues and Expenditures for City of Lynnwood, Scenario 1 (2008-2027)



Estimated Core Revenues and Expenditures for City of Lynnwood, Scenario 2 (2008-2027)



Estimated Core Revenues and Expenditures for City of Lynnwood, Scenario 3 (2008-2027)



Source: Berk & Associates Analysis, 2008

Note: The "bumps" in property tax revenues in 2010 represent revenues received from the levied but uncollected county road and fire district taxes. The combined levy rates for these two taxes are greater than the City's general levy rate, which the City will begin levying in the annexed areas in 2011 (For more information see Section 6.2)

Exhibit 9
Estimated Core Revenues and Expenditures, Scenario 1

Current City	2010	2015	2020	2025
Core Expenditures	49,699,379	64,897,081	81,338,742	102,057,619
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**49,699,379**	**64,897,081**	**81,338,742**	**102,057,619**
Core Resources	45,976,365	59,448,900	74,676,052	94,468,107
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**45,976,365**	**59,448,900**	**74,676,052**	**94,468,107**
Net Resources (000's)	(3,723,014)	(5,448,181)	(6,662,690)	(7,589,512)
Deficit/Surplus as % of Expenditures	-7%	-8%	-8%	-7%

Increment from Annexation Areas	2010	2015	2020	2025
Core Expenditures	15,699,676	15,464,904	19,500,204	24,089,953
Facility Debt Service	346,604	346,604	0	0
Subtotal Expenditures	**16,046,280**	**15,811,508**	**19,500,204**	**24,089,953**
Core Resources	9,823,944	11,004,205	14,713,485	19,091,817
State Sales Tax Credit	2,282,639	3,174,389	0	0
Subtotal Revenues	**12,106,584**	**14,178,594**	**14,713,485**	**19,091,817**
Net Resources (000's)	(3,939,696)	(1,632,914)	(4,786,719)	(4,998,136)
Deficit/Surplus as % of Expenditures	-25%	-11%	-25%	-21%

Entire City with Annexation	2010	2015	2020	2025
Core Expenditures	65,399,055	80,361,986	100,838,946	126,147,572
Facility Debt Service	346,604	346,604	0	0
Subtotal Expenditures	**65,745,659**	**80,708,589**	**100,838,946**	**126,147,572**
Core Resources	55,800,309	70,453,105	89,389,537	113,559,924
State Sales Tax Credit	2,282,639	3,174,389	0	0
Subtotal Revenues	**58,082,949**	**73,627,494**	**89,389,537**	**113,559,924**
Net Resources (000's)	(7,662,711)	(7,081,095)	(11,449,409)	(12,587,648)
Deficit/Surplus as % of Core Expenditures	-12%	-9%	-11%	-10%

Note: The Current City figures in this Exhibit are slightly different from numbers in Exhibit 7 (City without annexation) and the following two Exhibits (for Scenarios 2 and 3). The difference in revenue is due to a small increase in Property Tax that the City can collect on its portion of assessed value with annexations. Because the millage rate for property tax is calculated based on a 1% increase in total revenue *plus new construction* (and increased assessed value from annexation is treated as new construction), some Scenarios allow for a slightly higher millage rate for the City as a whole. The expenditures vary marginally due to the methods used to estimate the Current City share of costs and the magnitude and timing of staffing increases are different due to the annexation. The Current City costs with annexation are estimated by subtracting the incremental costs in the annexation areas from the project total larger-City costs.

Estimated Core Revenues and Expenditures, Scenario 2

Current City	2010	2015	2020	2025
Core Expenditures	49,699,379	64,894,061	81,338,742	102,053,359
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**49,699,379**	**64,894,061**	**81,338,742**	**102,053,359**
Core Resources	45,976,365	59,524,408	74,773,000	94,589,630
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**45,976,365**	**59,524,408**	**74,773,000**	**94,589,630**
Net Resources (000's)	(3,723,014)	(5,369,653)	(6,565,742)	(7,463,729)
Deficit/Surplus as % of Expenditures	-7%	-8%	-8%	-7%

Increment from Annexation Areas	2010	2015	2020	2025
Core Expenditures	16,346,927	17,140,423	21,820,604	27,496,838
Facility Debt Service	518,022	518,022	0	0
Subtotal Expenditures	**16,864,948**	**17,658,445**	**21,820,604**	**27,496,838**
Core Resources	14,518,032	17,984,121	25,365,968	34,785,166
State Sales Tax Credit	2,491,127	3,124,973	0	0
Subtotal Revenues	**17,009,159**	**21,109,094**	**25,365,968**	**34,785,166**
Net Resources (000's)	144,210	3,450,648	3,545,364	7,288,328
Deficit/Surplus as % of Expenditures	1%	20%	16%	27%

Entire City with Annexation	2010	2015	2020	2025
Core Expenditures	66,046,306	82,034,485	103,159,346	129,550,198
Facility Debt Service	518,022	518,022	0	0
Subtotal Expenditures	**66,564,328**	**82,552,507**	**103,159,346**	**129,550,198**
Core Resources	60,494,397	77,508,529	100,138,968	129,374,796
State Sales Tax Credit	2,491,127	3,124,973	0	0
Subtotal Revenues	**62,985,524**	**80,633,502**	**100,138,968**	**129,374,796**
Net Resources (000's)	(3,578,804)	(1,919,005)	(3,020,379)	(175,401)
Deficit/Surplus as % of Core Expenditures	-5%	-2%	-3%	0%

Estimated Core Revenues and Expenditures, Scenario 3

Current City	2010	2015	2020	2025
Core Expenditures	49,694,294	64,888,022	81,331,569	102,044,840
Facility Debt Service	0	0	0	0
Subtotal Expenditures	**49,694,294**	**64,888,022**	**81,331,569**	**102,044,840**
Core Resources	45,976,365	59,522,827	74,774,117	94,594,474
State Sales Tax Credit	0	0	0	0
Subtotal Revenues	**45,976,365**	**59,522,827**	**74,774,117**	**94,594,474**
Net Resources (000's)	(3,717,929)	(5,365,195)	(6,557,452)	(7,450,366)
Deficit/Surplus as % of Expenditures	-7%	-8%	-8%	-7%

Increment from Annexation Areas	2010	2015	2020	2025
Core Expenditures	24,843,318	25,688,259	32,283,776	41,230,927
Facility Debt Service	732,313	732,313	0	0
Subtotal Expenditures	**25,575,631**	**26,420,572**	**32,283,776**	**41,230,927**
Core Resources	21,349,046	25,597,308	35,342,551	47,986,888
State Sales Tax Credit	5,218,635	5,826,155	0	0
Subtotal Revenues	**26,567,681**	**31,423,463**	**35,342,551**	**47,986,888**
Net Resources (000's)	992,049	5,002,891	3,058,776	6,755,961
Deficit/Surplus as % of Expenditures	4%	19%	9%	16%

Entire City with Annexation	2010	2015	2020	2025
Core Expenditures	74,537,612	90,576,280	113,615,344	143,275,767
Facility Debt Service	732,313	732,313	0	0
Subtotal Expenditures	**75,269,925**	**91,308,594**	**113,615,344**	**143,275,767**
Core Resources	67,325,411	85,120,135	110,116,668	142,581,362
State Sales Tax Credit	5,218,635	5,826,155	0	0
Subtotal Revenues	**72,544,046**	**90,946,290**	**110,116,668**	**142,581,362**
Net Resources (000's)	(2,725,879)	(362,304)	(3,498,676)	(694,405)
Deficit/Surplus as % of Core Expenditures	-4%	0%	-3%	0%

Source: Berk & Associates analysis, 2008

The main reason for the negative projected result of annexation for Scenario 1 as compared to Scenario 2 is the difference in expected revenues, since the cost of serving the potential annexation areas in Scenarios 1 and 2 is approximately the same (See **Exhibit 10** and **Exhibit 12** in the next section of this report). Gateway annexation subarea that comprises Scenario 1 is estimated to generate much lower property and sales tax revenues than subareas that comprise Scenario 2. Due to a relatively high residential and commercial development projected for Scenario 2, sales tax on construction represents a significant component of the sales tax revenues, which is less for Scenario 1.

5.2 Operating Revenue Analysis

Tax and fee revenues are estimated based on the changes in the components of the City's tax base resulting from growth and annexation. Components of growth that could influence revenues include population, employment, land use changes, or base inflation in certain components of the tax base. Each of the City's tax and fee revenue sources is separately estimated by assessing changes in the tax base and applying current tax and fee rates to generate revenue projections.

Exhibit 10 shows estimated operating revenues for both the current City configuration and the increments from annexation for Scenarios 1 though 3. The revenues shown are for 2010, *assuming that the City would start receiving revenues on January 1, 2010*. This comparison is helpful as a **one-**

time snapshot of revenue impacts, as opposed to the cash flow estimates of revenues. A more detailed cash flow approach of revenue receipts, including how these would vary with different annexation dates, is presented later in Section 6.2 "Transition Operating Revenue Analysis". The table below provides a high-level overview of major revenue categories and the impact that differing revenue bases in the study areas have on the overall fiscal impact of annexation.

Exhibit 10
Estimated Operating Revenues for City of Lynnwood with and without Annexation Assuming Receipt of Revenues Starting January 2010 (Millions $)

Revenues	Current City	Scenario 1		Scenario 2		Scenario 3	
		Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase
Sales Tax	18.18	0.99	5%	2.74	15%	3.74	21%
Criminal Justice Sales Tax	0.51	0.20	40%	0.23	44%	0.43	85%
Property Tax	7.84	2.88	37%	5.03	64%	7.91	101%
Utility Taxes	1.58	0.54	34%	0.64	40%	1.18	74%
Admissions Tax	0.71	0.00	0%	0.00	0%	0.00	0%
Gambling Tax	0.28	0.00	0%	0.00	0%	0.00	0%
Red Light Camera Fees	2.50	0.00	0%	0.00	0%	0.00	0%
Building Permits and Fees	1.75	1.22	70%	1.22	70%	1.22	70%
Business Licenses and Permits	1.35	0.07	5%	0.14	10%	0.21	15%
Emergency Medical Services Levy	2.42	0.59	24%	1.04	43%	1.63	67%
Liquor Board Profits and Excise Tax	0.43	0.17	40%	0.19	44%	0.36	85%
Gas Tax	0.63	0.26	40%	0.28	44%	0.54	85%
Planning and Plan Check Fees	0.43	0.45	103%	0.45	103%	0.45	103%
Fines & Forfeits	2.75	1.33	48%	1.33	48%	1.33	48%
Recreation Charges	1.43	0.06	4%	0.06	4%	0.12	8%
Grants and Other Intergovernmental	0.06	0.02	40%	0.03	44%	0.05	85%
Other Charges	0.09	0.04	40%	0.04	44%	0.08	85%
Internal Charges for Service	1.54	0.62	40%	0.68	44%	1.30	85%
Ambulance Transport Fees	0.97	0.39	40%	0.43	44%	0.82	85%
Interest Income	0.54	0.00	0%	0.00	0%	0.00	0%
Total	**45.98**	**9.82**	**21%**	**14.52**	**32%**	**21.35**	**46%**

Source: Berk & Associates analysis, 2008

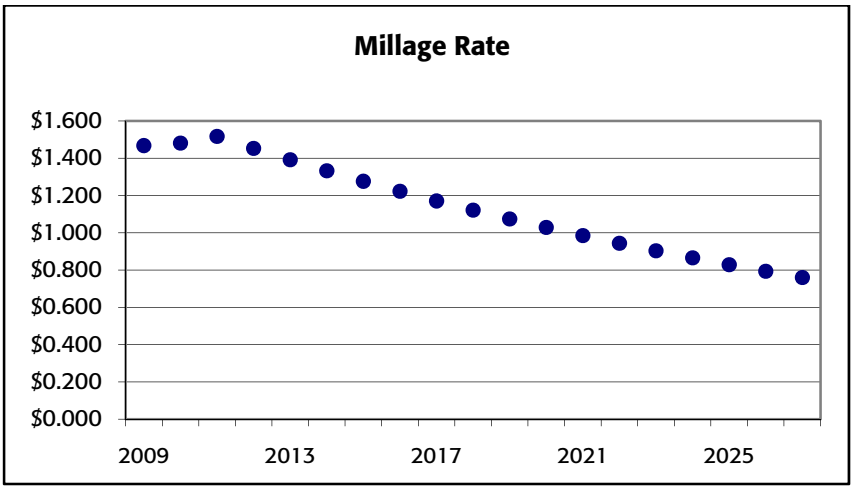
Overall, Scenario 1 would add approximately $9.82 million upon annexation or about a 21% increase in core City revenues. Scenario 2 is estimated to provide approximately $14.52 million of new core City revenues upon annexation, which would represent 32% increase. Considering that the population increases would be very similar in these scenarios, clearly Scenario 2 provides significantly higher revenues per capita, which is a primary factor in why this scenario performs so much better financially.

Scenario 3, which is the combination of Scenarios 1 and 2, would add approximately $21.35 million to the City's core revenues upon annexation, a 46% increase. It is worth noting that the revenues estimated for Scenario 3 are less than the sum of revenues estimated for Scenarios 1 and 2. This is primarily due to several revenue items that are based on a current relationship between revenues and staffing costs, including: planning and plan check fees, building permits and fees, and fines and forfeitures. In each of these cases, the costs associated with annexation do not vary significantly between the three scenarios, and thus neither do the revenues.

Property Taxes

Property Tax Limit. The property tax revenue (the amount that the City can collect) is limited to 1% above the previous year collections plus a levy on the value of new construction. Since property values are expected to increase by more than the allowed 1% increase in revenue (plus new construction), the property tax levy rate will necessarily decline over time. The result of this gradual reduction in the City's general property tax rate for Scenario 3 is shown in **Exhibit 11** below. The future rate depends entirely on the future assessed value in the current City and the value of new construction activity.

Exhibit 11
Scenario 3 - Lynnwood Projected Property Tax Levy Rate
Assuming Annexation in 2010



Source: Berk & Associates analysis, 2008

A useful measure of the level of new construction activity in a city is the percent of a city's total assessed value that comes from new construction in a given year. For both the current City of Lynnwood and the potential annexation areas, construction rates are based on development assumptions for parcels that are vacant, redevelopable, or already planned or permitted by Snohomish County (see development assumptions discussion earlier). For the City of Lynnwood, the projected average rate of construction in the City is estimated at approximately 0.7% of assessed value in 2008, increasing to 2.3% in 2010. This increase is attributable to expected redevelopment in the City Center and the Lynnwood High School site.

Assessed Value Base. In future years, the base assessed value is expected to increase at a rate of 2% above inflation. Additional assessed value will be added to the area through residential and commercial development. For the City of Lynnwood and contemplated annexation areas, estimates of assessed value per unit that are similar to current newer properties in the area are utilized to estimate the value of new construction, and consequently, the increase in the assessed value base.

Property Tax Lags. Due to lags associated with annexation and levying, the City would not begin to receive property tax revenues from the annexation area until 2011. Between annexation and 2011, however, the City would receive revenues associated with the County road and fire district levies. Please see Section 6.1 "Transition Operating Revenue Analysis" of this report for more information.

Retail Sales Taxes

One of the key revenue sources for cities is Retail Sales Tax. The subareas analyzed in Scenarios 1 and 2 (Gateway, Swamp Creek, Parkway, Larch Way, and Alderwood Manor) have a large amount of commercial development capacity – approximately 8.8 million square feet. Retail development is estimated to generate approximately $200 of taxable retail sales per square foot, office development approximately $25 per square foot, and hotel approximately $75 per square foot (based on experience in the Puget Sound Region).

These estimates are intended to be "net" impacts, and thus are lower than might be expected from a new establishment, particularly for retail, where average sales per square foot might be closer to $300. However, to be conservative, one must assume that some portion of the new sales will come from a redistribution of existing spending in the City. These per square foot estimates are based on an overall average for "typical" retail activity. Actual sales tax impacts will depend on the specific retail businesses that locate in the new development which could be higher or lower depending on the size of the market area served, the degree to which there are local competitors and the type of goods and services offered.

Of the 8.4% sales tax currently collected in the City and the potential annexation area, a 1% "local option" accrues to local jurisdictions. In the unincorporated area, the full 1% local sales tax accrues today to Snohomish County (with the exception of a small portion that is retained by the State Department of Revenue to cover collection and distribution costs). If the transaction location is within a city like Lynnwood, the city receives 85% of the 1% local sales tax and the County receives 15%. This tax is levied not only on businesses in the area, but also on construction activity and some transactions that are related to residence or location, such as certain online purchases or residential services like telephone and cellular services.

