Economic and Revenue Update April 2022

Presentation Outline

Part I: Economic Update and Forecast

1. Current conditions: brief summary of recent developments at both national and regional level
2. Looking forward: projections for this year and beyond for both the national and regional economies
3. Recommendation regarding which economic scenario (Baseline, Pessimistic, or Optimistic) should underlie the revenue forecast

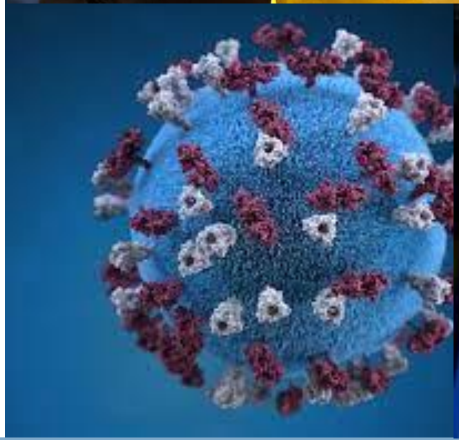
Part II: Revenue Forecast

1. Review revenues for which the Forecast Office is responsible
2. Summary of forecasts for most significant revenues: Sales, B&O and Payroll Taxes, as well as REET
3. Forecasts for remaining revenues, including private utility taxes and admissions tax
4. Projections for changes in Assessed Value and the value of new construction

Economic Update

World Events Continue to Drive Economic Uncertainty

- Within the US, the COVID pandemic appears to be ending. However, new variants could yet emerge, and as current events in Shanghai and elsewhere demonstrate, worldwide economic disruptions continue.
- Russia's war against Ukraine is a first and foremost a human tragedy, but it has also created significant economic consequences across the globe:
  - Supply-chain disruptions are constraining manufacturing output;
  - Loss of food production has led to escalating commodity prices; and
  - Escalating energy prices have already "hit home" here in the US.
- As a result of these compounding factors, inflation has increased rapidly, and expectations that it would decrease quickly have faded.
- Nonetheless, to date, the national and regional economy have shown great resiliency.



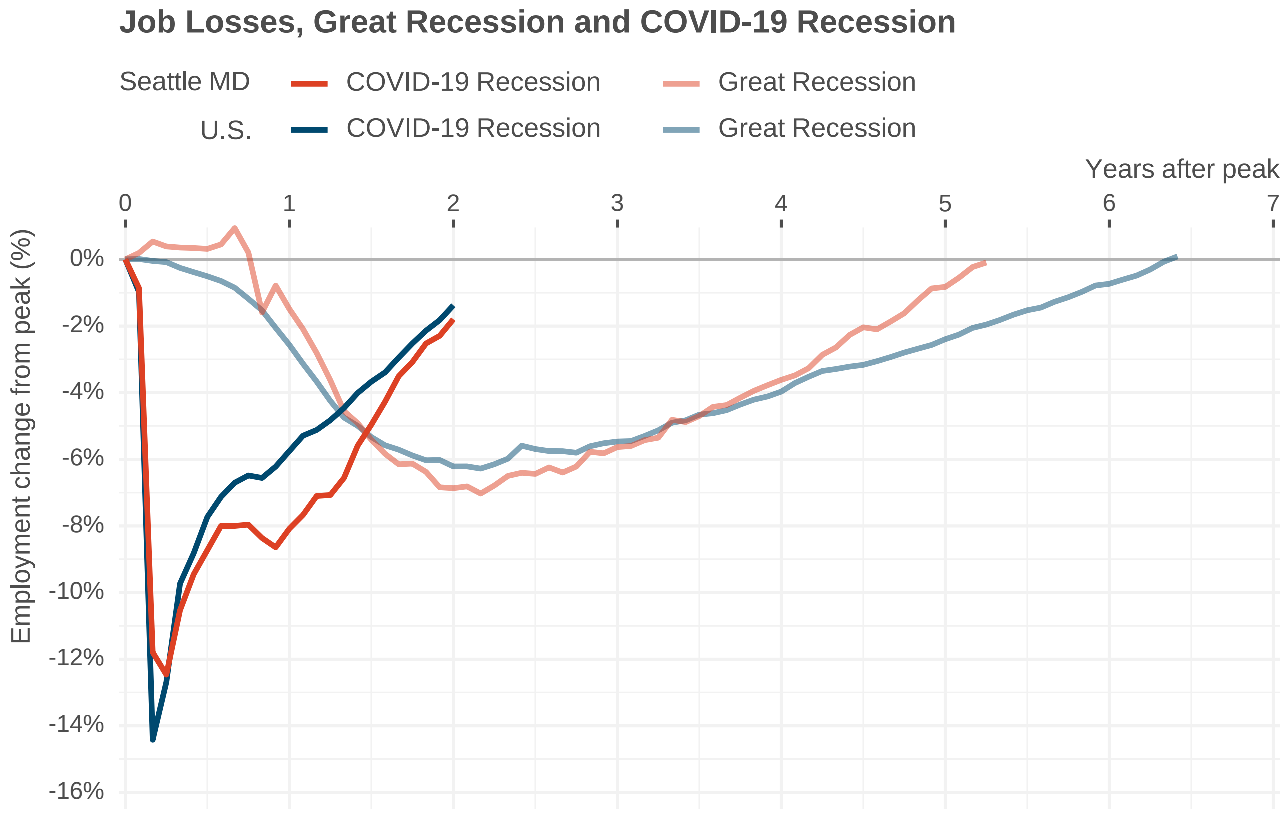
National Job Recovery Has Been Strong and Seattle is "Catching-Up"

- Job losses compared to February 2020 as of February 2022:

    -1.4% in United States

    -1.8% in Seattle Metropolitan Division area

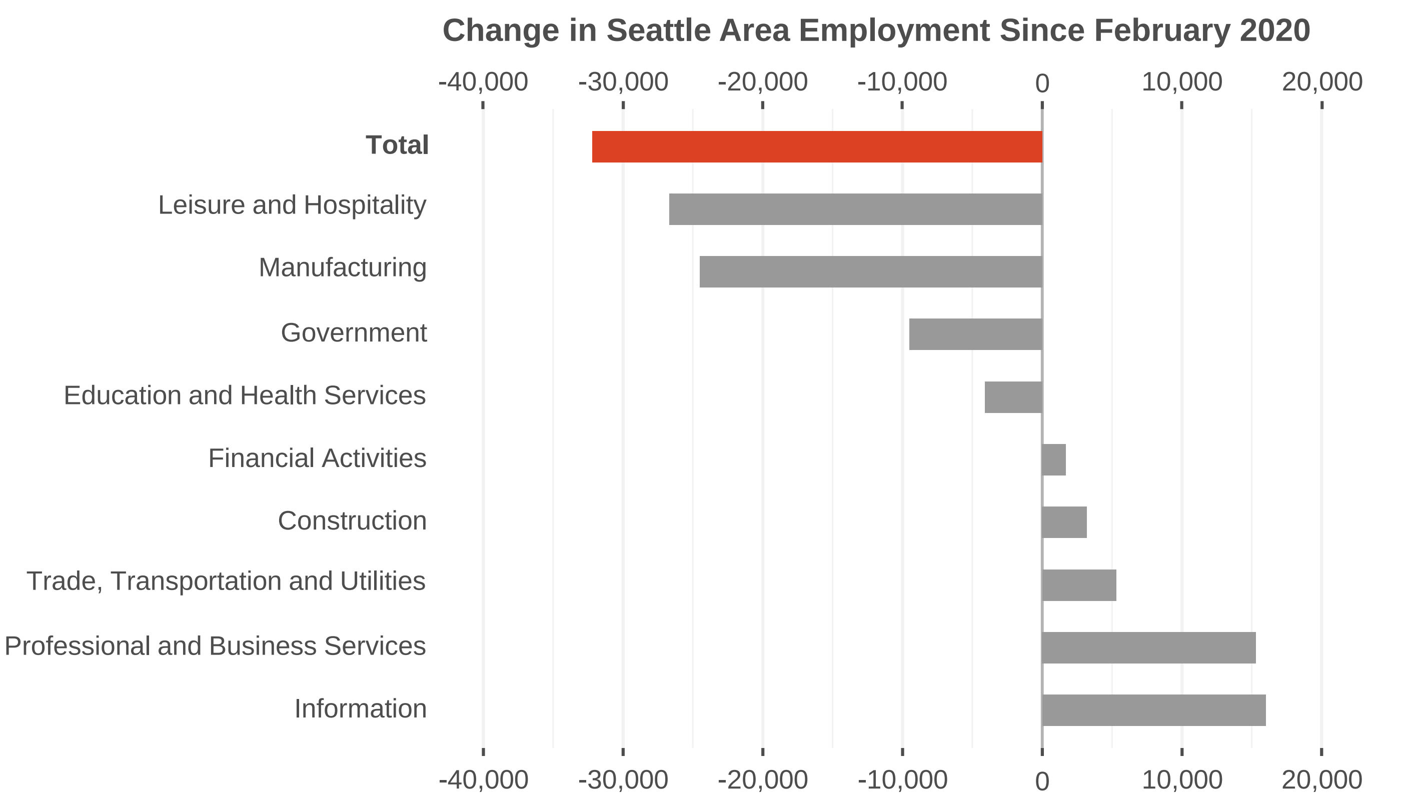
- U.S. job openings are at a record high. There are 1.8 openings per unemployed person.
- The U.S. average hourly wage is 12.1% above February 2020 level; in the Leisure & Hospitality sector it is 15.1% above.
- These wage gains have been somewhat diminished by the impacts of inflation.



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

Regional Job Impacts Vary by Sector: Job losses in Both Manufacturing and Leisure & Hospitality Still Persist

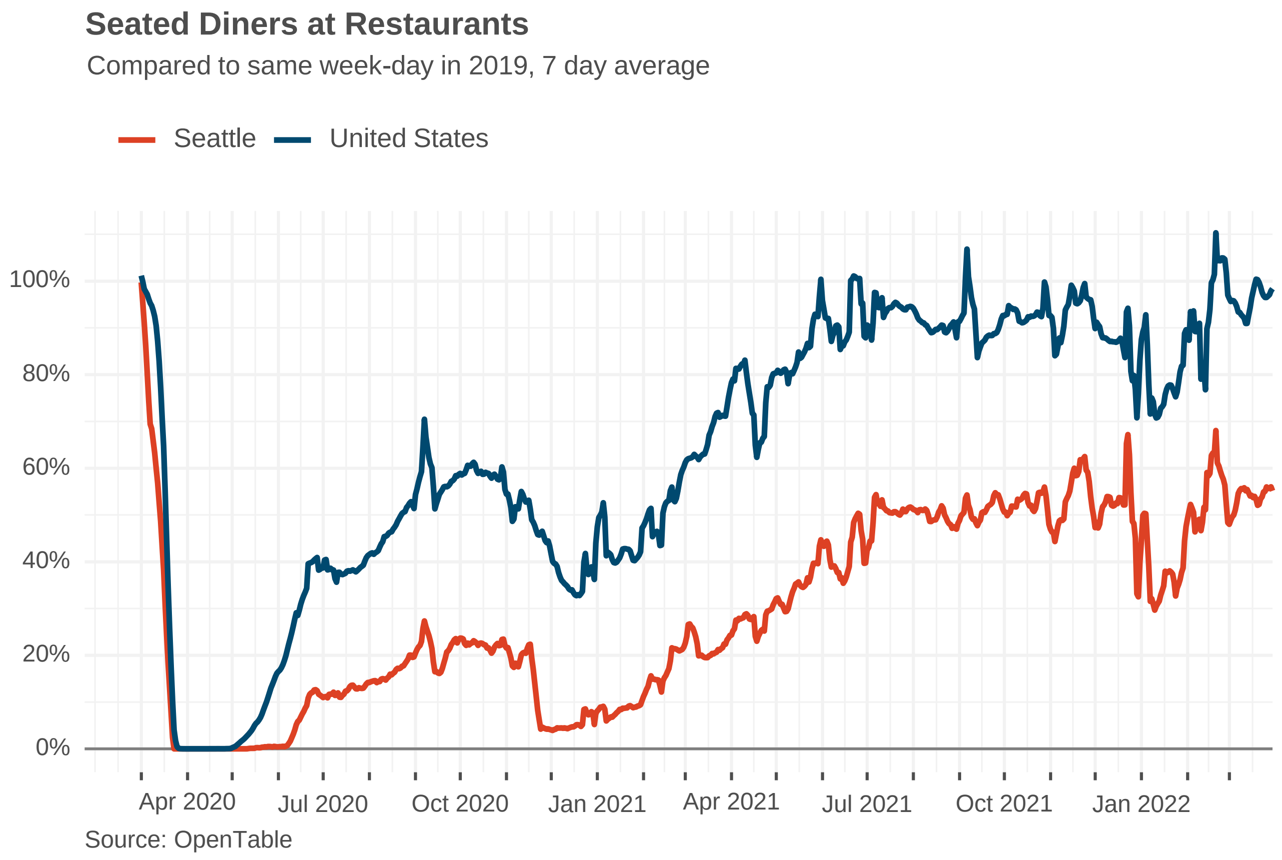
- Overall, the region is still "down" 30,000+ jobs since the pandemic began.
- However, the regional economy added about 44,000 jobs since September, and this job growth was broad based.
- Within the region, about 85% of jobs lost due to pandemic have now been restored.
- However, for the Leisure & Hospitality sector, this figure is just 66%. Demand for workers is growing, but employees are not returning quickly to this sector.
- Employment in the regional Manufacturing sector, which of course includes Boeing, also trails its pre-pandemic levels.
- Job growth in both the Information, and the Professional & Business Services sectors has offset losses in other sectors. Without the significant job growth seen in these two sectors, employment would still be well below pre-pandemic levels.



Source: Washington State Employment Security Department. Seasonally Adjusted.