The City of Lynnwood has a large retail tax base (due to Alderwood Mall and a number of car dealerships), therefore even though the City would almost double its population upon annexing subareas in Scenario 3 (combination of Scenario 1 and 2), the sales taxes will increase only by approximately 21% (see **Exhibit 13**).

Utility Taxes

In 2008, the City of Lynnwood imposed telephone utility taxes at a rate of 3% (including cell phones). There is also a 5% cable TV franchise fee. The City also receives an annual distribution under the State PUD privilege, set at a minimum of 0.75% of gross revenues, currently about $230,000 annually.

The City Council recently passed a resolution increasing the utility taxes: telephone by 3% in 2009 (to a total of 6%), a new cable utility tax at 1% in 2009, and solid waste to 6% in 2010. For the current City boundaries, these additional utility tax revenues will be earmarked to cover the debt service payments for the recreation center remodel and expansion (City ordinances 2745 and 2746). For annexation areas, these revenues will accrue to the general fund, since the full cost of the debt service is covered by the revenues collected in the current City.

Because these taxes are paid by both residences and businesses, revenues are projected based upon a per capita number for population and employment. In this analysis, it is assumed that starting in 2009, the additional revenues from tax increases within the current City boundaries will be offset by the recreation center expenditures, while for annexation scenarios these revenues will accrue to the general fund.

Other Revenues

Emergency Medical Services Levy. The City of Lynnwood is currently authorized by voters to levy a permanent Emergency Medical Services levy. The maximum levy allowed is $0.50. In 2008, the current levy rate is $0.45 per $1,000 of assessed value. Based on the input from City of Lynnwood staff, the analysis projects that the City will ask the voters to reset the levy to $0.50 in 2011, and continue to seek voter approval to reset the levy every five years throughout the planning period. The analysis assumes that the voters will reauthorize these levies on this schedule.

Criminal Justice Tax. Snohomish County levies a dedicated sales tax to support criminal justice expenditures. This 0.1% sales tax is collected by the Washington State Department of Revenue, and is distributed to Snohomish County and to cities within the County on a per capita basis. In 2008, Lynnwood estimates criminal justice sales tax revenues at a per capita rate of $13.60. Total future revenues are calculated on a per capita basis, with the annual per capita revenue assumed to increase at the rate of inflation.

Building Permits and Fees. Building permit and fee revenues are generally estimated based on current relationship between permit revenues and staffing in the Permits and Inspection division of Community Development Department. This current City ratio is then applied to the expected increase in permitting labor costs due to annexation in order to estimate future fee revenues. In essence, these revenues are targeted by policy to recover specific City costs on a fee-for-service basis. The assumption in this analysis that future cost recovery policies will largely mirror current policy.

Planning and Plan Check Fees. Similar to building permit and fee revenues, planning and plan check fee revenues are estimated based on the current relationship between permit revenues and staffing, with City costs based on labor positions directly related to performing these services. This current City ratio has been applied to the City's future planning salaries and benefits in order to estimate future fee revenues.

Gas Tax. A portion of the state-collected gas tax is shared directly with municipalities which bear a substantial portion of the overall costs of road maintenance and construction. The gasoline and diesel tax is a flat amount levied per gallon (rather than a percentage of the price at the pump), so even with increasing fuel prices, the state distributions will decrease if the number of gallons sold decreases.

Until 2005, cities had been receiving their gas tax in two distributions: a restricted portion (32%) to be used for capital; and an unrestricted portion (68%) allowed to be used for operating or capital funding. Recently, however, the dual-distribution and restriction have been removed, but most cities have continued to allot 32% of gas tax revenues to their capital program. In Lynnwood's 2008 budget, the split was about 50-50, and it is assumed going forward that this split will continue.

The maintenance portion of gas tax revenue estimates from the City's budget projects a per capita gas tax allocation of $17.84 in 2008. This per capita number is assumed to increase at the rate of inflation.

Liquor Board Profits and Excise Tax. According to Washington State law, a share of the state profits from liquor sales and state-collected excise tax on liquor is distributed directly to cities on a per capita basis. Currently, the revenue estimated in the City's budget projects the per capita distributions for liquor profits and excise taxes to be $11.43 in 2008. These per capita estimates are assumed to increase with inflation.

Admissions Tax. The City currently collects admissions tax of approximately $661,000 (2008). It is assumed that these revenues will continue to accrue to the City and increase with inflation. To be conservative, it is also assumed that the contemplated annexation areas will not include activities that are subject to the admissions tax and thus not contribute a net increase to this revenue source.

Recreation Charges. For projections of revenue from recreation charges within the City, the analysis estimated the per capita revenue at $38.23 for 2008, based on the City's budgeted revenues. This per capita revenue is expected to increase at the general inflation rate of 3.5%. It is assumed that some annexation area residents are already using Lynnwood parks and recreation facilities. Therefore, for additional revenue projections in the case of annexation, we have assumed that only 10% of the annexation area residents will be new users of parks and recreation services. It is important to note that it is difficult to estimate this source of revenue without a survey of recreation users, and it is possible that the amount projected may be under- or overstated. However, the City establishes and periodically reviews its fee structure for recreation programs and has the ability to make adjustments based on the actual experience post annexation.

Business Licenses and Permits. The City of Lynnwood charges a fee to obtain a business license for operation within the city limits. These revenues are projected on a per employee basis, estimated to be an average of $44 per employee in the City in 2008 (determined by dividing business license revenues by total Lynnwood employment). The source for 2007 employment estimates is PSRC (covered employment), while annual employment estimates are generated from land use and development assumptions within the model.

Fines and Forfeits. Fines and Forfeits revenues are estimated based on the current relationship between revenues and costs of municipal court-related services. This ratio has been applied to the expected increase in municipal court labor costs due to annexation in order to estimate future fee revenues. The municipal court-related costs include municipal court employees' salaries and benefits and the contracts for municipal defense and prosecution services.

Red Light Camera Fees. In 2007, the City installed automated cameras at about 10 intersections, in order to collect evidence against people running red lights. The revenue from the tickets was approximately $2.5 million in 2008 and is budgeted at the same amount for 2009. The City does not expect to see increased revenues from these cameras. This analysis assumes the revenue at $2.5 million per year, with no additional fees from annexation areas.

Grants and Other Intergovernmental. The grants considered in this analysis are for operational expenditures only, not those for capital projects. Future grants are estimated on a per capita basis and applied to the annexation area population. The current per capita revenues, according to the 2008 City budget, are $1.57. We have assumed that these will increase at the rate of inflation. It is important to note that it is difficult to estimate this source of revenue, as grants tend to fluctuate widely from year to year.

Internal Charges for Service. The City charges its fee-based utility funds for goods and services provided by the City. This allows for an accounting of the full cost of providing the fee-based services to the public. Revenues to the City include charges for general services (financial services, legal services, labor services, and information technology support), debt service payments, and equipment rental charges. Revenues in this category are projected to grow on a per capita basis. The current per capita rate is $41.20 based on the City's 2008 budget, which is expected to increase with inflation.

Other Charges. The City receives some small miscellaneous revenues that have been categorized as "Other Charges" for this analysis. These revenues are estimated on a per capita basis, averaging $2.40 for the City population in 2008, and are assumed to increase with inflation.

Gambling Tax. Gambling tax revenues for the City are approximately $260,000 in 2008 and are projected to increase with inflation. It is estimated that there would be a minor amount of gambling tax received from the potential annexation areas.

5.3 Operating Cost Analysis

The fiscal analysis estimates changes in the cost of services based on relationships between direct services such as maintenance workers or planners, and underlying demographic and community changes such as increases in population, housing units, commercial activity, and land area.

- Costs are broken up into labor and non-labor categories
- Non-labor costs in each department are driven by the number of Full Time Equivalents (FTEs) in that department

Drivers for FTEs in each position within all City departments are variable in the model, and fall into one of four categories:

- **Fixed.** These positions do not change over the planning horizon (for instance, there will always be one Police Chief).
- **Direct.** These positions are driven directly by changes to the underlying land base of the city, such as population or employment. The relationship between demand for services and the underlying land base is determined based on the types of services each position provides. For example, parks maintenance staffing is directly related to the number of park acres that must be maintained.
- **Indirect (by Position).** These positions are driven by staffing levels of one or more positions in a specific department. For instance, a Police Commander is related to growth in the number of Police Officers.
- **Indirect (by Department).** These positions are driven by staffing levels of one or more departments. For instance, an Accountant position in the Finance Department is related to total new staffing levels in most other City departments.

General Assumptions

Annual salary and wage escalation is assumed to be 4.0%, while annual benefits are assumed to grow at a rate of 6.0%. The assumption regarding benefits escalation accounts for the possibility of growth in overall benefits costs above inflation due to the expected continuation of higher benefit cost increases primarily related to health care costs.

Impacts on City Staffing and Operating Costs

Exhibit 12 shows estimated operating costs and staffing in full time equivalents (FTEs) for both current City configuration and increments from annexation for Scenarios 1 though 3. Similarly to operating revenues in the chapter above, the costs and staffing shown are for 2010, *assuming that all initial annexation-related FTEs are hired and in place on January 1, 2010*. A more detailed analysis of the transitional period's costs (first four years of annexation) is discussed in Section 6.3 The Exhibit provides a high-level summary of major operating cost centers and the impact of increases in staffing on the overall fiscal impact of annexation. The overall increase in staffing is consistent with current

staff levels and reasonable expectations for changes related to an annexation of this scale; however, staffing within each department has been based on detailed discussions with City staff and reflects current staff planning for post-annexation needs.

There are currently approximately 420 City FTEs paid for by the General and Street Funds. With growth within the current City, this number is anticipated to increase slightly by 5.6 FTEs to 425.6 in 2010. Annexation Scenario 1 would increase City staffing by approximately by 99.4 (23%), Scenario 2 by 104.4 FTEs (25%), while Scenario 3 is estimated to increase by 153.4 Full Time Equivalents, or 36%.

It is important to point out that even though Scenarios 1 and 2 geographically add up to Scenario 3, the staffing between the scenarios cannot be summed. The overarching concept is that the City will not be hiring additional staff until there is a demonstrated need that would justify adding an increment or a full FTE. This will likely happen in blocks: the existing staff will absorb the increase in work until there is a need to hire another person or a part-time position. The Berk analytical model "hires" most positions in the increments of 0.5 FTE (half-time), with some exceptions.

This concept can be better explained by a hypothetical example of a maintenance worker position in the Public Works Department. The position is driven by demand drivers of lane miles of roads. For Scenario 1, the analysis may estimate the total number of FTEs needed at 0.2 FTEs; for Scenario 2, it might be 0.4 FTEs (the number of lane miles of roads is higher in Scenario 2). However, if the rounding constraint of is 0.5 (i.e. positions are hired in at least half time increments), both Scenario 1 and 2 will end up with 0.5 FTEs. However under Scenario 3, the need would be 0.6 FTE's which would also be rounded to a new 0.5 FTE position as opposed to the 1.0 FTE's that would be implied by adding Scenarios 1 and 2. The following is a brief discussion of the departments with the most significant variations between Scenario 3 and the sum of Scenarios 1 and 2:

- **Community Development.** These incremental positions identified for this department are sufficient to meet the needs of all three scenarios with the same level of staffing. This suggests that Scenario 3 offer the maximum economies of scale in relation to the additional positions needed.
- **Fire Department.** This department also presents some significant economies of scale. In both Scenarios 1 and 2 the City would take over a fire station from Fire District 1. In the case of Scenario 3, the City would take over two stations, but could provide the same level of service with one fewer engine crew.
- **Police Department.** The police department is an example where there are diseconomies of scale, as the total staffing under Scenario 3 is greater than the sum of Scenarios 1 and 2. In this case, the additional combined staffing at the patrol level in Scenario 3 triggers the need for additional supervisory-level positions to maintain appropriate command and control. The smaller increases in staffing in either Scenario 1 or 2 do not trigger this need.

Exhibit 12
Estimated City of Lynnwood Staffing with and without Annexation
Snapshot: Assuming Annexation in January 2010
(Full Time Equivalents)

Staffing (FTEs)	Current City	Scenario 1		Scenario 2		Scenario 3	
		Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase
Legislative	7.8	0.1	1%	0.1	1%	0.1	1%
Executive	3.6	0.0	0%	0.0	0%	0.0	0%
Human Resources	5.0	3.1	62%	3.1	62%	3.2	64%
Community Affairs	3.0	2.0	67%	2.0	67%	2.0	67%
Admin Services	41.2	9.3	23%	9.3	23%	13.5	33%
Build-Prop Services	11.5	2.5	22%	3.0	26%	4.0	35%
Community Development	21.1	16.1	76%	16.1	76%	16.1	76%
Economic Development	3.2	1.2	38%	1.2	38%	1.2	38%
Fire	60.5	26.5	44%	26.5	44%	39.0	64%
Muni Court	12.8	6.8	53%	6.8	53%	6.8	53%
Parks & Rec	101.5	0.0	0%	1.0	1%	1.0	1%
Police	117.7	18.3	16%	18.3	16%	45.0	38%
Public Works	37.0	13.5	36%	17.0	46%	21.5	58%
Total	**425.8**	**99.4**	**23%**	**104.4**	**25%**	**153.4**	**36%**

Estimated Operating Costs for City of Lynnwood with and without Annexation
Snapshot: Assuming Annexation in January 2010 (Millions $)

Costs	Current City	Scenario 1		Scenario 2		Scenario 3	
		Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase	Increment Increase with Annexation	Percent Increase
Legislative	0.33	0.01	2%	0.01	2%	0.01	2%
Executive	0.50	0.00	0%	0.00	0%	0.00	0%
Human Resources	0.65	0.37	58%	0.37	58%	0.39	61%
Community Affairs	0.38	0.25	67%	0.25	67%	0.25	67%
Admin Services	4.48	0.96	21%	0.96	21%	1.38	31%
Build-Prop Services	1.99	1.37	69%	1.64	83%	2.30	116%
Community Development	2.39	2.13	89%	2.13	89%	2.34	98%
Economic Development	0.38	0.12	31%	0.12	31%	0.12	31%
Fire	8.77	3.75	43%	3.75	43%	5.52	63%
Muni Court	1.22	0.63	52%	0.63	52%	0.63	52%
Parks & Rec	6.06	0.00	0%	0.08	1%	0.08	1%
Police	16.65	3.73	22%	3.79	23%	8.50	51%
Public Works	4.61	2.41	52%	2.82	61%	3.77	82%
Legal (contract)	0.68	0.29	43%	0.29	43%	0.29	43%
Library (contract)	0.62	0.00	0%	0.00	0%	0.00	0%
Total	**49.70**	**16.05**	**32%**	**16.86**	**34%**	**25.58**	**51%**

Source: City of Lynnwood, 2008; Berk & Associates, 2008

Staffing increases generally drive operating costs. Labor costs such as salaries and benefits are directly driven by increases in number of FTEs. The non-labor costs for new positions are estimated by applying a current ratio of non-labor to labor costs for each department to each FTE, and this ratio remains unchanged throughout the analysis. Annexation Scenario 1 would increase the costs by $16.1 million (32%), while Scenario 2 by $16.9 million (34%). Scenario 3 is estimated to increase City operating costs by approximately $25.6 million, or 51%. **Technical Appendix A** provides the departmental staffing increases and expense projections for the three annexation scenarios over the study period.

Municipal Court

The Municipal Court Department is currently staffed with a total of 12.8 FTEs in 9 different positions. This department provides the process for resolution of violations of State statutes and the Municipal Code. Three of the positions, Court Administrator, Court Operations Supervisor, and Probation Supervisor, are "fixed," and will not change with annexation or growth in the current city. The other six positions are assumed to be driven by total population of the current City and annexation areas, although at less than a one-to-one ratio. These positions are Legal Specialist, Probation Assistant, Probation Officer, Clerk 1, and Data Entry Clerk. In addition, the analysis assumes that the currently contracted 0.8 judge FTEs will be replaced by two full-time judges.

Municipal Court staffing increases will not differ between Scenarios 1, 2, and 3:

- **Scenario 1:** There will be 19.5 FTEs in 2010, an incremental increase of 6.8
- **Scenario 2:** There will be 19.5 FTEs in 2010, an incremental increase of 6.8
- **Scenario 3:** There will be 19.5 FTEs in 2010, an incremental increase of 6.8

Administrative Services

The Administrative Services Department is currently staffed with 41.2 FTEs in 25 different positions. This department provides accounting, finance, and computer support to the City, among other functions. Most of the manager, coordinator, and director positions are fixed, and will not change due to annexation or growth in the current City. Most IT and some finance positions are indirectly driven by the staffing increases in the Community Development, Fire, Parks and Recreation, Police, and Public Works departments. Finally, certain accounting and finance positions are indirectly driven by the growth in other positions in the department.

Future Administrative Services Department staffing levels will vary under the following scenarios:

- **Scenario 1:** There will be 50.5 FTEs in 2010, an incremental increase of 9.3
- **Scenario 2:** There will be 50.5 FTEs in 2010, an incremental increase of 9.3
- **Scenario 3:** There will be 54.7 FTEs in 2010, an incremental increase of 13.5

Human Resources

The Human Resources Department is currently staffed by 5 FTEs in 7 separate positions. Two of the positions, Human Resources Director and Labor Relations Manager, are fixed and will not increase due to annexation or growth in Lynnwood. The other positions are all indirectly driven by staffing increases in other departments, including Administrative Services, Community Development, Fire, and Police, among others.

The Human Resources department will see similar staffing increases under all three scenarios:

- **Scenario 1:** There will be 8.1 FTEs in 2010, an incremental increase of 3.1
- **Scenario 2:** There will be 8.1 FTEs in 2010, an incremental increase of 3.1
- **Scenario 3:** There will be 8.2 FTEs in 2010, an incremental increase of 3.2

Legislative

There are currently six Council Members, one Council President, and one staff position (at 0.8 FTE) in the Legislative Department. Council President and Council Member positions are fixed and will not increase due to annexation or growth. The Administrative Assistant position is directly driven by population, at a ratio of 20% of total population growth.

The Legislative Department will need the same, small staffing increase under all scenarios: Administrative Assistant position will rise to 0.9 in 2010, an incremental increase of 0.1.

Executive

The Executive Department is currently staffed by 3.6 FTEs in four different positions. Three of the positions, Assistant Administrator, Executive Assistant, and Mayor, are fixed. The fourth position, consisting of part time employees, is indirectly driven by the Assistant Administrator and Executive Assistant staffing levels. Since those positions will remain fixed under all three scenarios, there will not be an increase in FTEs for any position in the Executive Department.

Community Development

The Lynnwood Community Development Department is currently staffed by 21.1 FTEs in 18 different positions. The Community Development Department is responsible for planning, building inspection, and code enforcement. Most planner, inspection, and technician positions are directly driven by a change in construction assessed value. The other positions in the Department are either fixed, or indirectly driven by staffing levels in related positions.

The Community Development Department is expected to grow under all three scenarios:

- **Scenario 1:** There will be 37.2 FTEs in 2010, an incremental increase of 16.1
- **Scenario 2:** There will be 37.2 FTEs in 2010, an incremental increase of 16.1
- **Scenario 3:** There will be 38.2 FTEs in 2010, an incremental increase of 16.1

In addition to FTEs increase driven by annexation, the Community Development department will also grow due to the projected development spike in the city that includes the City Center and Lynnwood High School site redevelopment. Based on this growth, Community Development is projected to add 10 FTEs in 2011 and 2012 (over 2008 base). Once the Lynnwood High School site is redeveloped, the staffing will decrease by 4 FTEs by 2015. In reality, the City would not grow permitting staff as rapidly as is projected in the model, but would rather contract out the work. For this reason, the fiscal model approximates a surge in contracting costs over the 2011-2014 period via increasing and decreasing FTEs.

Economic Development

The Economic Development Department is currently staffed with a total of three FTEs in three different positions. A quarter of the Director's and 60% of the Tourism Manager's salary and benefits are paid by Tourism Fund (funded by hotel tax). This analysis does not include projections for the Tourism Fund, therefore, only those portions of the Director's and Tourism Manager's City expenditures that are funded by the General Fund are included. In addition, there is an existing deficiency within the department for an Economic Development senior staff position, which is included in the base analysis. Thus, the General Fund-funded positions total 3.2 FTEs in 2008.

The Director of the department is a fixed position, and will not change because of annexation and growth. The positions of Tourism Manager and Economic Development Senior Staff are driven directly by population, at a ratio of 50% of population growth. The Administrative Assistant position is driven indirectly by other positions in the Economic Development Department, including Tourism Manager and Senior Staff.

Future Economic Development staffing levels will be dependent on the annexation scenario:

- **Scenario 1:** There will be 4.4 FTEs in 2010, an incremental increase of 1.2
- **Scenario 2:** There will be 4.4 FTEs in 2010, an incremental increase of 1.2
- **Scenario 3:** There will be 4.4 FTEs in 2010, an incremental increase of 1.2

Building and Property Services

The Building and Property Services Department currently serves the city through 11.5 FTEs in 5 positions. This Department provides maintenance and custodial services to City properties. The Building Operations and Maintenance Supervisor is a fixed position that will not change due to annexation or growth in Lynnwood. The other four positions, including custodians and maintenance workers, are indirectly driven by size increases in nearly all of the City's other departments.

The Building and Property Services Department will see the following increases under each scenario:

- **Scenario 1:** There will be 14 FTEs in 2010, an incremental increase of 2.5
- **Scenario 2:** There will be 14.5 FTEs in 2010, an incremental increase of 3
- **Scenario 3:** There will be 15.5 FTEs in 2010, an incremental increase of 4

Community Affairs

The Community Affairs Department currently consists of 2 FTEs – Community Affairs Director and Administrative Assistant. There is an existing deficiency within the department for a Community Affairs senior staff position, which is included in the base analysis, increasing the department to 3 FTEs. Two of the positions, Community Affairs Director and Senior Staff, are directly driven by total population, at ratios of 50% and 70% of population growth, respectively. The Administrative Assistant position is indirectly driven by the position of Community Affairs Director, and therefore will also see growth under annexation.

The Community Affairs Department will see the following increases under each annexation scenario:

- **Scenario 1:** There will be 5 FTEs in 2010, an incremental increase of 2
- **Scenario 2:** There will be 5 FTEs in 2010, an incremental increase of 2
- **Scenario 3:** There will be 5 FTEs in 2010, an incremental increase of 2

Police Department

The provision of police services is frequently one of the largest expense categories of any city, with Lynnwood not being an exception. The Police Department currently serves the City in three patrol areas with a total of 117 FTEs including commissioned and non-commissioned staff. In addition, there are about 60 volunteers engaged by the Department.

Lynnwood Police Department provided estimates of increased staffing that Lynnwood would face if it were to extend services to the annexation area. These estimates are based on the Department's

analysis of historical call volumes generated in the annexation areas, compared with call volumes generated in the existing City. The department staff also modeled patrol areas and other operational issues in developing their projections. **Exhibit 13** below shows the necessary staffing increases. The Department will likely reconfigure its patrol areas upon annexation based on geography and call levels.

Exhibit 13
Estimated Police Staffing Increases for Scenarios 1, 2, and 3

	Scenario 1	Scenario 2	Scenario 3
Administrative Assistant	0	0	1
Animal Control Officer	1	1	1
Crime Prevention Specialist	0	0	1
Deputy Police Chief	0	0	1
Evidence Technician	0	0	1
Police Clerk	1	1	3.5
Police Commander	1	1	1
Police Officer	15	15	26
Police Sergeant	0	0	5
Data Entry Clerk	0	0	0.5
Police Lieutenant	0	0	2
Police Cadet	0	0	1.5
Total	18	18	44.5

Source: Lynnwood Police Department, 2008; Berk & Associates, 2008

As another data point to inform this assessment, Berk & Associates used a proprietary forecasting model we have developed over the years to estimate police demand. Our forecasting model is based on the experiences of hundreds of Washington State cities, reflecting statistical analyses of the relationship between police staffing and the underlying characteristics of a city or study area. Among other things, the Berk model looks at characteristics like the type of housing, the tenure of households, the levels and nature of commercial activity, and the presence of major thoroughfares. The model finds that each of these factors is a strong predictor of demand for police services, but the presence of each drives demand in a different way. The initial model results for Lynnwood predicted a higher police demand in the annexation areas and the need for more officers than the Department's own estimates. The Department reviewed Berk's numbers and revised its staffing estimates upward.

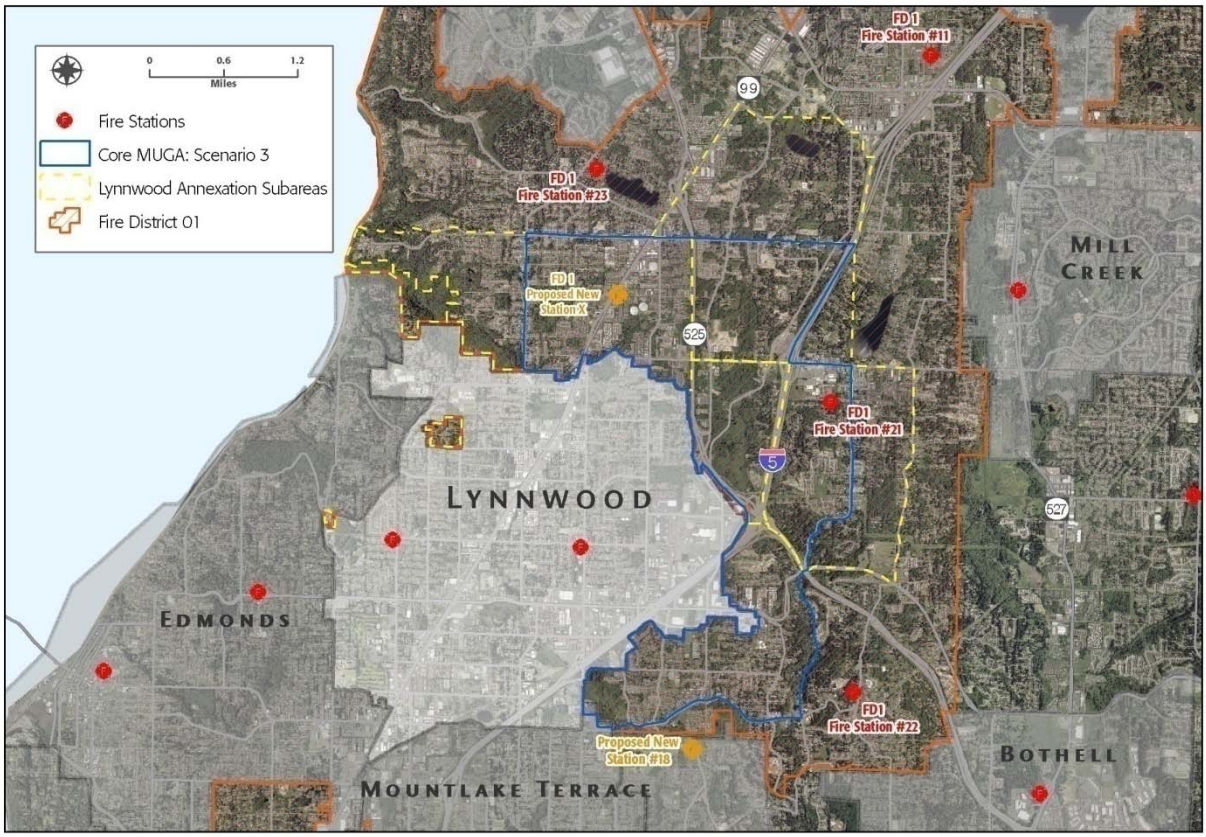
As discussed above, it is important to point out that combination of Scenarios 1 and 2 (Scenario 3) would require a higher number of command officers, due to span of control issues. A small amount of growth associated with Scenarios 1 and 2 can be handled within the existing command structure, but the larger increase in Scenario 3 would require a broadening at the lower and middle management levels (sergeants and lieutenants).

Jail. The City's jail has a maximum daily capacity of 46 individuals. In 2007, the number of total days served was 15,315, while the daily average of inmates was 42. The City also contracts with other municipalities to host its inmates; in 2007 there were 23,306 days served at other facilities. Lynnwood would not be able to expand the jail at its current location, so there would likely be an increase in contract costs as population of the City increases. The jail contract costs are expected to increase based on analysis of current jail days served in the City facility and by contract, and by applying estimated percent increase in demand calculated by the Berk police model.

Fire and Emergency Medical Services

Currently Lynnwood's Fire Department serves the City from two fire stations, with a total of 60 FTEs. **Exhibit 14** below shows existing City fire stations as well as those within Snohomish County Fire District 1 (FD1) boundaries as they relate to the contemplated study areas. FD1 currently serves all of the annexation areas.

Exhibit 14
Location of Fire Stations in Lynnwood and Fire District 1



Source: City of Lynnwood, Berk & Associates, 2008

Scenario 1. The Gateway subarea is currently served by Fire District 1 from Fire Station 23 near Lake Serene, outside the annexation area boundaries. A new fire station at Highway 99 and 156th St (within Gateway subarea boundaries) is scheduled to replace the aging Fire Station 23 in late 2010 or early 2011. For the purpose of this analysis, we are assuming that the station (Station X) will be completed before the effective date of the annexation and be transferred from District 1 to the City.

In the event of annexation under Scenario 1, the City would serve the annexation area from the new Fire Station X with an engine, a cross-personnel aid car, and a medic unit. In order to do so, an estimated 26.5 additional FTEs would be needed. These FTEs include 3 Battalion Chiefs (to fill one position), 4 lieutenants (to fill one position), 8 Firefighters/Paramedics (to fill two positions), 8 Firefighters (to fill two positions), 0.5 support staff, and one each of Medical Services Officer, Field Training Officer, and Fire Inspector.

Scenario 2. Assuming annexation under Scenario 2, the City would acquire Fire Station 21 located in the Larch Way subarea from Fire District 1. This would require staffing an engine, a cross-personnel aid car, and a medic unit, with a staffing level that essentially mirrors Scenario 1. An estimated 26.5 additional FTEs would be needed, including 3 Battalion Chiefs (to fill one position), 4 lieutenants (to fill one position), 8 Firefighters/Paramedics (to fill two positions), 8 Firefighters (to fill two positions), 0.5 support staff, and 1 each of Medical Services Officer, Field Training Officer, and Fire Inspector.

Scenario 3 (Scenarios 1 and 2 combined). This annexation scenario would result in the transfer of two fire stations and in some economies of scale. According to the Lynnwood Fire Department, in this scenario it would be best to staff an Aid/Paramedic Assessment Unit at 156th Station (Station X) and a dedicated medic unit at Station 21. The Aid/Paramedic Unit would be supported by a full paramedic response from current City Station 15, Station 21 and potentially Station X depending on the incident location, which would avoid overstaffing of paramedics.

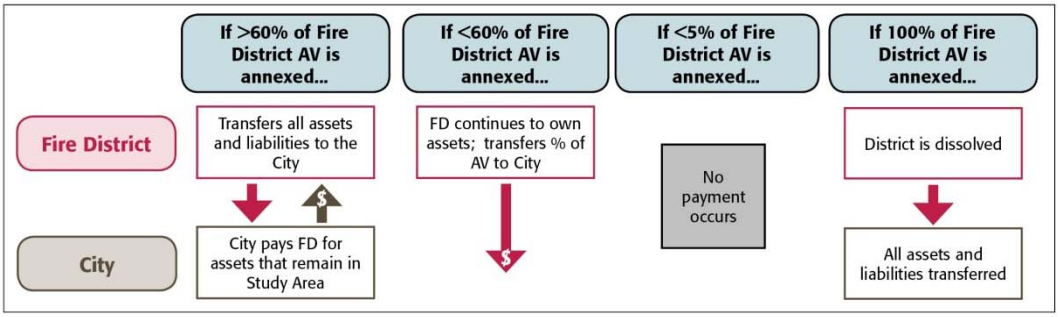
An estimated 39 additional FTEs would be needed, including 3 Battalion Chiefs (to fill one position), 8 lieutenants (to fill two positions), 12 Firefighters/Paramedics (to fill three positions), 12 Firefighters (to fill three positions), 1 support staff, and 1 each of Medical Services Officer, Field Training Officer, and Fire Inspector.

Recently, state law was revised such that upon annexation the City takes responsibility for fire services and will also receive any Fire District levy revenues that are collected from the date of annexation until the beginning of the following calendar year (for more detail see ESSB 5836).

Asset Transfer

State law guides the asset transfer in the event of a change in governance. In practice, asset transfer agreements are subject to negotiation and rely on communication between the two governments. For more information, please reference the Municipal Research and Services Center of Washington's (MRSC) Annexation Handbook, or RCW 35.02.190. The graphic below and text that follows explain how asset transfer works (**Exhibit 15**).