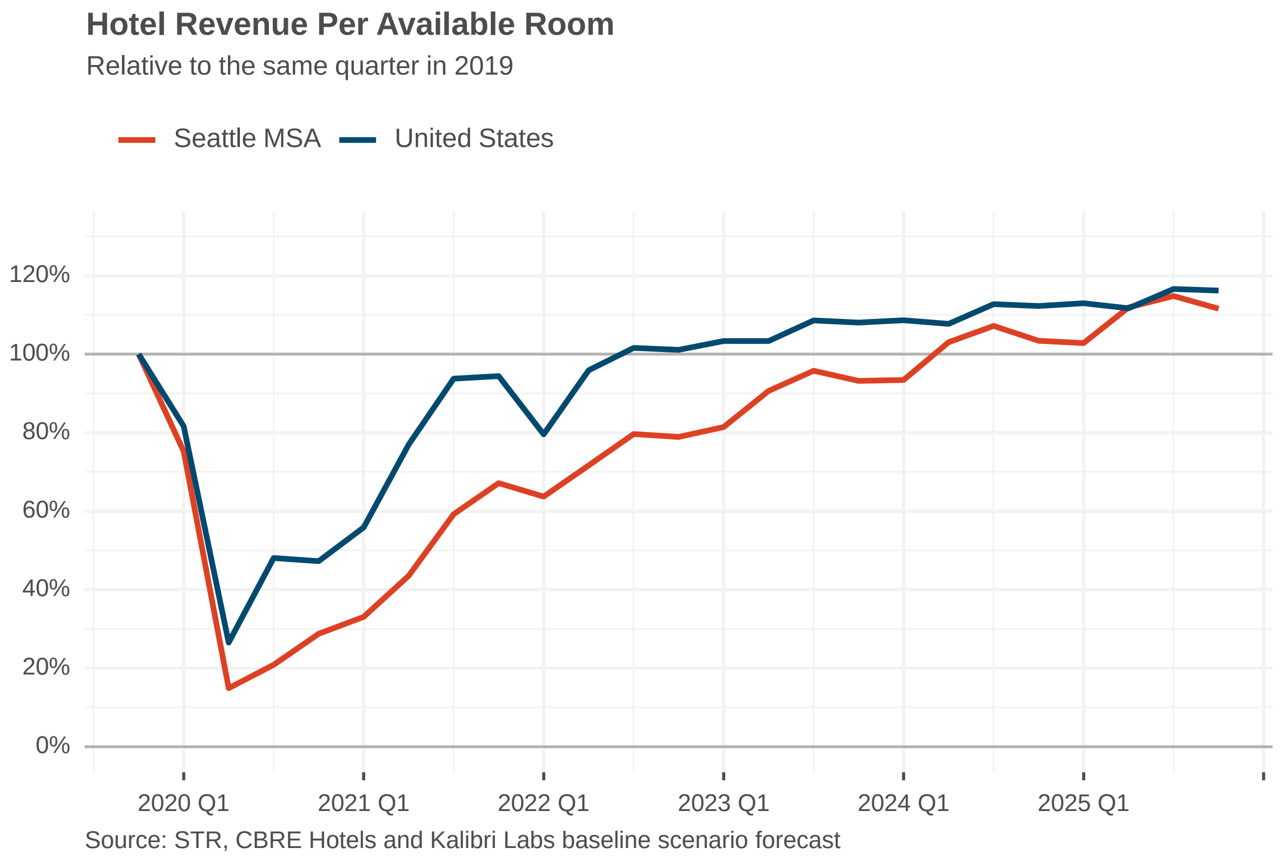
Restaurants are Seeing Recovery as the Omicron Wave Fades

- After initial signs of recovery early last summer, first Delta and then Omicron slowed business for most restaurants.
- And as the data here show, Seattle has demonstrated a generally more conservative approach to re-opening than the nation as a whole.
- With social distancing regulations and practices now easing, overall activity and associated tax revenues from this industry are anticipated to grow in the coming months. This includes Sales, B&O and "Soda Tax" revenues.
- Data available from OpenTable has provided a way to track these developments in a "real time".



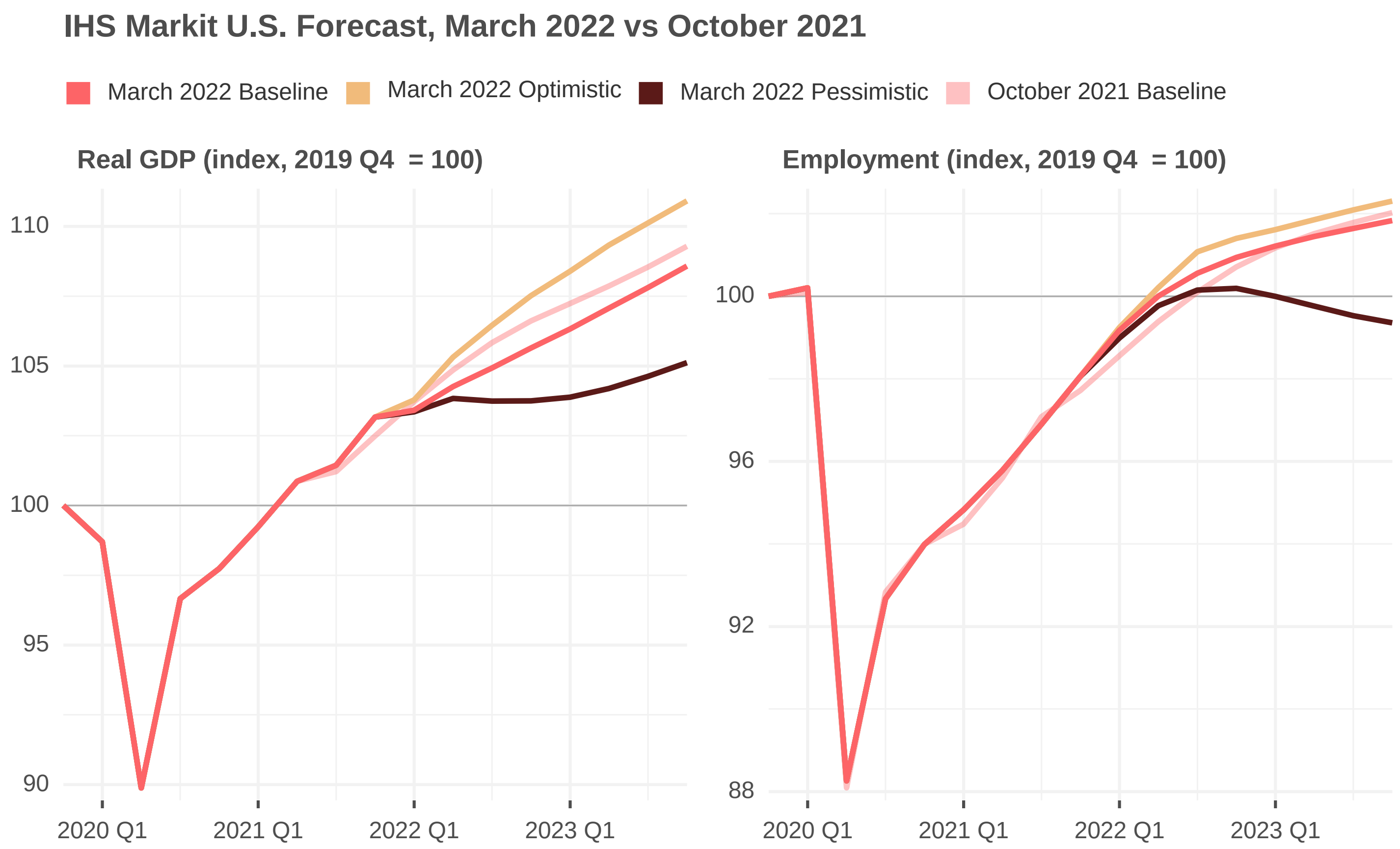
Recovery for Hotels is Expected to Take Somewhat Longer

- Seattle hotels depend on both leisure and business travel. Tourism drives peak demand in the summer, while business travel is a more steady, year-round driver.
- Reduced COVID-related restrictions will improve travel demand overall, but consensus within the industry is that full recovery at the local level could take until mid-2024.
- To help enhance our ability to forecast revenues from this sector, the Forecast Office recently purchased access to industry-specific data from STR and CBRE.
- The historic data and forecast shown in this graph are derived from these sources and have been used in developing our new revenue forecasts.