Exhibit 15
Asset Transfer: A Theoretical Example



Source: Berk & Associates, Revised Code of Washington

If 60% or more of the assessed real property valuation of a fire district is annexed to a city, the city will own all of the district's assets. However, the city is to pay the district a sum equal to the percentage of the value of the real and personal property in the district that remains outside the annexed area. The payment is to be made within one year of the annexation, in

cash, property, or contracts for fire protection services (RCW 35.02.190 and RCW 35A.14.380).

Another important point is that the residents in the fire protection district but outside the annexed area may hold an election to require the annexing city to assume responsibility for providing fire protection and for operating and maintaining district property, facilities, and equipment. In such a situation, the district must pay a reasonable fee to the city (or district) for the services it provides.

If less than 60% of the assessed real property valuation of a fire district is annexed to a city, the district maintains ownership of its assets. However, the district is to pay the city (in cash, properties, or contracts for fire protection services) a percentage of the value of its assets equal to the percentage of the value of the real property in the district that has been annexed into the city. This payment is to be made within one year, or within the time the district continues to collect taxes in the annexed area (RCW 35.02.200 and 35A.14.400).

If less than 5% of the area of the fire protection district is included in the area annexed, no payment is due the annexing city from the district, except in certain circumstances (RCW 35.02.205, RCW 35A.14.400).

If 100% of a fire protection district is included in the annexing city, all of the assets and liabilities of the district are to be transferred to the city upon annexation. The fire district in this case will be automatically dissolved.

In Scenario 1, the Gateway annexation subarea makes up about 8% of Fire District 1's 2008 assessed value; in Scenario 2, this percentage is about 12%, while in Scenario 3, it is 20%. As less than 60% of the assessed real property valuation of FD1 is being annexed to Lynnwood, under Washington State law, FD1 maintains ownership of its assets. However, the District is to pay the City (in cash, properties, or contracts for fire protection services) a percentage of the value of its assets equal to the percentage of the value of the real property in the district that has been annexed into the City. This payment is to be made within one year, or within the time the district continues to collect taxes in the annexed area (RCW 35.02.200 and 35A.14.400).

If an annexation were to occur, the City and District would need to reach an agreement on the value of the assets to be transferred, including the value of stations, vehicles, and cash in reserve. This analysis assumes that FD1 would transfer either facilities and equipment to the City or enough cash to cover stations and equipment, as part of the asset transfer. As there is no assurance that the new Station X would be built under the current scenario, Lynnwood may get one station (Station 21) plus cash balance for the City's share of district assets. This analysis assumes that transfer of a new Station X would be financially equal to the transfer of liquid assets.

Public Works

The Public Works Department is currently staffed by 37 FTEs (including part-time) in 22 different positions. Public Works employees are responsible for engineering public facilities, designing traffic controls, and maintaining City streets. Positions in the engineering area are directly driven by changes in total population, land area, and construction assessed value. Positions related to traffic control and maintenance are directly driven by lane miles of roads, number of traffic signals, and population. Certain director and supervisory positions are fixed, while others are indirectly driven by staffing increases within the department.

In addition, it is important to note that some Public Works department employees are also working in Water, Sewer, and Stormwater divisions. Since utility funds are fee-supported, these positions have not been included in this analysis. Enterprise funds are also outside of scope for this analysis.

The three annexation scenarios will affect Public Works staffing in the following ways:

- **Scenario 1:** There will be 50.5 FTEs in 2010, an incremental increase of 13.5
- **Scenario 2:** There will be 54 FTEs in 2010, an incremental increase of 17
- **Scenario 3:** There will be 58.5 FTEs in 2010, an incremental increase of 21.5

The difference between scenarios are attributed to the differences in drivers, where the land area in Scenario 2 is more than twice than Scenario 1, and lane miles of roads are almost three times more.

Parks and Recreation

The Parks and Recreation Department is currently staffed by 47 full-time FTEs in 25 different positions, plus approximately 50.5 FTEs in part-time positions. These employees work at aquatics and recreation centers, design and plan parks and cultural events, and maintain parks and recreation facilities. The majority of the positions, 20 out of 26, are fixed and will not increase due to annexation or Lynnwood's own growth. These fixed positions include recreation supervisors, directors, planners, and superintendents.

The City is planning on expanding the Recreation Center, and certain positions have been added to accommodate for this. In Phase I of the expansion, expected to be completed in 2011, the City is projecting the addition of 4 FTEs (all in Aquatics Division), attributable to the current City. Phase II Expansion will serve the expanded City population, and will include the addition of 1 FTE for Recreation Clerk, 2 FTEs for Recreation Program Assistant, and 1 FTE for Recreation Assistant in 2014, all attributable to annexation.

With annexation under Scenarios 2, the City would add only 7.7 acres of active park space (Hageman Park - City-owned property with development in the planning stages) and about 100 acres of open space (**Exhibit 16**). These park additions would require the need for one additional maintenance FTE. Scenario 1 has approximately 20 acres of open space and would not require any additional maintenance staff.

Exhibit 16
Parks Land in Annexation Subareas, 2008

PARK NAME	ACRES	SUBAREA	FEATURES
Lunds Creek Property	21.0	Gateway	Open space
Hemlock Acres	0.2	Swamp Creek	Open space
Manor Way property	9.0	Swamp Creek	Open space
Swamp Creek Regional Stormwater Facility	90	Parkway	Open space
Tutmark Hill, aka Doc Hageman Park	7.7	Larch Way	Will be developed in 2010
Total	127.9		

Source: City of Lynnwood, 2008; Berk & Associates, 2008

Contracts

Legal. The City contracts with law firms for City Attorney services, as well as prosecution and public defender services. The contract costs are estimated to rise as population increases, at a ratio of 50% of population growth.

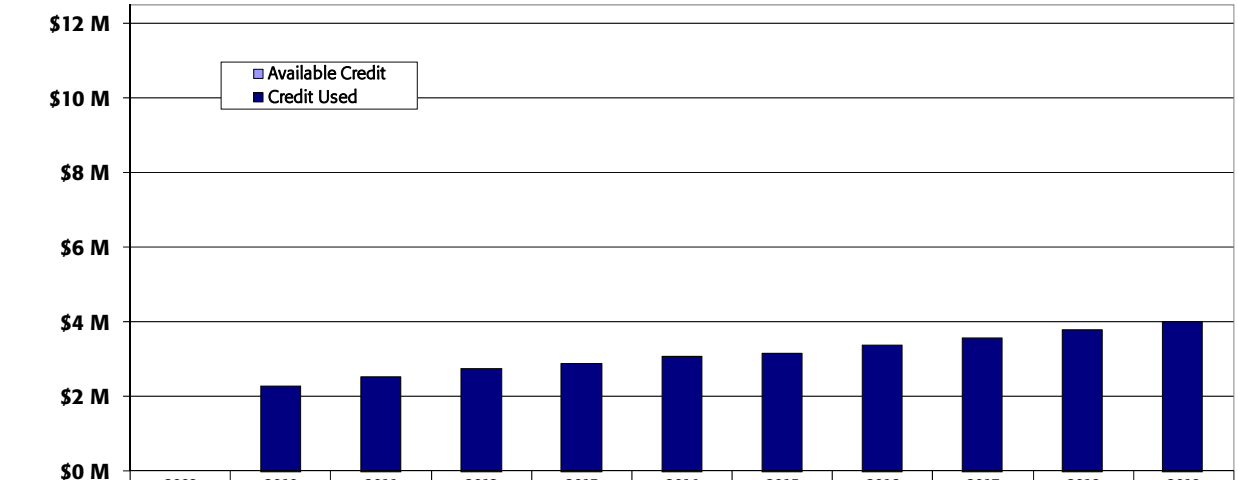
Library. The City owns and maintains the Library building, contracting for library services with Sno-Isle Libraries. The library is currently available for use by all residents of the Sno-Isle Library District, including the residents in the MUGA. No change in use is expected. This analysis assumes that additional staff or facility space are not required upon annexation.

5.4 State Sales Tax Credit

Since Lynnwood has a population of less than 400,000 and is located in a county with a population of more than 600,000, the City would qualify for the State sales tax credit (see Section 1.2 for more detailed description). Scenarios 1 and 2 are estimated to have populations of more than 10,000, but less than 20,000, and would thus qualify for 0.1% sales tax credit. Scenario 3 contains more than 20,000 people and would qualify for the 0.2% credit.

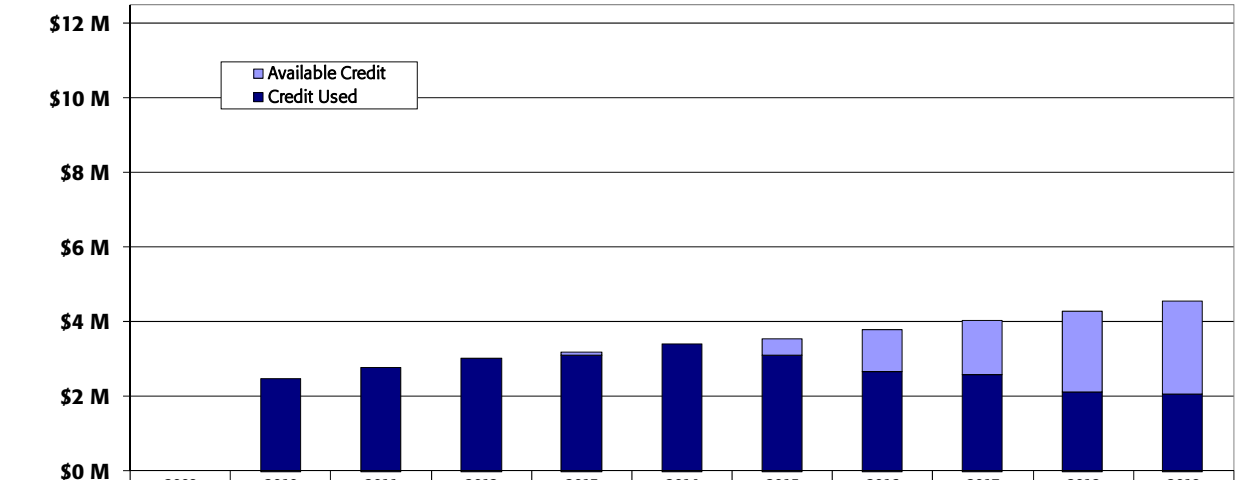
The statute allows the City to recoup the loss due to annexation up to the maximum 0.1% or 0.2% of sales tax revenues. However, considering Lynnwood's large sales tax base, estimates show that in Scenarios 2 and 3, the City would not be eligible for the full possible credit in some years (as the City's eligible costs are estimated to be less than the potential credit). Given the magnitude of the shortfalls in Scenario 1, it is expected that the State sales tax credit would be fully utilized in all years. **Exhibit 17** shows the estimate of maximum State sales tax credit available for each scenario and the portion that is estimated to be used during the ten-year transition period.

Exhibit 17
Scenario 1: State Sales Tax Credit



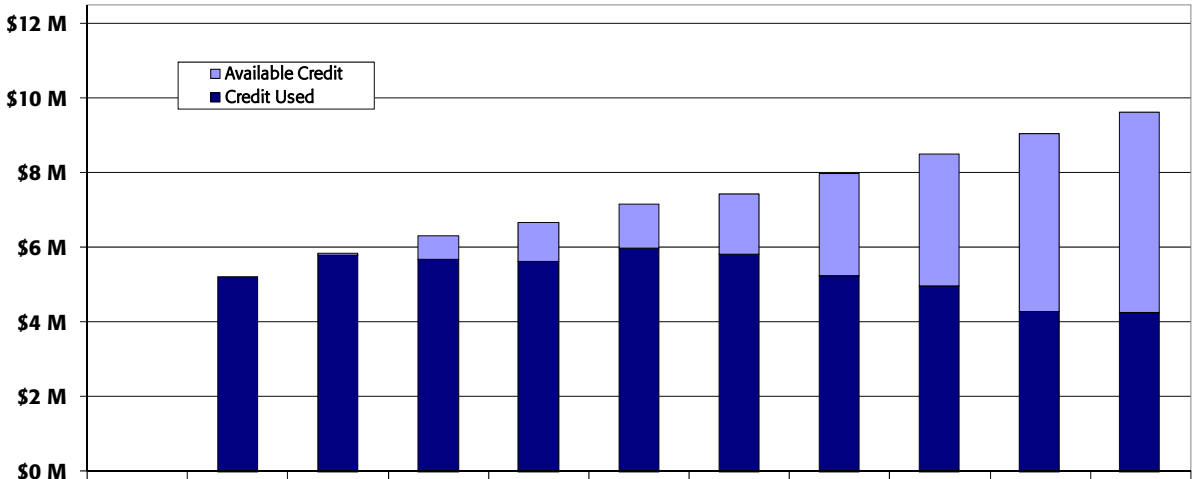
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Available Credit	0	0	0	0	0	0	0	0	0	0	0
Credit Used	0	2,282,639	2,544,765	2,754,764	2,889,447	3,080,299	3,174,389	3,384,665	3,583,766	3,795,144	4,019,586
Max Credit	0	2,282,639	2,544,765	2,754,764	2,889,447	3,080,299	3,174,389	3,384,665	3,583,766	3,795,144	4,019,586

Scenario 2: State Sales Tax Credit



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Available Credit	0	0	0	0	66,930	0	419,938	1,108,980	1,450,922	2,163,533	2,484,273
Credit Used	0	2,491,127	2,788,922	3,021,414	3,121,405	3,413,751	3,124,973	2,685,978	2,585,824	2,130,421	2,083,347
Max Credit	0	2,491,127	2,788,922	3,021,414	3,188,335	3,413,751	3,544,910	3,794,958	4,036,746	4,293,954	4,567,620

Scenario 3: State Sales Tax Credit



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Available Credit	0	0	51,129	626,390	1,060,061	1,180,507	1,628,989	2,732,758	3,530,334	4,764,164	5,386,851
Credit Used	0	5,218,635	5,791,045	5,698,338	5,624,143	5,982,280	5,826,155	5,254,986	4,976,155	4,294,780	4,260,563
Max Credit	0	5,218,635	5,842,174	6,324,728	6,684,204	7,162,787	7,455,144	7,987,744	8,506,489	9,058,944	9,647,414

Source: Berk & Associates analysis, 2008

The statute does not specifically call out whether the State sales tax credit can be used only to cover operating deficits or also to provide funding for capital expenditures:

"The revenues from the tax authorized in this section may not exceed that which the city deems necessary to generate revenue equal to the difference between the city's cost to provide, maintain, and operate municipal services for the annexation area and the general revenues that the cities would otherwise expect to receive from the annexation during a year."

There has not been a definitive opinion by an Attorney General or any State agency as to whether the credit may be used to cover capital expenditures. However, a number of cities around the region are basing their analyses of annexation impacts on the assumption that the following costs will be eligible for sales tax credit calculation: (1) direct operating impacts from annexation, (2) allocation of a portion of fixed costs (such as Fire Chief's salary), (3) annexation-related equipment costs, and (4) annexation-related additional facility costs (costs to house annexation-related staffing increases). Capital infrastructure costs (road construction, surface water management facilities, etc.) are assumed to not be eligible.

Of these four elements, three are clearly related to impacts directly tied to annexation, while the fourth (fair share of fixed labor costs) is not. There are two possible approaches to calculating the costs related to serving the annexation area: (1) an incremental cost approach, which would only account to direct, indirect, one-time costs that could be specifically tied to the annexation; and (2) an average cost approach which would include the incremental costs plus a fair share of the city's fixed costs. For the purposes of calculating the State sales tax credit, this analysis uses the broader definition of total allocable costs (an average cost approach).

Since Lynnwood is pursuing two independent annexations (Lynnwood North and East – Scenarios 1 and 2), a question arises of how to account for these annexations should they both pass. It is

uncertain whether the City would be required to set separate thresholds for each area or one threshold for both.

As **Exhibit 17** demonstrates, Lynnwood would likely not need the full amount of State sales tax credit available in all years for Scenarios 2 and 3. In these instances, it is best to think of the potential availability of additional State sales tax credit as an added level of insurance to mitigate potential financial risks associated with annexation.

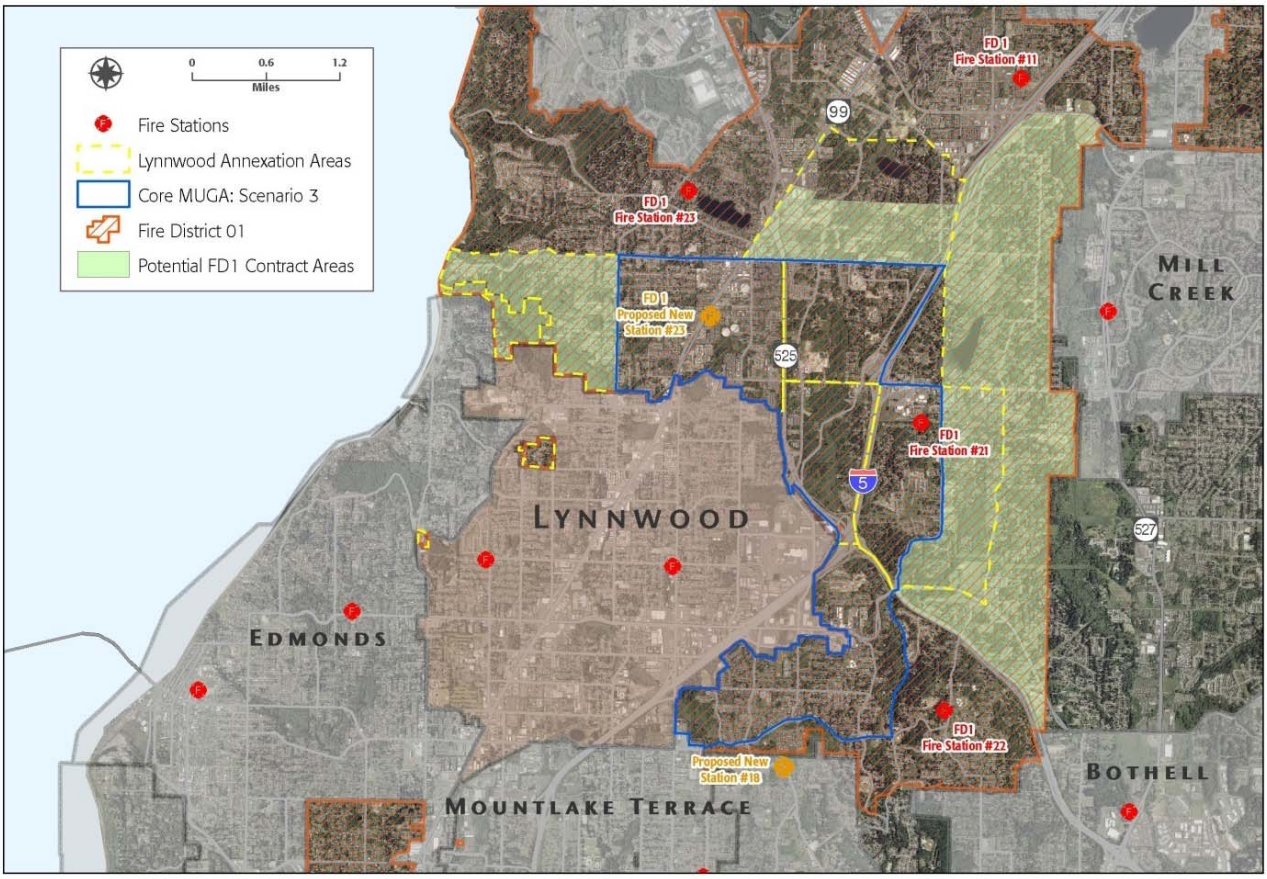
5.5 Potential Fire District Service Contract

Upon annexation, the City of Lynnwood would be responsible for provision of fire services to the newly annexed areas. Under the State's fire district asset transfer laws (described previously in more detail under Fire and Emergency Medical Services in Section 5.3 of this report), the City would likely acquire fire stations from Snohomish County Fire District 1 (FD1): new Fire Station in Scenario 1, Station 21 in Scenario 2, and both of these stations in Scenario 3 (for more information see Section 5.3 "Operating Cost Analysis" of this report). This analysis assumes that Lynnwood would take over these stations, and so the full cost of providing the services from these stations was included in the costs of annexation.

Upon annexation, the City will provide fire and EMS services to some portions of Fire District 1 from its newly acquired fire stations: in Scenario 1, Meadowdale Gap and Lunds Gulch; in Scenario 2, a north-south area between new Lynnwood boundaries and Mill Creek; and in Scenario 3, the previously mentioned areas plus portions of Lake Stickney. The City and Fire District 1 will need to approve a services contract for these areas. **Exhibit 18** shows these potential contract areas shaded in green. Lynnwood Fire Department suggested that they would likely not require additional staff and equipment to serve these areas.

As a point of reference, Fire District 1 is currently contracting with the City of Edmonds for provision of services in difficult to reach areas near the City. Edmonds is looking to renegotiate this contract at 60% to 65% of FD1 revenues to provide service in the area.

Exhibit 18
Potential Fire District 1 Contract Areas



Source: City of Lynnwood, 2008; Berk & Associates, 2008

The contract terms and payment amount will be determined through negotiation between Lynnwood and FD1; however, based on information about Edmonds' contract, this analysis presents some high-level estimates of potential revenues to the City, based on percent of revenues collected by FD1 (**Exhibit 19**).

Exhibit 19
Estimated Potential Revenues to City of Lynnwood from Fire District 1 Contract

	Scenario 1		Scenario 2		Scenario 3	
	2008	**2009**	**2008**	**2009**	**2008**	**2009**
Fire District 1 Expense Levy Rate	$1.3257	$1.5000	$1.3257	$1.5000	$1.3257	$1.5000
Fire District 1 EMS Levy Rate	$0.5000	$0.4864	$0.5000	$0.4864	$0.5000	$0.4864
Potential contract areas	Meadowdale and Lund's Gulch		Area east of Larch Way		Meadowdale and Lund's Gulch, portion of Lake Stckney, and area east of Larch Way	
Estimated Taxable Assessed Value	$434.6 M	$465.5 M	$2,005.0 M	$2,025.0 M	$2,970.3 M	$3,042.7 M
Estimated Fire District 1 Revenue	$0.8 M	$0.9 M	$3.7 M	$4.0 M	$5.4 M	$6.0 M
Estimated FD 1 Contract @ 50% of Revenue	**$0.4 M**	**$0.5 M**	**$1.8 M**	**$2.0 M**	**$2.7 M**	**$3.0 M**
Estimated FD 1 Contract @ 65% of Revenue	**$0.5 M**	**$0.6 M**	**$2.4 M**	**$2.6 M**	**$3.5 M**	**$3.9 M**

Source: City of Lynnwood, 2008; Snohomish County Assessor's Office, 2008; Berk & Associates, 2008

Based on the analysis of Fire District 1 assessed value, expense and EMS levy rates, and potential revenues, the City of Lynnwood may potentially be able to receive between $500,000 and $600,000 in Scenario 1, $2.4 million and $2.6 million in Scenario 2, and $3.5 million to $3.9 million in Scenario 3. Due to the fact that the terms of any future contract will need to be negotiated with Fire District 1, these potential revenues were excluded from the base evaluation of annexation feasibility.

5.6 One-Time Costs

Exhibit 20 below shows one-time costs for the three scenarios, including vehicle, equipment, plan and document updates, and other costs.

Exhibit 20
One-Time Costs for Annexation Scenarios 1, 2, and 3

	Scenario 1	***Scenario 2***	***Scenario 3***
	Gateway	*Swamp Creek, Parkway, Larch Way, Alderwood Manor*	*Gateway, Swamp Creek, Parkway, Larch Way, Alderwood Manor*
Public Works			
Vehicles	$380,000	$380,000	$584,000
Plan and Document updates	$348,000	$348,000	$535,000
Community Development			
Vehicles	$180,000	$180,000	$180,000
Plan updates	$228,000	$228,000	$420,000
Police			
Equipment	$81,500	$81,500	$165,000
Vehicles	$470,000	$470,000	$955,000
Fire			
Transition negotiations	$100,000	$100,000	$100,000
Total	**$1,787,500**	**$1,787,500**	**$2,939,000**

Source: City of Lynnwood, 2008; Berk & Associates, 2008

The Public Works department estimates approximately $584,000 in vehicle equipment for Scenario 3, including dump trucks, backhoes, and other vehicles for street maintenance. There are a number of City documents that would require review and modification, including Public Works' portion of City Comprehensive Plan, 6-Year Transportation Plan, and a number of others, projected at approximately $535,000. Scenarios 1 and 2 are assumed to require approximately 65% of vehicle and plan update costs for Scenario 3. In addition to these General and Street fund expenditures, Stormwater, Water, and Sewer divisions would need $1.3 million in one-time costs, mostly for vehicles. These costs are assumed to be paid out of utility funds and are not included in this analysis.

The Community Development department requires vehicles for inspectors and code enforcement staff, as well as a motor pool vehicle. As staffing is the same for each of the three scenarios, this cost

would remain the same, at $180,000. Additionally, in Scenario 3, Community Development would need $420,000 for three urban center subarea plans, updates to the City Comprehensive Plan, and one-time expenses involved in extending the coverage of the City's permitting system to include information on parcels, structures, and uses in place at the time of annexation. Scenarios 1 and 2 would require approximately $228,000 each.

For the Police Department, the largest one-time costs are for vehicles. The department generally provides vehicles for patrol officers (at $90,000 each), command officers and detectives (at $25,000 each), and animal control ($35,000). In Scenario 3, the City has estimated an additional cost of $955,000 for 17 new staff vehicles, and $165,000 in equipment for officers and civilian employees. Scenarios 1 and 2 require $470,000 for eight vehicles and $82,000 in equipment.

It is assumed that the Fire Department would acquire the vehicles and equipment needed for the new firefighters along with the stations from Fire District 1 through asset transfer, so no one-time costs have been estimated. However, there will likely be additional legal expenses due to negotiations with the Fire District, estimated at $100,000 for each scenario.

The City may not be able to use its water & sewer utility billing system to charge for stormwater in the annexed areas, as the City will not assume responsibility for water and sewer service in the annexation areas. Thus, the City will need a new billing system for stormwater. The costs for this system are not included in this analysis, as they are assumed to be paid from the stormwater fund.

5.7 Facilities

General City Facilities

Lynnwood is outgrowing its City Hall space. The police facilities are currently operating at capacity in terms of parking, locker space, and office space. Similarly, Municipal Court has inadequate space to handle even its current work load. In light of these facility difficulties, the City will need additional facilities for new employees attributable to both city growth and annexation.

Eventually, Lynnwood may wish to expand its existing City Hall and other facilities by building new space; however, this decision will be made over time and will require separate cost and financing estimates. For this analysis, we assume that the City will lease additional space for all departments with new staff, with the following exceptions: (1) fire department, as fire stations are assumed to be acquired as part of the asset transfer from Fire District 1, and (2) parks & recreation department, as there are current plans to expand the recreation center.

The following assumptions were made for calculation of facility costs:

- 250 square feet of office space per FTE (gross)
- $16 per square foot per year rental costs
- $100 per square foot tenant improvements
- $5,000 per FTE in one-time office equipment costs to outfit the workstations

The space need projections are based on five-year projected new FTEs (2010-2014), for facility costs associated with both City growth and annexation. The projections assume that the City acquires the space with enough capacity for staffing through 2014. **Exhibit 21** summarizes FTEs requiring additional space, square feet needed, and the amount of rent, tenant improvements, and equipment cost.

Exhibit 21
Estimated Facility Impacts of City Growth and Annexation, 2010

	Current City	Scenario 1	Scenario 2	Scenario 3
FTEs Requiring Additional Space	27.1	59.9	65.9	99.0
Square Feet Needed	6,769	16,463	17,963	26,238
Rent in 2010	$116,018	$282,161	$307,870	$449,700
Tenant Improvements	$676,899	$1,646,250	$1,796,250	$2,623,750
Equipment Cost	$12,500	$335,750	$350,750	$526,250

Source: City of Lynnwood, 2008; Berk & Associates, 2008

Current City. For facilities associated with City growth through 2014, approximately 27 FTEs will be added, which translated into the need for approximately 6,800 sf. The rent for this space is estimated at $116,000 in 2010, with tenant improvements at $675,000 and $12,500 in one-time office equipment costs.

Scenario 1. In addition to City growth, there will also be a need for space for approximately 60 FTEs associated with annexation (through 2014), translating into 16,463 sf of facilities, $282,161 in rent (in 2010), $1.6 million tenant improvements, and $335,750 in one-time office equipment costs.

Scenario 2. There will be a need for space for approximately 65 FTEs associated with annexation (through 2014), translating into 17,963 sf of facilities, $307,870 in rent (in 2010), $1.8 million tenant improvements, and $350,750 in one-time office equipment costs.

Scenario 3. There will be a need for space for approximately 99 FTEs associated with annexation (through 2014), translating into 26,000 sf of facilities, $450,000 in rent (in 2010), $2.6 million tenant improvements, and $530,000 in one-time office equipment costs.

Public Works

Estimates of additional space for office-based Public Works FTEs are included in general facilities projections (see above). New vehicle and equipment purchases for Streets and Stormwater, along with an increase in maintenance shop-based staff, generate a need for either a second maintenance center of a major expansion of the existing facility. For Scenario 3, this second facility has been assumed. This facility would require a land purchase of 4 to 5 acres and a new building, at an estimated cost of approximately $5 million. The increase in vehicles would also require the need for at least 3 additional service bays at the current maintenance center at a cost of about $800,000. A new maintenance center would also house an additional 10 FTEs for stormwater, which are not included in this analysis.

The cost for new maintenance center is assumed to be split between General/Street funds and Stormwater fund, 45% versus 55%, respectively. Therefore, in Scenario 3, General and Street fund share of this project is estimated at $2.75 million. About half of the cost for additional service bays would be borne by the General and Street funds, amounting to about $400,000.

For Scenarios 1 and 2, Public Works would still require additional space to service and store vehicles and house additional maintenance staff, but not enough to justify a second maintenance center. This analysis assumes that the City would expand the existing center or acquire existing light industrial space nearby. General and Street funds would pay approximately $560,000 in Scenario 1, or $1.6 million in the larger Scenario 2 area. There would also be the need for two additional service bays at the existing maintenance center in either Scenario 1 and 2, amounting to $270,000 from the General and Street fund.

6.0 TRANSITION PERIOD ANALYSIS

6.1 Overview and Key Findings

This analysis builds upon the annual-level snapshot estimates and focuses on the specific monthly inflows and outflows of City revenues and costs for the first four years after the effective date of annexation. The goal of this analysis is to give the City decision-makers a sense of cash flow requirements during the phasing-in of various revenue sources and building-up of City service capabilities and facilities.

The effective date of annexation chosen by the City will have an impact on both revenues and expenditures in the transition period. Many of the revenues are not time sensitive and will begin accruing to the City immediately upon annexation. Other revenue sources such as sales taxes, property taxes, and state-shared revenues have certain lags associated with distributions, and are therefore time sensitive. The City has more direct control over transition expenditures and can decide to delay certain costs or phase-in staff as needed to offset the initial impact of annexation. Based on the operating revenue and cost assumptions detailed in the following sections, Berk & Associates has modeled the monthly cash flow estimates from six months prior to annexation through the end of 2014.

As part of the transition analysis, the City requested that Berk & Associates assess the "best" possible months to annex taking into account the various revenue lags and staffing assumptions. The City has some flexibility in choosing the effective date of annexation and therefore can minimize the impacts of the transition period. The main revenue factors that contribute to whether or not a particular month may be more or less favorable include:

- **Property tax revenues.** Most property owners do not pay their property taxes in equal monthly installments; cities receive the bulk of property tax revenues in May and June and in November and December. Annexation dates on or before April 1 or after October 1 would take advantage of these large revenue distribution months. There is also an issue of which levy rate would apply to the annexed areas in the transition period. The City will always be in a position to receive property tax revenues associated with the annexed areas whether they are based on the City's general levy rate or the levied but uncollected county fire and road taxes. It is worth noting that comparatively, the revenues received from the levied but uncollected county fire and road taxes would be more than the City would get if it were levying its own property tax. If the annexation were to occur before August 1, 2010, property tax revenues based on the City's general levy rate would not begin until January 2011. If the annexation were to occur after August 1, 2010, property tax revenues based on the City's general levy rate would not begin until January 2012.
- **Sales tax revenues.** Sales tax changes only take effect on the first day of each quarter (January 1, April 1, July 1, and October 1). There is always a lag of two months between sales tax collections and revenue distributions. The City can minimize any sales tax revenue lags by having an effective date of annexation that falls on the first day of the quarter.
- **State sales tax credit.** The threshold amount, as described in Section 1.2, represents the amount of sales tax credit revenues that City expects to receive each fiscal year. This threshold amount is provided to the Department of Revenue by March 1 each year. However, the statute is unclear on the timing for submittal of the threshold amount for the first fiscal year. The transition analysis assumes that annexations that are completed on or before April 1 would be eligible to receive State sales tax credit revenues in Year 1 of the transition period (2010). Annexations that

occur after April 1 will not be eligible to receive State sales tax credit revenues until Year 2 (2011). In both scenarios, State sales tax credit revenues will begin on July 1 (beginning of State fiscal year) and continue until the threshold amount has been reached or June 30th of the next year, whichever is sooner.