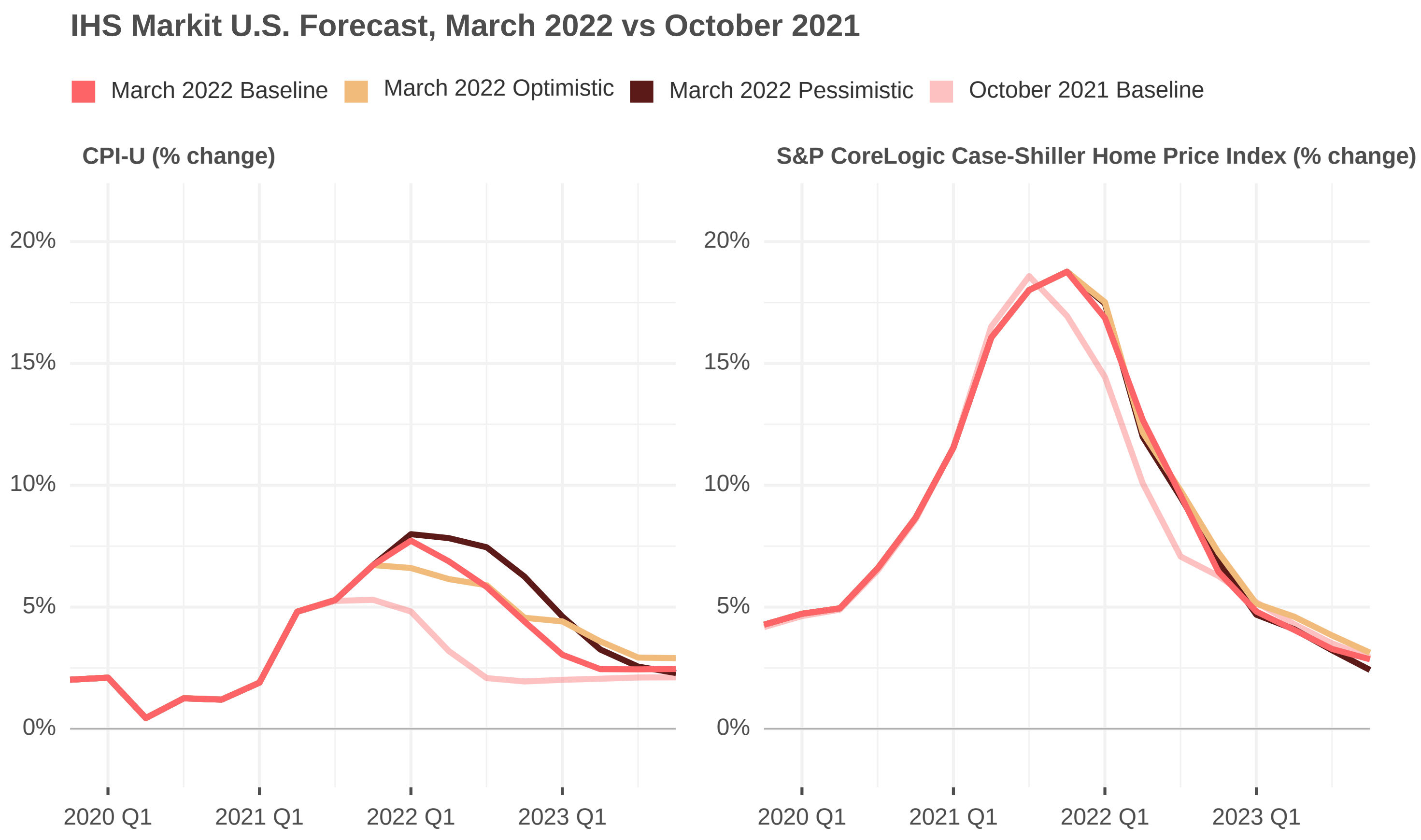
Looking Forward at the National Economy: Recovery Expected to Continue but Russia's Invasion of Ukraine Creates Uncertainty

- National economic trends are generally positive:
  - U.S. employment growth shows resilience and labor-force participation is increasing.
  - Baseline forecasts of national employment growth are somewhat stronger than in October.
- However, global slowdown, supply-chain disruptions and higher inflation, which have been exacerbated by the war, pose increasing downside risks
- IHS Markit probabilities March 2022
  - Baseline 50%
  - Optimistic 15% (was 20% in October)
  - Pessimistic 35% (was 30% in October)



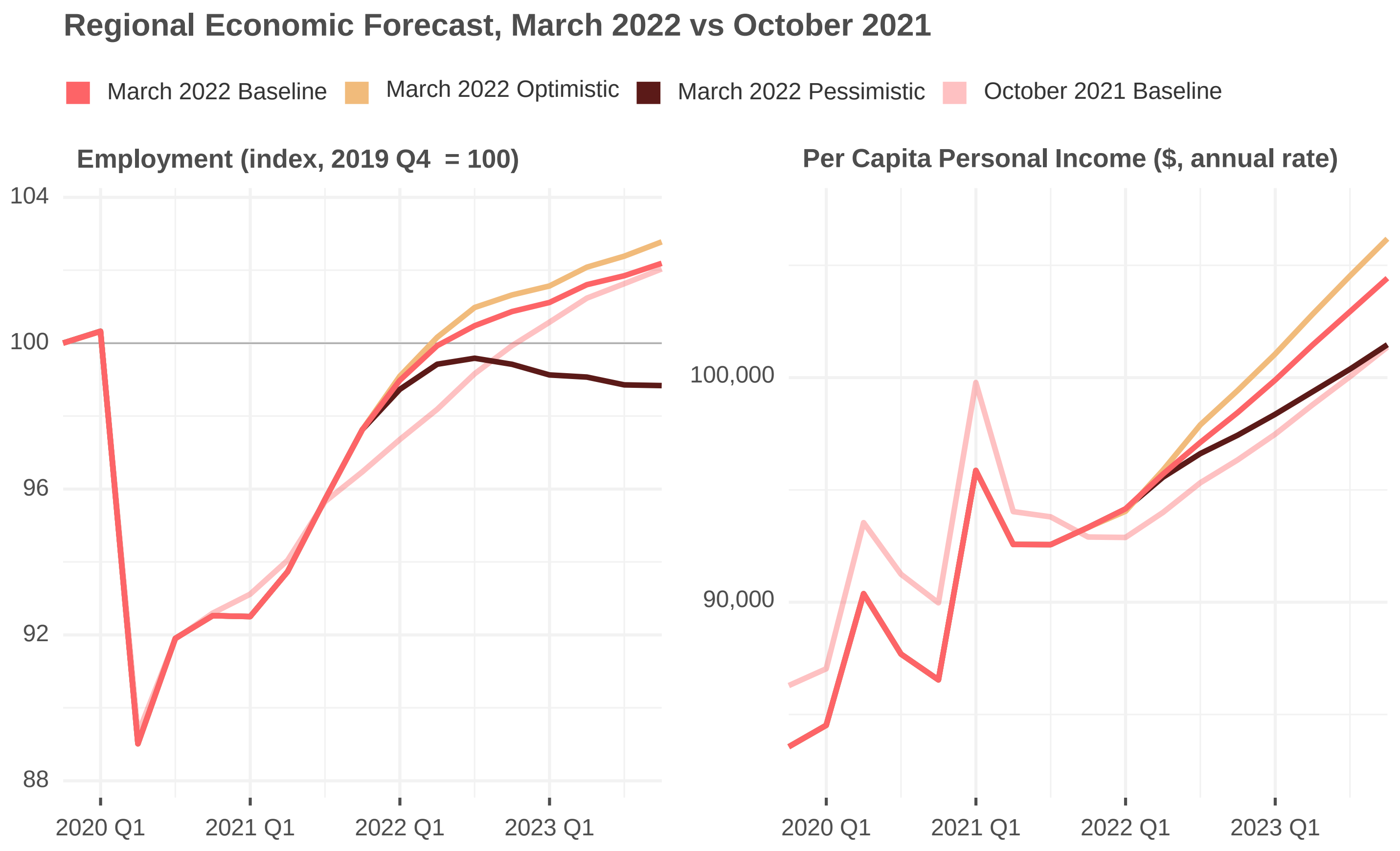
Inflation Has Accelerated Quickly and is Now Expected to be More Persistent