Based on the various revenue lags, there are four dates that would maximize the City's cash flow:

- **March 1, 2010.** The advantage of annexing in March would be that the City would be eligible to collect State sales tax credit revenues beginning in July 2010. The City would also take advantage of the large property tax revenue months of May, June, November, and December. However, due to sales tax revenue lags, the City would not receive sales tax revenues until July and would not receive any sales tax revenues for the month of March.
- **April 1, 2010.** Similar to March, an effective annexation date of April 1, 2010 the City would be eligible to receive State sales tax credit revenues beginning in July 2010. The City would also take advantage of the large property tax revenue months of May, June, November, and December. An annexation date of April 1 also minimizes the sales tax revenue lags. The City would receive its first sales tax revenues in July 2010.
- **October 1, 2010.** In this scenario, the City would not receive State sales tax credit revenue until July 2011. The advantage of annexing in October is that the City would receive levied but uncollected county road and fire property taxes for both 2010 and 2011. The City would take advantage of the large property tax collection months of November and December. However, the portion of the levied but uncollected county road tax revenues would have to flow into the City's Street Fund. The uses of these funds would be limited to transportation-related expenses. An annexation date of October 1 also minimizes the sales tax revenue lags. The City would receive its first sales tax revenues in January 2011.
- **November 1, 2010.** Similar to October, the City would not receive State sales tax credit revenue until July 2011. Also, the City would receive levied but uncollected county road and fire taxes for both 2010 and 2011. The portion of the levied but uncollected county road tax revenues would have to flow into the City's Street Fund and would be limited to transportation-related expenses. Due to sales tax revenue lags, the City would receive its first sales tax revenues in April 2011 and would not receive any sales tax revenues for November or December.

For the purposes of this report and to illustrate the potential net incremental cost and revenues that would occur during the transition period, the City chose an effective annexation date of *November 1, 2010*. **Exhibit 22** below shows the expenditure and revenue categories analyzed in the transitional period for Scenarios 1, 2, and 3, which include:

- **Labor.** Salaries, benefits, overtime, and contract expenditures.
- **Non-Labor Ongoing Costs.** Associated non-labor costs and rental costs for new facilities.
- **New Facility-Related Costs.** Office equipment needed for new facilities.
- **Other One-Time Costs.** Vehicle costs for Public Works, Police, and Community Development; City document and plan updates for Public Works and Community Development; and Fire transition negotiations.
- **Facility Debt Service.** Includes the debt service payments for all tenant improvements, Public Works Yard, and additional service bays for Public Works.
- **Core Resources.** Tax and fee revenues.
- **State Sales Tax Credit.** The projected amount of calendar year (January – December) State sales tax credit revenues.

Exhibit 22
Estimated Net Incremental Costs & Revenues Scenario 1:
Assuming Annexation in November 2010

Increment from Annexation Areas	2010	2011	2012	2013	2014
Core Expenditures					
Labor	1,839,855	10,503,959	11,473,946	11,820,154	12,510,123
Non-Labor Ongoing Costs	413,918	2,118,711	2,526,793	2,734,604	2,586,816
New Facility-Related Costs	359,664	0	0	0	0
Other One-Time Costs	1,381,880	294,919	118,195	213,784	0
Subtotal Core Expenditures	**3,995,317**	**12,917,589**	**14,118,934**	**14,768,542**	**15,096,939**
Facility Debt Service	57,767	346,604	346,604	346,604	346,604
Subtotal Expenditures	**4,053,084**	**13,264,193**	**14,465,538**	**15,115,145**	**15,443,543**
Core Resources	1,933,598	9,772,630	9,780,787	10,056,732	10,534,464
State Sales Tax Credit	0	1,272,383	2,649,764	2,822,105	2,984,873
Subtotal Revenues	**1,933,598**	**11,045,013**	**12,430,552**	**12,878,838**	**13,519,337**
Net Resources (000's)	(2,119,486)	(2,219,180)	(2,034,986)	(2,236,308)	(1,924,205)
Deficit/Surplus as % of Expenditures	-52%	-17%	-14%	-15%	-12%

Estimated Net Incremental Costs & Revenues Scenario 2:
Assuming Annexation in November 2010

Increment from Annexation Areas	2010	2011	2012	2013	2014
Core Expenditures					
Labor	1,921,355	11,024,095	12,218,133	12,599,832	13,496,603
Non-Labor Ongoing Costs	443,229	2,303,093	2,771,978	2,988,371	2,871,656
New Facility-Related Costs	375,732	0	0	0	0
Other One-Time Costs	1,381,880	294,919	118,195	213,784	0
Subtotal Core Expenditures	**4,122,196**	**13,622,106**	**15,108,306**	**15,801,986**	**16,368,259**
Facility Debt Service	86,337	518,022	518,022	518,022	518,022
Subtotal Expenditures	**4,208,533**	**14,140,128**	**15,626,328**	**16,320,008**	**16,886,281**
Core Resources	2,837,426	14,567,982	14,874,278	15,690,528	16,735,698
State Sales Tax Credit	0	1,394,461	2,905,168	3,071,410	3,267,578
Subtotal Revenues	**2,837,426**	**15,962,443**	**17,779,446**	**18,761,937**	**20,003,276**
Net Resources (000's)	(1,371,107)	1,822,315	2,153,118	2,441,929	3,116,995
Deficit/Surplus as % of Expenditures	-33%	13%	14%	15%	18%

Estimated Net Incremental Costs & Revenues Scenario 3: Assuming Annexation in November 2010

Increment from Annexation Areas	2010	2011	2012	2013	2014
Core Expenditures					
Labor	2,645,587	15,883,931	17,723,609	18,691,055	20,006,514
Non-Labor Ongoing Costs	575,717	3,196,885	3,961,600	4,392,034	4,403,821
New Facility-Related Costs	563,732	0	0	0	0
Other One-Time Costs	2,168,159	598,708	332,782	213,784	0
Subtotal Core Expenditures	**5,953,196**	**19,679,524**	**22,017,991**	**23,296,872**	**24,410,335**
Facility Debt Service	122,052	732,313	732,313	732,313	732,313
Subtotal Expenditures	**6,075,248**	**20,411,837**	**22,750,305**	**24,029,185**	**25,142,648**
Core Resources	4,272,202	21,355,577	21,463,549	22,602,114	23,988,196
State Sales Tax Credit	0	2,768,723	5,617,892	5,661,240	5,803,211
Subtotal Revenues	**4,272,202**	**24,124,300**	**27,081,441**	**28,263,354**	**29,791,407**
Net Resources (000's)	(1,803,047)	3,712,463	4,331,137	4,234,169	4,648,759
Deficit/Surplus as % of Expenditures	-30%	18%	19%	18%	18%

Source: Berk & Associates, 2008

Technical Appendix D provides detail of the cash flow scenarios.

6.2 Transition Operating Revenue Analysis

The effective date of annexation chosen by the City will have an impact on when and how much new revenue is received. Many of the revenue sources are not time sensitive and will begin immediately upon annexation. Other revenue sources such as sales taxes, property taxes, and state-shared revenues have certain lags associated with distributions and are time sensitive. A matrix describing each revenue source, the relevant RCWs concerning revenue lags, and the estimated month of first revenue receipts are included in **Technical Appendix E**.

Retail Sales Tax

Sales tax changes, due to the result of the annexation, may only take effect quarterly on January 1, April 1, July 1, and October 1. *RCW 82.14.055,* which provides the authority to make sales tax changes, states that the City must notify the Department of Revenue at least 75 days prior to the effective date of annexation. There is always a lag of two months between sales tax collections and distributions. Depending on the effective date of annexation, this lag can increase up to an additional two months. To minimize the sales tax revenue lag the effective date of annexation should take place on the first day of the quarter (January 1, April 1, July 1, or October 1). These lags also apply to Criminal Justice tax revenues.

Property Taxes

RCW 84.09.030 provides the authority for the City to levy its property tax upon the annexed areas provided that the annexation is officially completed by August 1. If the annexation is completed after August 1, the city will have to wait until the following year to levy the tax. Based on an effective annexation date of November 1, 2010, the City would not receive property tax revenues until January

2012. Between the effective date of annexation and January 2012, the City will be able to receive the levied but uncollected county road and fire tax revenues in lieu of its regular property tax revenues.

RCWs 35.13.270 and 35A.14.801 state that in order to receive the levied but uncollected road and fire tax revenues, the City must first notify the county treasurer and assessor of the annexation at least 30 days before the effective date. Also, the road tax revenues must be deposited into the City's Street Fund and limited to transportation-related expenses. Since most of the near-term cost impacts are for General Fund activities, it may be necessary to use inter-fund loans to move Road Levy funds to the General Fund to ensure that there are adequate resources to meet the needs of the annexation area. These loans would need to be repaid from General Fund sources over time.

State-Shared Revenues (Gas Tax, Liquor Board Profits, and Liquor Excise Taxes)

State-shared revenues are distributed to cities based on population. For the City to have its population adjusted to reflect the annexation, the Office of Financial Management (OFM) must certify the annexation, after which it will notify the appropriate state agencies of the population change. The new population figures are not recognized by the distributing state agencies until the date that OFM approves the annexation certificate submitted to it by the City.

The City can maximize its revenue from state-shared revenues by beginning its census procedures before the effective date of annexation. Consulting with OFM prior to the annexation date will allow the City to also begin the enumeration process before annexation actually occurs. Even if the City is able to meet all of the required deadlines set forth by OFM, it still might not receive state-shared revenues in the quarter in which it annexes. For example, when OFM's population staff is developing annual estimates (March 1 – May 31), large annexations may not get processed in time.

Based on an effective annexation date of November 1, 2010, the City will begin to receive state-shared revenues in April 2011. This assumes that the City obtains certification from OFM in a timely manner. A chart of the annual filing dates, dates of expected first revenue receipts, and the documents needed to begin the certification process are included in **Technical Appendix E.**

State Sales Tax Credit

As described in Section 5.4, the City will be eligible to receive State sales tax credit revenues in the transition period for all three scenarios. The specific timing of the first revenues will depend on the effective date of annexation and could lag by as much as one year. However, based on a November 1, 2010 annexation date, the City would begin to receive State sales tax credit revenues in July 2011. This assumes that the City submits its annual threshold amount by March 1, 2011. The City will also be eligible to receive these revenues through June 2020.

6.3 Transition Operating Cost Analysis

Staffing

Monthly staffing levels in the transition analysis build off of the annual snapshot estimates. Acknowledging that not all incremental FTEs due to annexation would be hired on day one, we worked with each department to develop the staffing assumptions used in the transitional analysis. This included positions that would be pre-hired before or phased-in after the effective date of annexation. For most departments, staffing level increases attributable to the annexation areas were phased-in at about 70% of full staffing levels for the first year of annexation (2010). For some departments, the phasing-in was less than 70% of full staffing levels due to rounding constraints for

certain positions. The remaining staffing needs in the transition period were hired in 2011, 2012, and 2013 so that by 2014 the City would be at a fully staffed level and consistent with the annual snapshot annexation estimates. Note: The annexation transition period could include contracting with service providers while the City builds up its own staffing capabilities.

- **Scenario 1.** The fully staffed level at the end of the transition period is 95.5 FTEs
- **Scenario 2.** The fully staffed level at the end of the transition period is 103.6 FTEs
- **Scenario 3.** The fully staffed level at the end of the transition period is 150.5 FTEs

Exhibit 23 below illustrates the ramping-up effort in the transition period for all three scenarios.

Exhibit 23
Annexation Staffing for Scenario 1: Assuming Annexation in November 2010

Incremental FTEs in Transition Period	2010	2011	2012	2013	2014
Legislative	0.1	0.1	0.1	0.1	0.1
Executive	0.0	0.0	0.0	0.0	0.0
Human Resources	2.5	2.5	2.5	2.5	2.5
Community Affairs	1.0	1.9	1.9	1.9	1.9
Admin Services	4.8	5.8	5.8	5.8	5.8
Build-Prop Services	2.0	2.0	2.0	2.0	2.0
Community Dev	11.6	15.1	15.1	15.1	15.1
Econ Dev	0.6	1.1	1.1	1.1	1.1
Fire	26.5	26.5	26.5	26.5	26.5
Legal	0.0	0.0	0.0	0.0	0.0
Library	0.0	0.0	0.0	0.0	0.0
Muni Court	4.3	5.8	6.3	6.3	6.3
Parks & Rec	0.0	0.0	0.0	0.0	4.0
Police	5.3	10.3	14.2	18.2	19.2
Public Works	8.5	11.0	11.0	11.0	11.0
Total Transition FTEs	**67.2**	**82.1**	**86.5**	**90.5**	**95.5**
Fully Staffed Level*	**99.4**	**91.3**	**92.1**	**90.5**	**95.5**
% of Fully Staffed Level	*68%*	*90%*	*94%*	*100%*	*100%*

*Includes 5.0 FTEs pre-hired six months prior to annexation
**Consistent with annual snapshot estimates

Annexation Staffing for Scenario 2: Assuming Annexation in November 2010

Incremental FTEs in Transition Period	2010	2011	2012	2013	2014
Legislative	0.1	0.1	0.1	0.1	0.1
Executive	0.0	0.0	0.0	0.0	0.0
Human Resources	2.5	2.5	2.5	2.5	2.5
Community Affairs	1.0	1.9	1.9	1.9	1.9
Admin Services	4.8	5.8	5.8	5.8	5.8
Build-Prop Services	2.0	2.0	2.0	2.0	2.5
Community Dev	11.6	15.1	15.1	15.1	15.1
Econ Dev	0.6	1.1	1.1	1.1	1.1
Fire	26.5	26.5	26.5	26.5	26.5
Legal	0.0	0.0	0.0	0.0	0.0
Library	0.0	0.0	0.0	0.0	0.0
Muni Court	4.3	5.8	6.3	6.3	6.3
Parks & Rec	0.5	1.0	1.0	1.0	5.0
Police	5.8	11.3	15.2	19.2	20.8
Public Works	11.0	16.0	16.0	16.0	16.0
Total Transition FTEs	**70.7**	**89.1**	**93.5**	**97.5**	**103.6**
Fully Staffed Level*	**104.4**	**96.8**	**98.1**	**97.5**	**103.6**
% of Fully Staffed Level	*68%*	*92%*	*95%*	*100%*	*100%*

*Includes 5.5 FTEs pre-hired six months prior to annexation
**Consistent with annual snapshot estimates

Annexation Staffing for Scenario 3: Assuming Annexation in November 2010

Incremental FTEs in Transition Period	2010	2011	2012	2013	2014
Legislative	0.1	0.1	0.1	0.1	0.1
Executive	0.0	0.0	0.0	0.0	0.0
Human Resources	2.6	2.6	2.6	2.6	2.6
Community Affairs	1.0	1.9	1.9	1.9	1.9
Admin Services	6.0	8.5	8.5	8.5	8.5
Build-Prop Services	2.0	2.5	3.0	3.0	3.0
Community Dev	11.6	15.1	15.1	15.1	15.1
Econ Dev	0.6	1.1	1.1	1.1	1.1
Fire	39.0	39.0	39.0	39.0	39.0
Legal	0.0	0.0	0.0	0.0	0.0
Library	0.0	0.0	0.0	0.0	0.0
Muni Court	4.3	5.8	6.3	6.3	6.3
Parks & Rec	0.5	1.0	1.0	1.0	5.0
Police	17.0	28.5	37.9	45.4	48.4
Public Works	12.0	18.0	19.5	19.5	19.5
Total Transition FTEs	**96.7**	**124.1**	**136.0**	**143.5**	**150.5**
Fully Staffed Level*	**153.4**	**143.2**	**144.6**	**144.0**	**150.5**
% of Fully Staffed Level	*63%*	*87%*	*94%*	*100%*	*100%*

*Includes 5.5 FTEs pre-hired six months prior to annexation
**Consistent with annual snapshot estimates

Source: Berk & Associates, 2008

The departments and positions that were pre-hired and other assumptions used are detailed below.