- Inflation is now not expected to moderate until the second half of 2023. Last fall, the expectation was that inflation would have already started to decrease by this time.
- Increasing housing costs have been a significant inflation driver both nationally and locally.
- Inflation will increase the nominal value of our forecasts, but that can be misleading because tax revenues generally will not go as far in terms of purchasing services.
- Increasing inflation may also disrupt the recovery overall. Price and wage uncertainty makes the return on economic investments less predictable.



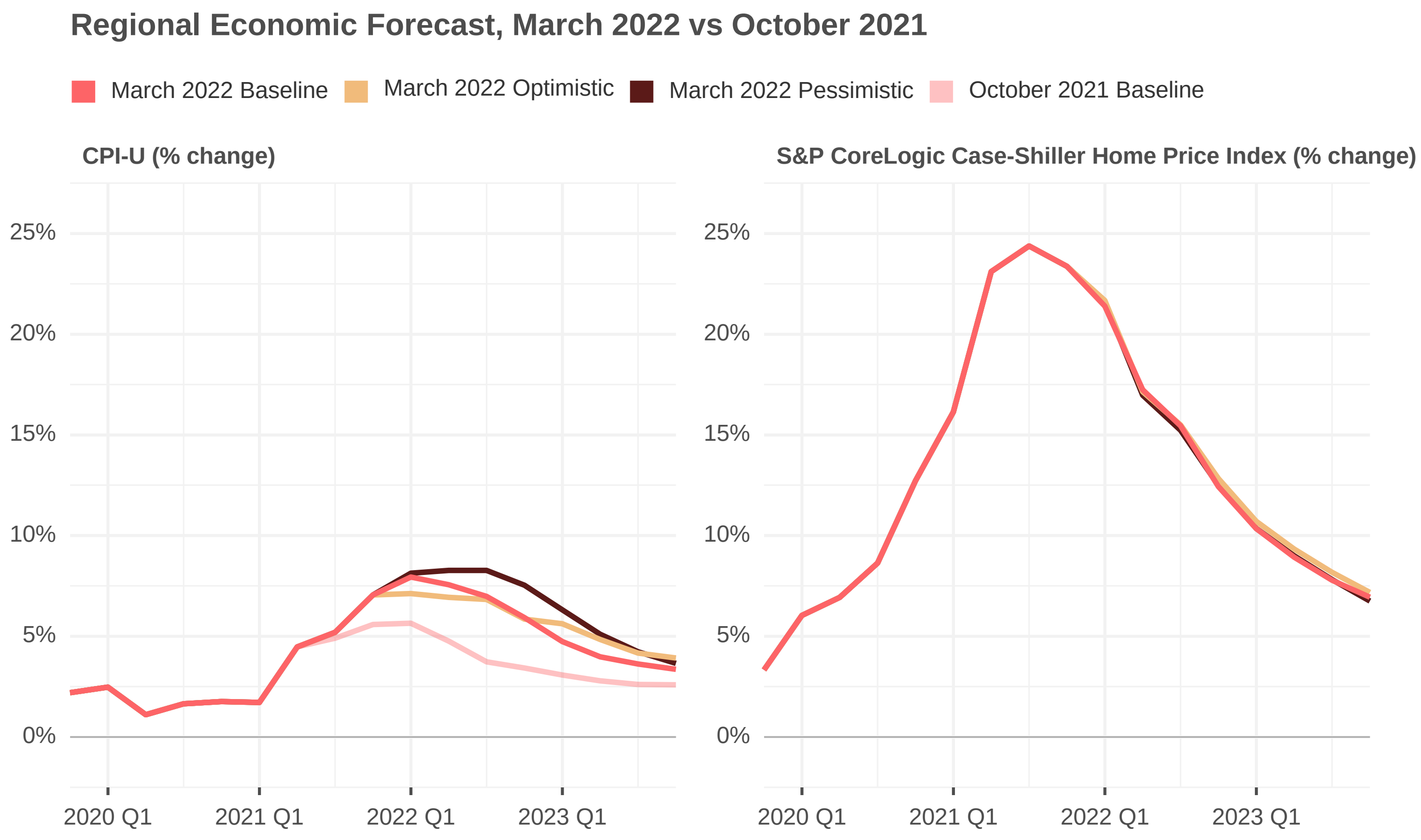
Regional Economic Forecast for the Seattle Metro Area

- National trends are reflected in our regional economic forecast.
- The regional forecast has generally improved relative to last fall, with employment and income expected to grow more rapidly than projected previously. Part of the additional growth in income is directly attributable to inflation.
- However, overall uncertainty has increased the probability and the potential severity of the pessimistic scenario.
- Also note that a significant revision in historic data on personal income (visible in the graph) led us to update the forecasting model, which complicates comparisons to previous forecasts.



Inflation Forecast for the Seattle Metro Area

- Consistent with the national forecast, we now anticipate that higher inflation rates will persist well into 2023.
- Like elsewhere across the country, increasing food and energy prices are key inflation drivers, but escalating home costs (also seen in rents) have returned as a major component of increases in the local cost of living. Seattle area home prices escalated by more than 20% over the past year.
- The revised baseline forecast for CPI-U in 2022 is 7.0%; up from 4.3% in the November forecast. For 2023 and 2024, the baseline forecasts are 3.8% and 2.7%, respectively.
- The upward revision in our inflation projection is consistent with recent forecasts at both the State and County level. Both have increased the magnitude and length of their projections regarding the current inflationary period.



Economic Scenario Recommendation

- The Office of Economic and Revenue Forecast recommends that the Baseline economic forecast continue to serve as the basis for our forward-looking revenue estimates.
- While the national forecasting services have increased the probability of the pessimistic scenario, the issues of concern are general, and we do not see that the regional economy is more at risk than the nation as a whole. In addition, over the past year, the City's actual revenues have generally matched or exceeded the forecasts tied to the baseline scenario.
- In addition, as we have noted previously, we see potential upside, relative to the national forecasts, as recovery in our Leisure &Hospitality sector catches up to results seen in other cities, and regional employment growth in other sectors remains strong.
- This all said, the most recent information from IHS Markit suggests that they are becoming more pessimistic overall, and future downward revisions are not unlikely.

In the section that follows, we will highlight how reliance on either the Pessimistic or Optimistic scenarios would affect the revenue projections, but this is for illustrative purposes. The Baseline scenario is our recommendation.

Revenue Update

Revenue Sources Projected by the Forecast Office

General Fund Revenue Sources

- Retail Sales Tax
- Business and Occupation (B&O) Tax
- Business License Tax Certificate Fees
- Private Utility Taxes

Non-General Fund Revenue Sources

- Payroll Expense Tax
- Real Estate Excise Tax (REET)
- Admission Tax

Inputs to Property Tax Forecasts

- Assessed Value of Real and Personal Property
- Value of New Construction

Baseline, Pessimistic and Optimistic forecasts are developed for each of these sources

Forecasting Approach – Updates and Refinements

- **Basic approach to forecasting Sales, B&O, REET and Admissions Tax revenues remains consistent.**
  - National and regional economic forecasts serve as inputs to econometric models that track the relationship between these economic fundamentals (employment, income, etc.) and specific City revenue streams.
  - As noted above, revisions in historic income and employment data led to model revisions to adjust to these new inputs.
  - To help improve overall forecasts, we have purchased access to additional data, including hospitality information, but also real-time measures of employees' "return to office" work patterns.

- **Working to enhance projections of Assessed Value and the Value of New Construction**
  - Going forward, forecasts of new construction to be linked to projections of taxable construction activity, consistent with the approach taken at the King County forecast office.
  - Also assessing whether data and forecasts from real estate investment firms could help improve forecasts of changes in assessed value, which are ultimately linked to the market transactions closely tracked by these firms.

Forecasting Approach - Payroll Expense Tax

- 2021 was the initial year of tax collection. All payments were made at year-end. Final 2021 payments of $248 million exceeded our forecast by ~25%

- In 2022, payments will be made quarterly, but no payment data yet available. The August Forecast will provide an opportunity to incorporate quarterly payment data, as well as additional information from the Employment Security Department.

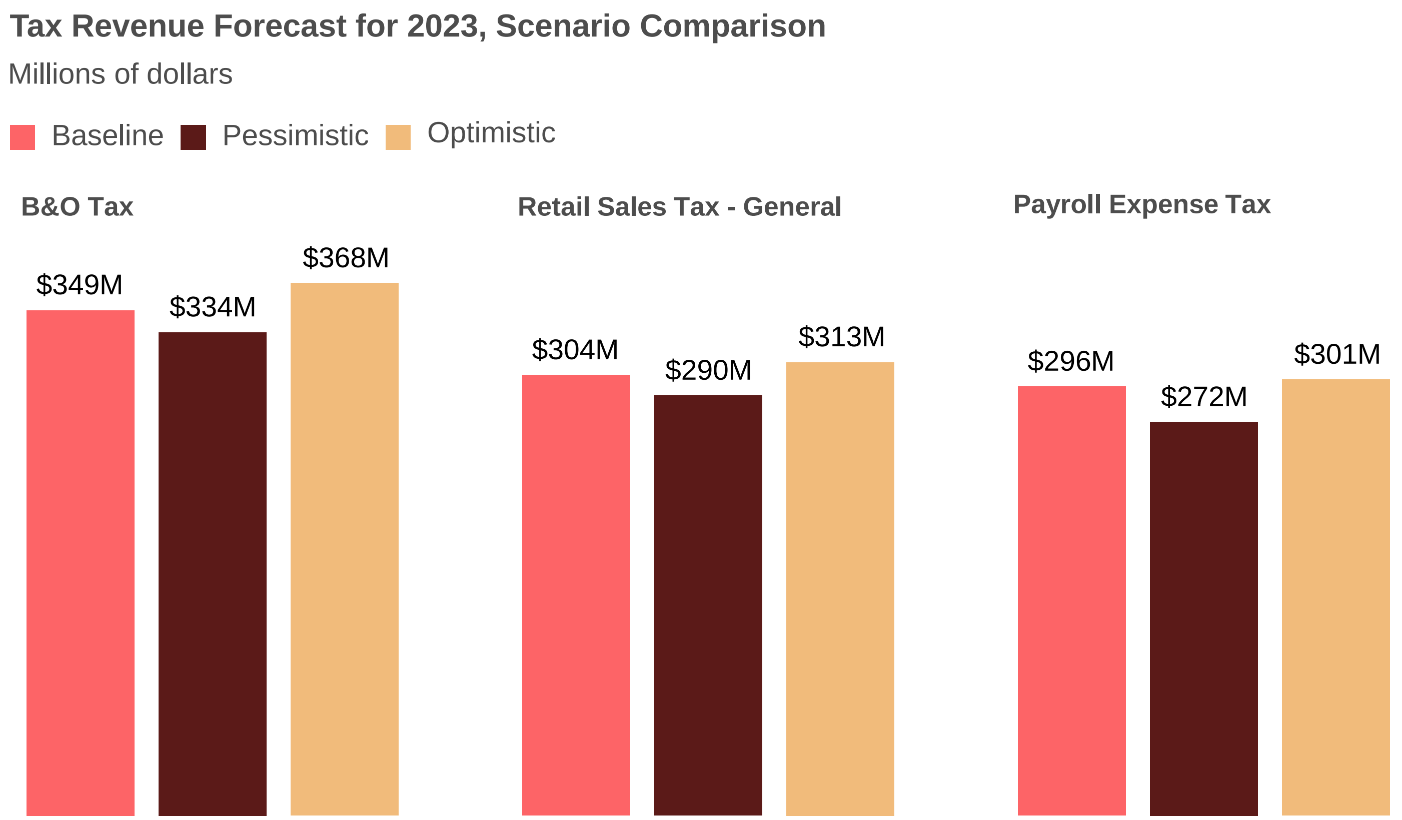
- Information and Professional & Business Services account for more than 82% of the tax receipts. This means that revenues are heavily dependent on just two sectors, rather than a diversified tax base. Accurate forecasting for any individual sector of the economy can be difficult.

- The shift to “remote work” likely means that the results for 2021 will not be representative of the long-term tax base. And 2022 is likely to be a year of transition – different from 2021, but not fully predictive of long-term work patterns. By August, we may have a better sense of how this transition is progressing.

- Our approach to revising the Payroll Expense Tax forecast has been to scale projections for 2022 and future years to the actuals revenues received in 2021, and to link projected revenue growth to overall trends in employment and wages in the relevant sectors.

How Do Forecasts Vary Across Economic Scenarios?