Police

There is a timing gap that exists for Police Officers between testing, academy, training, and readiness for patrol activities. The hiring process begins once a Patrol Officer is hired and undergoes testing. After testing there is typically a waiting period of about three months until the officer is admitted into the academy. The officer attends the academy for six months. The training period that occurs after graduation from the academy lasts about three months. The transition analysis assumes that the total timing gap is about a full year after testing for an officer to be ready for patrol. In addition to salary and benefit costs, there are other costs that the Department will incur for each rookie Patrol Officer hired which include:

- $1,000 per officer for testing
- $15,000 per officer for attending the academy

In order to maintain the level of service in the annexed areas, the Department would need to use overtime as backfill for positions while the ramp-up of officers is occurring. As officers become ready for patrol activities the amount of overtime would decrease. The rate at which the Patrol Officers would be hired is 1/3 of the fully staffed level. This would also be the rate at which overtime would decrease. The fully staffed levels and an example of the staffing phase-in are detailed below.

- To be fully staffed in the transition period, a total of:
  - 12 Patrol Officers will need to be hired in Scenarios 1 and 2
  - 19 Patrol Officers will need to be hired in Scenario 3
- Beginning immediately on day one after annexation, 1/3 of the fully staffed level will begin the hiring process. Using Scenario 3 as an example, six officers will begin the hiring process in year 1.
- One year after annexation (beginning of year 2), six more Patrol Officers will begin the hiring process. The first six officers would now be ready for patrol activities and overtime would be reduced by 1/3.
- Two years after annexation (beginning of year 3), the final six Patrol Officers will begin the hiring process. The second six officers would now be ready for patrol activities and overtime would be reduced by another 1/3.
- Three years after annexation (beginning of year 4, or November 2014 assuming a November 1, 2010 annexation date), the final six Patrol Officers will be ready for patrol activities and overtime, used as backfill, would be eliminated.

Staffing increases associated with command positions (Deputy Police Chief, Commander, Sergeant, and Lieutenant) are assumed to be hired on day one after annexation. All other Police staffing level increases attributable to the annexation areas were phased-in at about 70% of full staffing levels for the first year of annexation (2010). The remaining staffing level increases in the transition period were gradually phased-in until the fully staffed level was reached.

Human Resources & Administrative Services

- For Scenarios 1, 2, and 3, one HR Analyst would be pre-hired six months prior to November 1, 2010 to assist with the City in recruiting and hiring.
- For Scenarios 1, 2, and 3, one-half Computer Technician/Engineer would be hired six months prior to November 1, 2010 to assist with IT issues.

Public Works

- There will need to be some pre-hires six months prior to annexation in Public Works to help the Department absorb the impacts of annexation. These include Engineering Techs (CAD/GIS and Permitting), Project Manager, and Traffic Signal Technician Lead. For Scenario 1, there would be a total of 3.5 FTEs hired six months prior to November 1, 2010. For Scenario 2 an additional 0.5 Engineering Tech 1 would be needed for a total of 4.0 FTEs. This additional Engineering Tech 1's demand driver is based on the total land area of the annexed areas and reflects the large increase in land area between Scenario 1 and Scenario 2. There would also be a total of 4.0 FTEs pre-hired six months prior to annexation in Scenario 3.
- There is a possibility of contracting with the County to fill City staffing needs for up to three years in the transition period. The incremental staffing costs used in the transition analysis were determined to be sufficient to represent this possibility.

One-Time Costs

- All one-time costs are consistent with the annual estimates described in Section 5.4
- Police vehicles for Patrol Officers will be phased in based on the number of officers ready for patrol activities. In Scenarios 1 and 2, one patrol vehicle would be procured in 2011 with an additional vehicle bought in 2012. The remaining two vehicles would be purchased in 2013 for a total of four patrol vehicles. In Scenario 3, a total of eight vehicles will be procured for Patrol Officers. Three vehicles would be purchased in both 2011 and 2012. The remaining two vehicles would be purchased in 2013. For the transitional analysis, all non-patrol vehicles are assumed to be procured in Year 1 (2010).
- The City documents required to be updated by Public Works would be completed incrementally over the transition period with most of the work completed in 2010.

6.4 Cash Flow Management

The timing of the effective date of annexation has a large effect on revenues in the first few years of annexation. However, the existence of the State sales tax credit means that there is more flexibility in selecting an annexation date. The decision to pre-hire positions or to further delay other non-essential positions is also a major timing factor to consider. Staggering or delaying the hiring process will also aid current City staff in the transition and integration of new staff.

If annexation were to occur after August 1, the City would receive County Road Fund property tax revenues for more than a year. While these are property tax revenues (and they will be replaced by the City's regular property tax levy in 2012), the County Road Fund revenues will need to flow into the City's Street Fund. This will mean that the City's Street Fund will be "overfunded" in the interim years, while the City's General Fund will be "underfunded." To balance things out, the City will probably want to adjust interfund transfer payments from the General Fund to the Street Fund for some period of time.

7.0 CAPITAL FACILITIES ANALYSIS

7.1 Major Capital Costs and Needs

Generally, upon annexation, as capital needs are better understood, there are likely to be more needs than there are resources coming from the annexation area. This situation is comparable to the base City situation, which has unfunded portions of its current capital needs, thus the long-term funding situation is unlikely to be dramatically different from the status quo. In the absence of a full capital assessment, available data on capital needs is limited to projects identified as part of Snohomish County's Transportation Improvement Program (TIP), Transportation Needs Report (TNR), Comprehensive Plan, and Drainage Needs Report. This analysis reviewed these documents and presents summary information.

If the City of Lynnwood annexes any of the annexation subareas, it would be advisable to conduct a more thorough assessment of capital needs. This assessment would look at needs for roads and sidewalks, surface water, parks, and other potential investments, all in the context of the City of Lynnwood's design requirements and overall service goals.

Roads

Exhibit 24 below summarizes identified road projects in Scenarios 1, 2, and 3, and their estimated cost and amount funded, where available. The majority of funding for county road improvements comes from county property taxes, impact fees, and a motor vehicle license fee. It is important to note that several of the projects cover two or three annexation subareas or cross into subareas not considered for annexation.

Exhibit 24
Identified Near Term & High Priority Road Project Needs, 2007

Scenario One: Near Term & High Priority Projects

Subarea/Project	Number	Year	Type	TIP Funding	Assessment Cost
Gateway					
35th Ave (156th to 164th)	AC-17	2009	CASI	$1,511,000	$4,929,000
Meadowdale/Gateway					
52nd Ave W (148th to Lynnwood City Limits)	AC-15	2009	ALOSI	$9,202,000	$10,790,000
Total				$10,713,000	$15,719,000

Scenario Two: Near Term & High Priority Projects

Subarea/Project	Number	Year	Type	TIP Funding	Assessment Cost
Alderwood Manor/North Road					
SR-524 (I-5 to SR 527)	JP-8	2012	STATE	No	$105,400,000
Lake Stickney/Swamp Creek					
Ash Way (Gibson Rd to 164th St SW)*	AO/C-12	2010	CASI	$200,000	$40,623,000
Larch Way/ North Road					
Larch Way (178 St SW to SR 524)	C.07	2009	Ped. Fac.	$2,033,000	NA
Parkway					
28th Ave W (164th St to SR 525 Off-Ramp)	AC-19	2011	ALOSI	$420,000	$4,521,000
Ash Way, NE of Alderwood Mall	F.26	2009	Bridge	$1,275,000	NA
Total				$3,928,000	$150,544,000

Scenario Three: Near Term & High Priority Projects

Subarea/Project	Number	Year	Type	TIP Funding	Assessment Cost
Alderwood Manor/North Road					
SR-524 (I-5 to SR 527)	JP-8	2012	STATE	No	$105,400,000
Gateway					
35th Ave (156th to 164th)	AC-17	2009	CASI	$1,511,000	$4,929,000
Lake Stickney/Swamp Creek					
Ash Way (Gibson Rd to 164th St SW)*	AO/C-12	2010	CASI	$200,000	$40,623,000
Larch Way/ North Road					
Larch Way (178 St SW to SR 524)	C.07	2009	Ped. Fac.	$2,033,000	NA
Meadowdale/Gateway					
52nd Ave W (148th to Lynnwood City Limits)	AC-15	2009	ALOSI	$9,202,000	$10,790,000
Parkway					
28th Ave W (164th St to SR 525 Off-Ramp)	AC-19	2011	ALOSI	$420,000	$4,521,000
Ash Way, NE of Alderwood Mall	F.26	2009	Bridge	$1,275,000	NA
Total				$14,641,000	$166,263,000

* Part of project outside of annexation area

NA = Not Available

ALOSI = Arterial Level of Service Increase

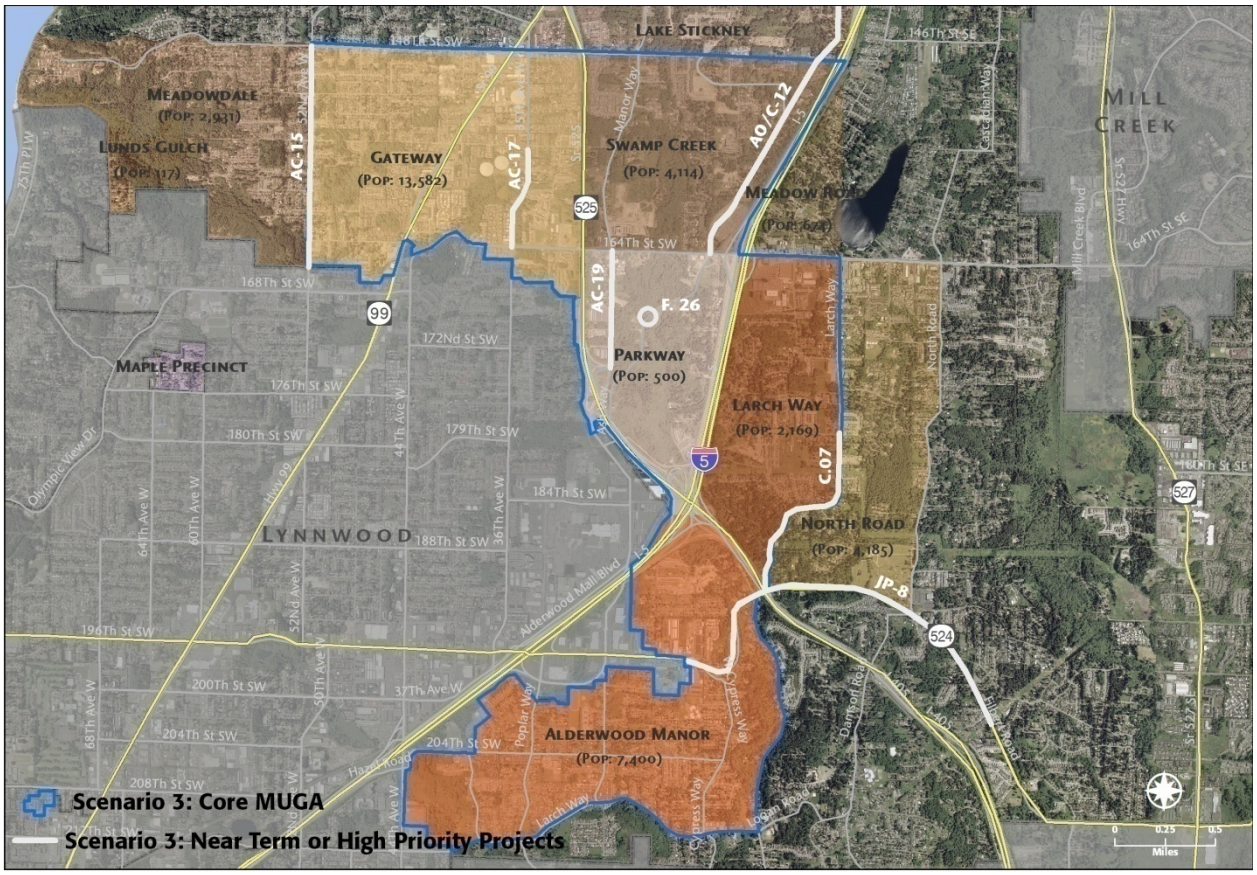
CASI= Critical Arterial System Improvement

STATE= Supportive State Highway Improvements

Source: Snohomish County TIP; TNR; Comprehensive Plan -Transportation Element, 2008

Overall, a funding disparity exists between identified project needs and projects slated for construction in the six-year TIP for each scenario. However, the two projects included in Scenario 1 do have a majority of the project cost funded. Additionally, it is difficult to know the total cost for all the projects because the TIP does not provide total costs, just the amount funded. Comparatively, the City of Lynnwood has an estimated $300 million in road project needs, with $646,000 funded.

Exhibit 25
Map: Near Term & High Priority Road Projects, 2007



Map created December, 2008

BERK & ASSOCIATES

Source: Snohomish County; Berk & Associates, 2008

Exhibit 25 shows the location of the projects included in the three scenarios. One large project of note in Scenarios 2 and 3 is the improvement of SR 524 from I-5 to 204th Street SE (JP-8). The project was initially going to be funded through a regional transportation improvement district as part of Proposition 1 in 2007, with the County partially matching the funding. The proposition failed and the Washington Department of Transportation (WSDOT) currently has no plans to do the project in the near future.

A 2006 revised estimate by WSDOT put the project cost at $105.4 million. One segment of the proposed project is already within the City's limits. Another segment is in the Alderwood Manor subarea. Part of the highway also borders the North Road subarea. Discussions with WSDOT staff indicate that it is not clear how much responsibility the City would have for improving the road if the project was slated for construction sometime in the future.

Another significant project also included in Scenarios 2 and 3 is the widening and upgrading of Ash Way from Gibson Road to 164th Street (AO/C-12), which has an estimated cost of over $40 million and has $200,000 in funding. However, the entire project is not in Swamp Creek subarea, as can be seen in **Exhibit 25**.

Surface Water Management

Currently, Snohomish County's Drainage Needs Report has identified a number of capital needs for surface water management improvement in all of the annexation subareas. **Exhibit 26** summarizes the County's recommended projects for the three annexation scenarios. **Note:** only projects slated for construction in 2009 are listed as having funding.

Funding sources for stormwater improvements include surface water fees, the main source of funding for drainage projects, and Real Estate Excise Tax II (REET II) revenue. Snohomish County Public Works noted that funding for projects with tentative start dates after 2009 is "uncertain" because the surface water fees will sunset at this time. Additionally, REET II revenue is declining and the amount allocated to stormwater projects is not known until the County budget is adopted. As a result, projects planned for after 2009 may need to find additional sources of funding to start. Projects not funded in the Capital Improvement Program (CIP) currently have no planned start dates.