- Consistent with the underlying economic forecast, revenue forecast risks are larger on the downside
- In addition to the factors affecting the national economic growth, the main regional risk factors for sales tax include the uncertainty regarding the speed of leisure & hospitality recovery and the construction sector outlook
- For B&O tax, additional uncertainty arises from the timing of annual filings
- Payroll tax forecast is complicated by the lack of information regarding the tax base
- For 2022 and 2023, the pessimistic scenario forecast for the three sources combined is $30 million (3.4%) and $54 million (5.7%) lower than baseline



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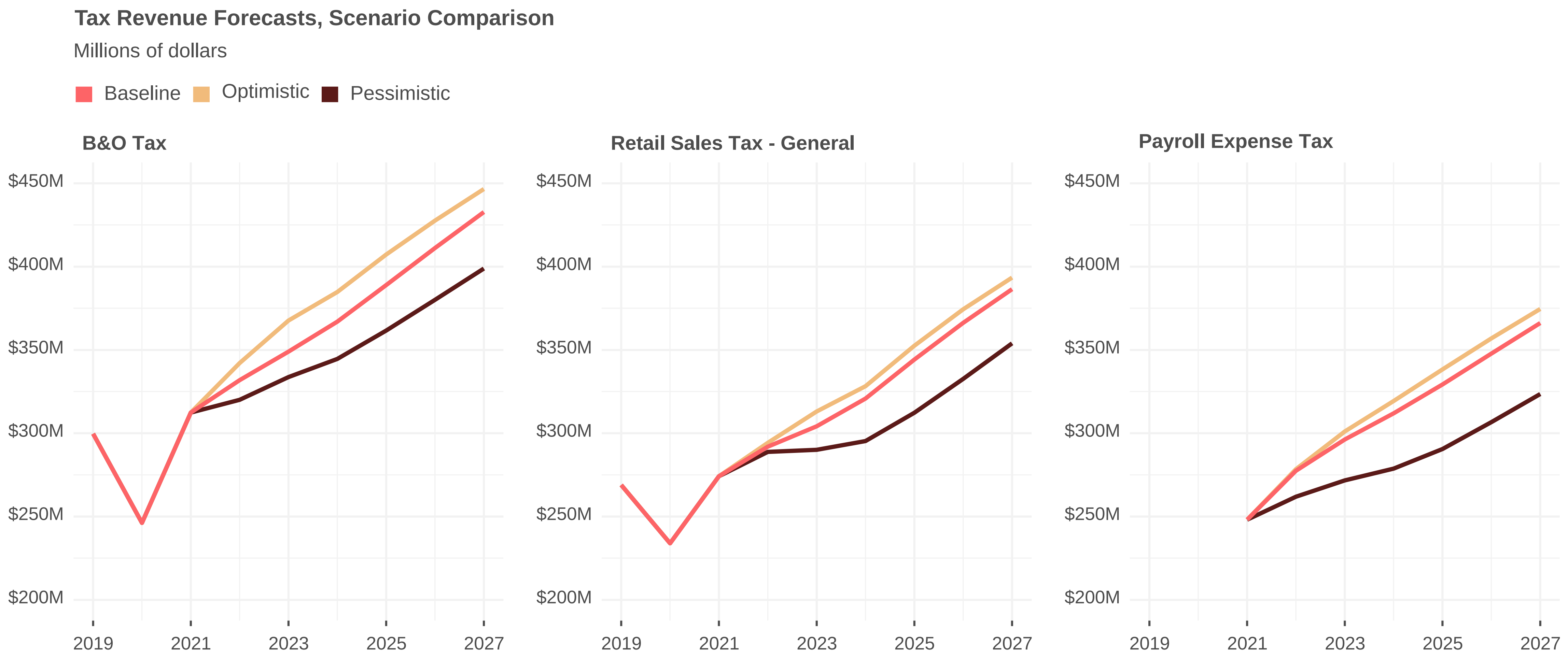
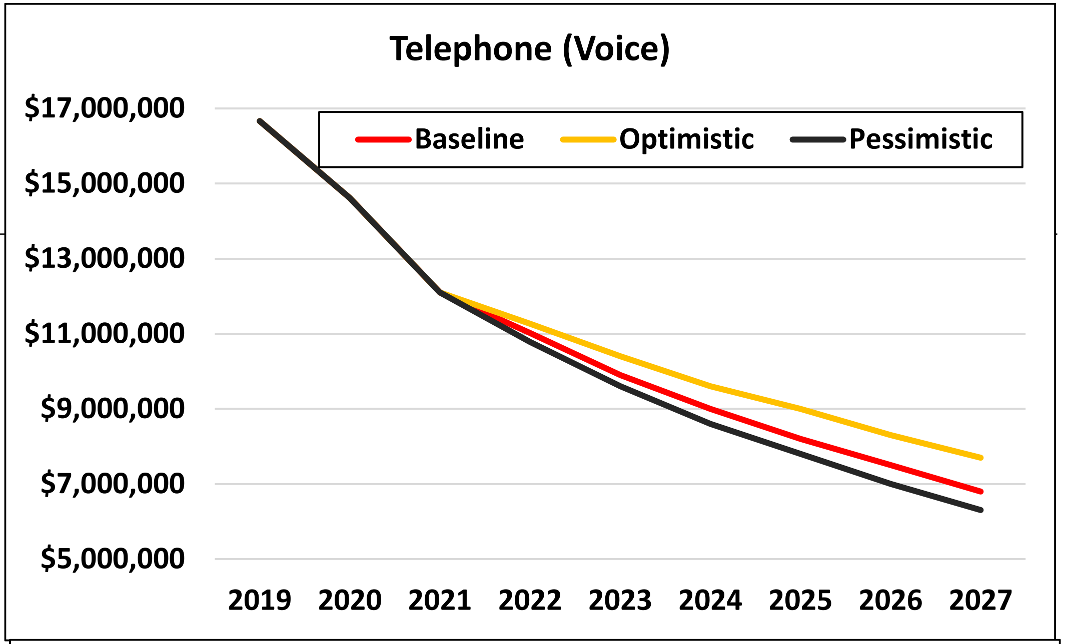
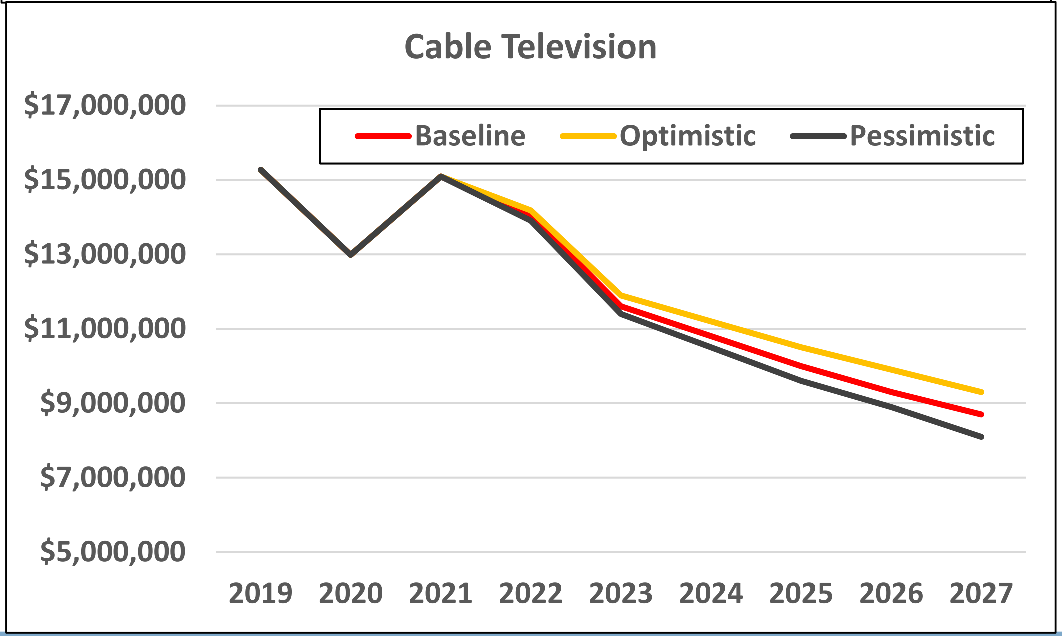


Private Utilities: Cable and Telephone

- Taxes on cable and telephone represent a small share of overall General Fund revenues. The tax rate for telephone is 6%; and for cable is 10%. Each generates less than $15 million per year.
- Both cable and telephone tax revenues have been declining for an extended period. This pattern reflects changes in consumer behavior as people move away from traditional cable and telephone services and shift to streaming services and non-voice communication.
- Our forecasts anticipate that the decline in demand for these services will continue for the near term.
- The behavioral shifts driving the decline in revenues are not driven by broader economic conditions, so the forecasts do not vary significantly across the different economic scenarios.





Remaining Revenues

Admission Tax

- Tax rate is 5%. Major taxpayers include Climate Pledge Arena, UW sports, the Space Needle, the "Wheel" and the city's movie theaters.
- Forecast essentially unchanged from November. Recent results have generally tracked to the previous forecast. Revisions may occur in the future as we see more evidence about how the public responds to the easing of COVID restrictions

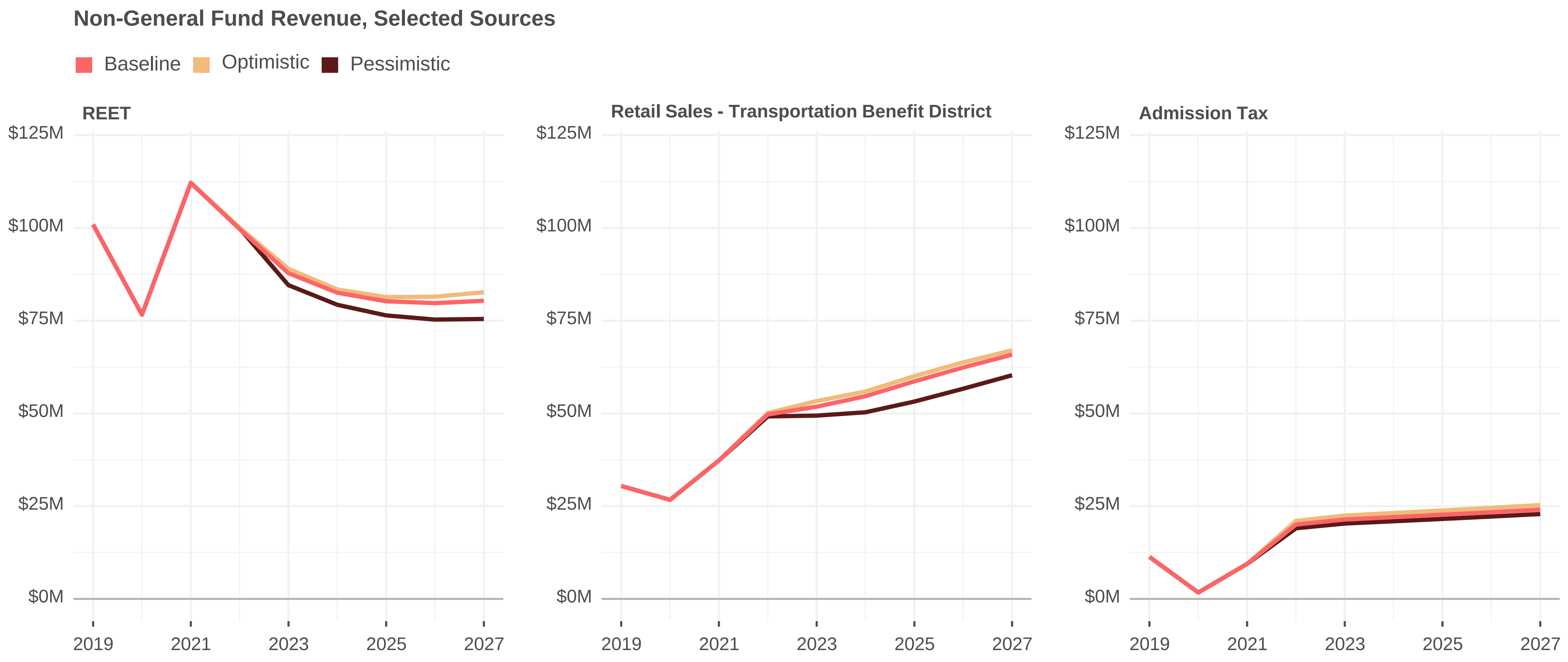
Natural Gas and Steam

- Rising energy prices have led to upward revisions of these forecasts and further escalation in energy prices could drive further revenue growth going forward.

Real Estate Excise Tax (REET)

- REET is a tax on real estate transactions and thus revenues depend on both the volume and value of these transactions.
- The REET revenue estimate has been revised upward for each of the six years included in the forecast. However, the housing market is expected to cool down and with rising mortgage rates as a result of aggressive monetary policy tightening. As a result, annual REET revenue is predicted to decline somewhat over the next few years.

Non-General Fund Revenues



Property Taxes: Assessed Value and New Construction

- Per state law, the City's property tax revenues can grow by 1% plus the value of new construction.
- Changes in Assessed Value (AV) to existing structures and property do not change property tax revenues.
- Over the past 10 years, new construction has added almost 1.8% to AV each year, on average.
- Construction activity had peaked before the pandemic hit and has continued to slow somewhat over the past two years. The forecast anticipates that new construction activity will stabilize, and that new construction will add about 1.4% to AV per year going forward.
- The forward-looking forecasts of future new construction are tied closely to our forecasts of taxable construction activity, and the variation across the three scenarios is consistent with how overall construction activity is expected to perform under each scenario.

Summary of Baseline Biennial Forecast, including 2022, 2023 and 2024

Revenue Source	2021 Actuals ($ M)	2022 Revenues November Forecast ($ M)	2022 Revenues April Forecast ($ M)	2022 Revenues Diff: April vs Nov.	2023 April Forecast ($ M)	2024 April Forecast ($ M)
General Fund Revenues - Selected Sources						
B&O and Sales Taxes						
Business and Occupation Taxes	$312.4	$317.4	$331.9	$14.4	$349.0	$367.0
Business License Fees	$16.7	$18.1	$17.7	($0.4)	$18.6	$19.5
Retail Sales - General	$274.2	$280.0	$291.9	$11.9	$304.2	$320.8
Retail Sales - Criminal Justice	$25.2	$23.9	$26.5	$2.6	$27.6	$28.9
Utility Taxes - Private						
Cable Television	$15.1	$12.4	$14.1	$1.6	$11.6	$10.8
Telephone	$12.4	$12.2	$11.0	($1.2)	$9.9	$9.0
Garbage	$2.0	$1.5	$2.2	$0.7	$2.2	$2.3
Natural Gas & Steam	$15.3	$12.8	$15.7	$2.9	$14.7	$14.7
General Fund Total - Selected Sources	**$673.2**	**$678.4**	**$710.9**	**$32.5**	**$737.8**	**$773.1**
Percent Change from Previous Year		***0.8%***	***5.6%***		***3.8%***	***4.8%***
Non-GF Revenues - Selected Source						
Payroll Expense Tax	$248.1	$233.9	$277.5	$43.6	$296.3	$312.0
REET	$112.2	$88.0	$99.7	$11.7	$87.8	$82.6
Admission Tax	$9.5	$20.1	$20.1	$0.0	$21.4	$22.0
Retail Sales - Trans. Benefit District	$37.3	$47.8	$49.7	$2.0	$51.8	$54.7
Non-GF Total - Selected Sources	**$407.1**	**$389.7**	**$447.0**	**$57.3**	**$457.3**	**$471.2**