Exhibit 26
Recommended Stormwater Improvements, 2007

Scenario One: Recommended Stormwater Capital Improvement Projects

Subarea/Project	Number	Year	Type	CIP Funding	Cost
Gateway					
164th St SW and 49th Pl SW	PS-LG-04	LT	Riparian	No	$25,000
Creek upstream of 164th St SW	PS-LG-06	LT	Riparian/LWD	No	$564,000
164th St SW	PS-LG-07	LT	Culvert	No	$35,000
North of 164th St SW, East of 52nd Ave W, West of 48th Ave W	PS-LG-08	LT	Wetland	No	$500,000
48th Ave W north of 159th St SW	PS-LG-09	2010	Culvert	Uncertain	$87,000
44th Ave W and 153rd Pl W	PS-LG-14	LT	Drainage System	No	$30,000
Near 45th Pl W south of 149th Pl SW	PS-LG-15	LT	Pond	No	$143,000
46th Pl W south of 149th Pl SW	PS-LG-16	LT	Drainage System	No	$94,000
161st Pl SW	PS-LG-33	LT	Culvert	No	$107,000
Subtotal				**$0**	**$1,585,000**
Gateway/Meadowdale					
150th Pl SW and 52nd Ave W	PS-LG-17	2009	Drainage System	$478,000	$478,000
Subtotal				**$478,000**	**$478,000**
Total				**$478,000**	**$2,063,000**

Scenario Two: Recommended Stormwater Capital Improvement Projects

Subarea/Project	Number	Year	Type	CIP Funding	Cost
Alderwood Manor					
Golde Creek between 203rd St SW and 204th St SW	SW-SC-01	LT	Culvert	No	$141,000
Golde Creek upstream of 28th Ave W	SW-SC-03	LT	Culvert	No	$540,000
Golde Creek upstream of Larch Way	SW-SC-04	LT	Culvert	No	$207,000
Golde Creek north of 198th Pl SW and 25th Pl W	SW-SC-12	LT	Pond	No	$786,000
Golde Creek between 204th St SW and 205th Pl SW	SW-SC-13	LT	Riparian	No	$144,000
Scriber Creek Upstream of 212th St SW	SW-SC-15	LT	LWD	No	$56,000
Golde Creek upstream from Larch Way	SW-SC-16	LT	LWD	No	$94,000
Subtotal				**$0**	**$1,968,000**
Larch Way					
Alder Creek and 18th Pl S W	SW-MI-03	2009	High Flow Bypass/Culvert	$481,000	$481,000
Swamp Creek off of Larch Way, North of Filbert Road	SW-MI-08	LT	Culvert	No	$29,000
Subtotal				**$481,000**	**$510,000**
Parkway					
Maple Road at I-405/I-5 Intersection	SW-MI-02	2012	High Flow Bypass	Uncertain	$999,000
Middle Swamp Creek at access road at I-405/I-5	SW-MI-06	LT	Culvert	No	$30,000
Between 148th St SW and I-405/I-5	SW-MI-10	LT	Wetland	No	$4,447,000
Subtotal				**$0**	**$5,476,000**
Parkway/Swamp Creek					
Middle Swamp Creek: Upstream of I-405, downstream of L. Stickney E	SW-MI-13	LT	Riparian	No	$156,000
Subtotal				**$0**	**$156,000**
Swamp Creek					
Swamp Creek: Upstream from 164th St SW	SW-MI-12	LT	LWD	No	$72,000
Subtotal				**$0**	**$72,000**
Total				**$481,000**	**$8,182,000**

Scenario Three: Recommended Stormwater Capital Improvement Projects

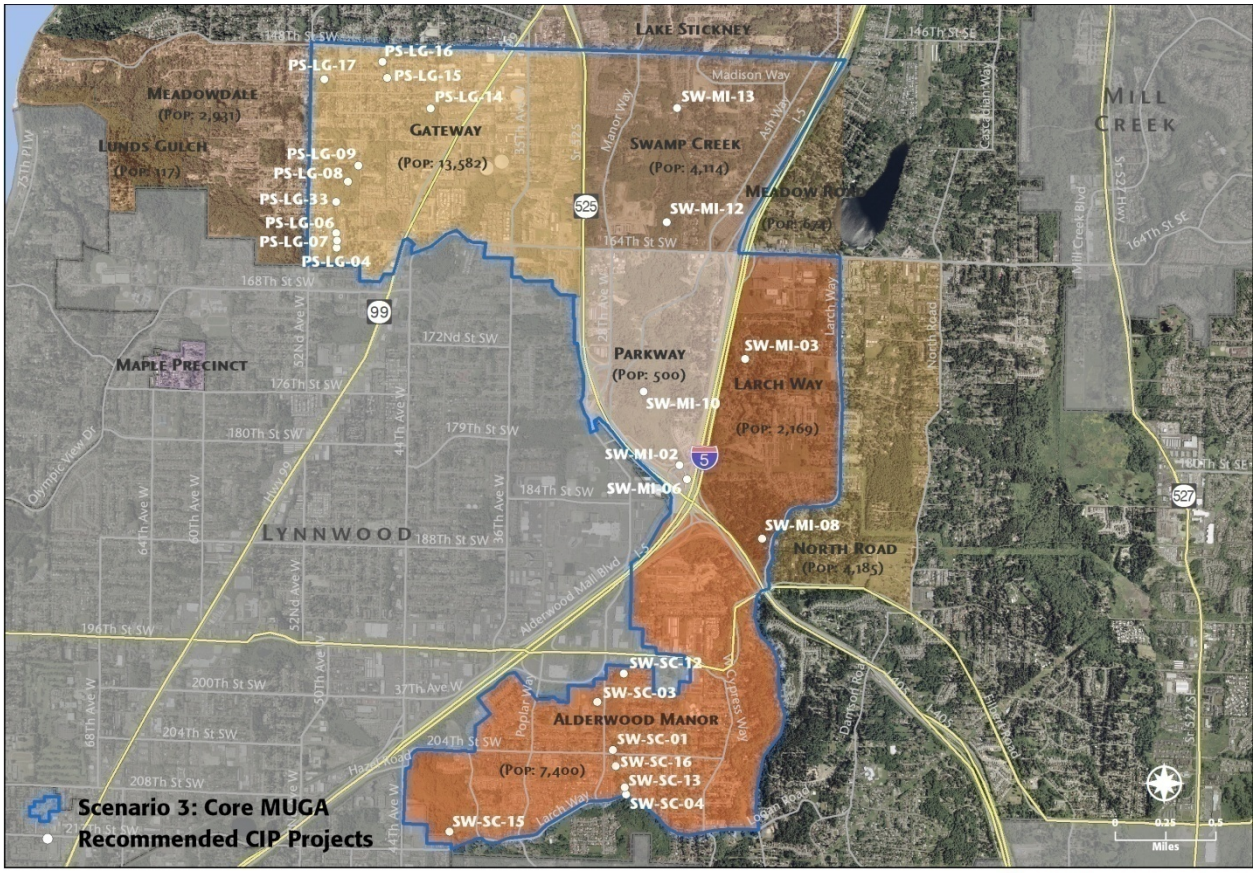
Subarea/Project	Number	Year	Type	CIP Funding	Cost
Alderwood Manor					
Golde Creek between 203rd St SW and 204th St SW	SW-SC-01	LT	Culvert	No	$141,000
Golde Creek upstream of 28th Ave W	SW-SC-03	LT	Culvert	No	$540,000
Golde Creek upstream of Larch Way	SW-SC-04	LT	Culvert	No	$207,000
Golde Creek north of 198th Pl SW and 25th Pl W	SW-SC-12	LT	Pond	No	$786,000
Golde Creek between 204th St SW and 205th Pl SW	SW-SC-13	LT	Riparian	No	$144,000
Scriber Creek Upstream of 212th St SW	SW-SC-15	LT	LWD	No	$56,000
Golde Creek upstream from Larch Way	SW-SC-16	LT	LWD	No	$94,000
Subtotal				**$0**	**$1,968,000**
Gateway					
164th St SW and 49th Pl SW	PS-LG-04	LT	Riparian	No	$25,000
Creek upstream of 164th St SW	PS-LG-06	LT	Riparian/LWD	No	$564,000
164th St SW	PS-LG-07	LT	Culvert	No	$35,000
North of 164th St SW, East of 52nd Ave W, West of 48th Ave W	PS-LG-08	LT	Wetland	No	$500,000
48th Ave W north of 159th St SW	PS-LG-09	2010	Culvert	Uncertain	$87,000
44th Ave W and 153rd Pl W	PS-LG-14	LT	Drainage System	No	$30,000
Near 45th Pl W south of 149th Pl SW	PS-LG-15	LT	Pond	No	$143,000
46th Pl W south of 149th Pl SW	PS-LG-16	LT	Drainage System	No	$94,000
161st Pl SW	PS-LG-33	LT	Culvert	No	$107,000
Subtotal				**$0**	**$1,585,000**
Gateway/Meadowdale					
150th Pl SW and 52nd Ave W	PS-LG-17	2009	Drainage System	$478,000	$478,000
Subtotal				**$478,000**	**$478,000**
Larch Way					
Alder Creek and 18th Pl S W	SW-MI-03	2009	High Flow Bypass/Culvert	$481,000	$481,000
Swamp Creek off of Larch Way, North of Filbert Road	SW-MI-08	LT	Culvert	No	$29,000
Subtotal				**$481,000**	**$510,000**
Parkway					
Maple Road at I-405/I-5 Intersection	SW-MI-02	2012	High Flow Bypass	Uncertain	$999,000
Middle Swamp Creek at access road at I-405/I-5	SW-MI-06	LT	Culvert	No	$30,000
Between 148th St SW and I-405/I-5	SW-MI-10	LT	Wetland	No	$4,447,000
Subtotal				**$0**	**$5,476,000**
Parkway/Swamp Creek					
Middle Swamp Creek: Upstream of I-405, downstream of L. Stickney E	SW-MI-13	LT	Riparian	No	$156,000
Subtotal				**$0**	**$156,000**
Swamp Creek					
Swamp Creek: Upstream from 164th St SW	SW-MI-12	LT	LWD	No	$72,000
Subtotal				**$0**	**$72,000**
Total				**$959,000**	**$10,245,000**

Note: Funding for projects is marked as "Uncertain" because the main funding source for drainage capital projects (surface water fees inside UGAs) will sunset in 2009 unless officials extend the fee to some future date. If that funding source is not extended, the 6-year CIP plan will have to be adjusted.

LT=Long term project; not date scheduled

Source: Snohomish County Drainage Needs Report, 2002

Exhibit 27
Map: Identified Stormwater Improvements Needs



Map created December, 2008 | BERK & ASSOCIATES

Source: Snohomish County; Berk & Associates, 2008

Each scenario has considerable stormwater facility needs and minimal dedicated funding. Specifically, the Alderwood Manor and Gateway subareas have seven and ten identified projects, respectively. Most of these projects are culvert and drainage related. **Exhibit 27** above shows the location of these projects.

Scenario 1 has an estimated cost of a little over $2.0 million with $478,000 in known funding. Scenario 2 has an estimated cost of over $8.1 million with $481,000 in funding, and Scenario 3 has an estimated cost of over $10.2 million with only $959,000 in known funding. In comparison, within the City of Lynnwood there are eight projects listed in the City's Capital Facilities Plan. These projects have an estimated cost of $5.8 million, and they are almost completely funded with $5.4 million appropriated.

One project of note in the Parkway subarea (SW-MI-10) is the acquisition of approximately157 acres of wetlands in the Middle Swamp Creek Subbasin at a cost of $4.4 million. This project is included in Scenarios 2 and 3, and accounts for almost half of the estimated cost for stormwater projects in these scenarios. It specifically involves the acquisition of property between 148th Street SW to the north, and the intersection of SR 525 and I-5. The City and County already own approximately 90 acres of parcels in this area, and this effort would aim to preserve the majority of the wetland area.

Parks and Recreation

The City's comprehensive plan includes an inventory of the existing parks and facilities and existing park needs, if any, based on the City's level-of-service (LOS) standards. The plan cites an overall standard of 10 acres of parkland per 1,000 people. Five of these acres are for *Core Parks*, three acres for *Open Space*, and two acres for *Special Use Facilities*. Note, *Core Parks* include mini, neighborhood, and community parks. Currently, the City does not meet its LOS standards for total park acres, *Core Parks*, or *Open Space*. The only type of park that the City does meet its LOS standard is the *Special Use* category.

Exhibit 28
Park and Recreation Needs, 2007

		CURRENT INVENTORY (Ac)				ACRES NEEDED TO BRING UP TO CURRENT SERVICE LEVEL (above existing inventory)			
	Population (2007)	Core Parks	Open Space	Special Use	Total Park Acres	Core Parks	Open Space	Special Use	Total Park Acres
Lynnwood	35,490	143.3	59.1	81.5	283.8	34.2	47.4	0.0	71.1
Scenario 1	13,582	0.0	0.0	0.0	0.0	102.1	88.2	16.7	135.8
Scenario 2	14,182	9.0	97.9	0.0	106.9	96.1	0.0	17.9	34.9
Scenario 3	27,764	9.0	97.9	0.0	106.9	164.0	32.8	45.1	170.7

Source: City of Lynnwood Comprehensive Plan; Berk & Associates, 2008

Berk & Associates analyzed how the inventory and needs would change under the three annexation scenarios. **Exhibit 28** shows the figures for each scenario. Under any of the scenarios, bringing the City up to the higher level-of-service through increasing the number of park acres is a policy-level decision that has operating implications for the City, in addition to capital costs.

Overall, the City would lack enough total park acreage, *Core Park* acreage, *Special Use* acreage, and trail miles to meets its LOS standards. The City would also need to increase the amount of open space in every scenario, with the exception of Scenario 2. Scenario 2 also had the least need with only 34.9 total additional acres needed. This is due to the large amount of existing open space in the Parkway subarea - this open space is the same wetland area proposed for additional property acquisition in the Surface Water Management section above. It also should be noted that the nine acre Hageman Park was included as a *Core Park* in the Larch Way subarea, as can be seen in Scenarios 2 and 3.

7.2 Capital Revenues

Our analysis provides estimates of the revenues from the Real Estate Excise Tax and the capital portion of the Gas Tax, which are held aside as available funding for capital infrastructure needs in the contemplated annexation areas. These revenues for Scenarios 1, 2, and 3 (including City) are displayed in **Exhibit 29** below. For annexation areas only, Scenario 1 amounts to an estimated $11.2 million over the next 20 years in present value terms, Scenario 2 to $21.3 million, and Scenario 3 results in an estimated $32.4 million.

Exhibit 29
Estimated Capital Revenues for Lynnwood (millions), Scenario 1

	Current	2010	2015	2020	2025
REET					
City	1.18	1.21	1.90	2.65	3.71
Annexation Area	0.00	0.39	0.57	0.83	1.22
Total	1.18	1.60	2.47	3.49	4.92
Gas Tax					
City	0.56	0.58	0.65	0.72	0.79
Annexation Area	0.00	0.23	0.26	0.29	0.33
Total	0.56	0.81	0.91	1.01	1.11
Total	**$1.74**	**$2.42**	**$3.38**	**$4.49**	**$6.04**

Estimated Capital Revenues for Lynnwood (millions), Scenario 2

	Current	2010	2015	2020	2025
REET					
City	1.18	1.21	1.90	2.65	3.71
Annexation Area	0.00	0.84	1.23	1.81	2.65
Total	1.18	2.05	3.13	4.46	6.35
Gas Tax					
City	0.56	0.58	0.65	0.72	0.79
Annexation Area	0.00	0.26	0.31	0.36	0.42
Total	0.56	0.84	0.96	1.08	1.21
Total	**$1.74**	**$2.89**	**$4.09**	**$5.54**	**$7.56**

Estimated Capital Revenues for Lynnwood (millions), Scenario 3

	Current	2010	2015	2020	2025
REET					
City	1.18	1.21	1.90	2.65	3.71
Annexation Area	0.00	1.24	1.81	2.64	3.86
Total	1.18	2.45	3.71	5.29	7.57
Gas Tax					
City	0.56	0.58	0.65	0.72	0.79
Annexation Area	0.00	0.49	0.57	0.65	0.74
Total	0.56	1.07	1.22	1.37	1.53
Total	**$1.74**	**$3.51**	**$4.92**	**$6.66**	**$9.10**

Source: Berk & Associates analysis, 2008

Real Estate Excise Tax (REET)

If Lynnwood were to annex the contemplated study areas, the City would expect to receive Real Estate Excise Taxes on an annual basis. REET revenues are levied in two halves: The first half (0.25% of the taxable value of a real estate transaction) may be used for a variety of capital uses, including development of parks. The second half (the second 0.25%) must be used on a more constrained list of projects — a list that includes improvements to roads and roadways, but excludes investments in parks.

Since REET is based on the total value of real estate transactions in a given year, the amount of REET revenues a city receives can vary substantially from year to year based on the normal fluctuations in the real estate market. During years when the real estate market is active, revenues are higher, and during softer real estate markets, revenues are lower. For the purposes of this analysis, it is assumed that 5.0% of residential property and 2.5% of commercial property turn over in any given year.

Based on the analysis, Scenario 1 is estimated to generate approximately $400,000 in REET revenues from the annexation areas in 2010, Scenario 2 – $840,000, and Scenario 3 would generate an estimated $1.2 million.

Gas Tax Revenues

Until 2005, cities had been receiving their gas tax in two distributions: a restricted portion (32%) to be used for capital; and an unrestricted portion (68%) allowed to be used for operating or capital funding. Recently, however, the dual-distribution and restriction have been removed, but most cities have continued to allot about one-third of the gas tax revenues to their capital program. In Lynnwood's 2008 budget, the split was about 50-50, and it is assumed going forward that this split will continue.

Based on the analysis of the per capita gas tax distributions, Scenario 1 is estimated to generate approximately $230,000 in gas tax revenues for capital projects in 2010 from the annexation areas. Scenario 2 is expected to generate an estimated $260,000, and Scenario 3 – an estimated $490,000.