Economic and Revenue Update

April 10, 2023

Office of Economic and Revenue Forecasts

&

City Budget Office

Presentation Outline

Part I: Update on economic developments since the November Forecast – recent and current events

Part II: Revised Economic Forecasts – looking forward to what is expected to come

- National Economy – summary of results from IHS Markit's national economic model
- Regional Economy – summary of results from the Forecast Office's regional economic model

Part III: April Revenue Forecast – General Fund and other major revenue sources

- General Fund Revenues
- Non-GF "General Government" Revenues – including JumpStart Payroll Tax and REET
- Non-GF Transportation Revenues

Part 1

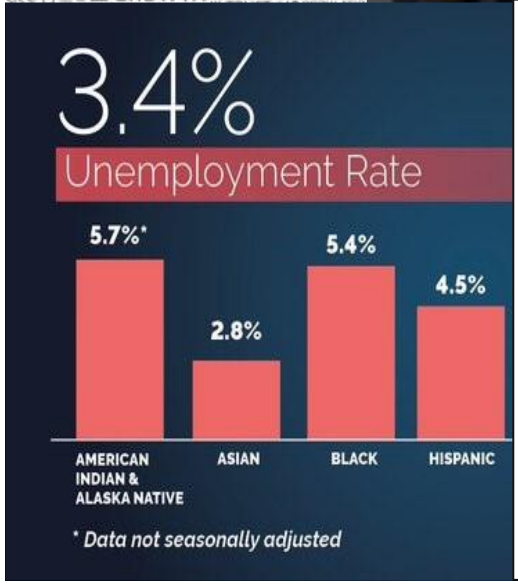
Economic Update – Recent Developments

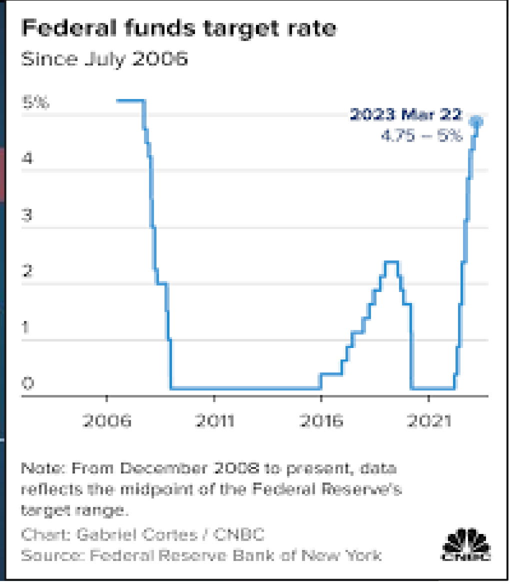
National Outlook Has Improved Since the Last Forecast, But Risks Remain . . .

- Recent job growth has been more modest than in first half of 2022, but still strong. Over the last 5 months, national job growth has averaged just over 300K per month. The general consensus is that the job growth is currently constrained by the available supply of workers.

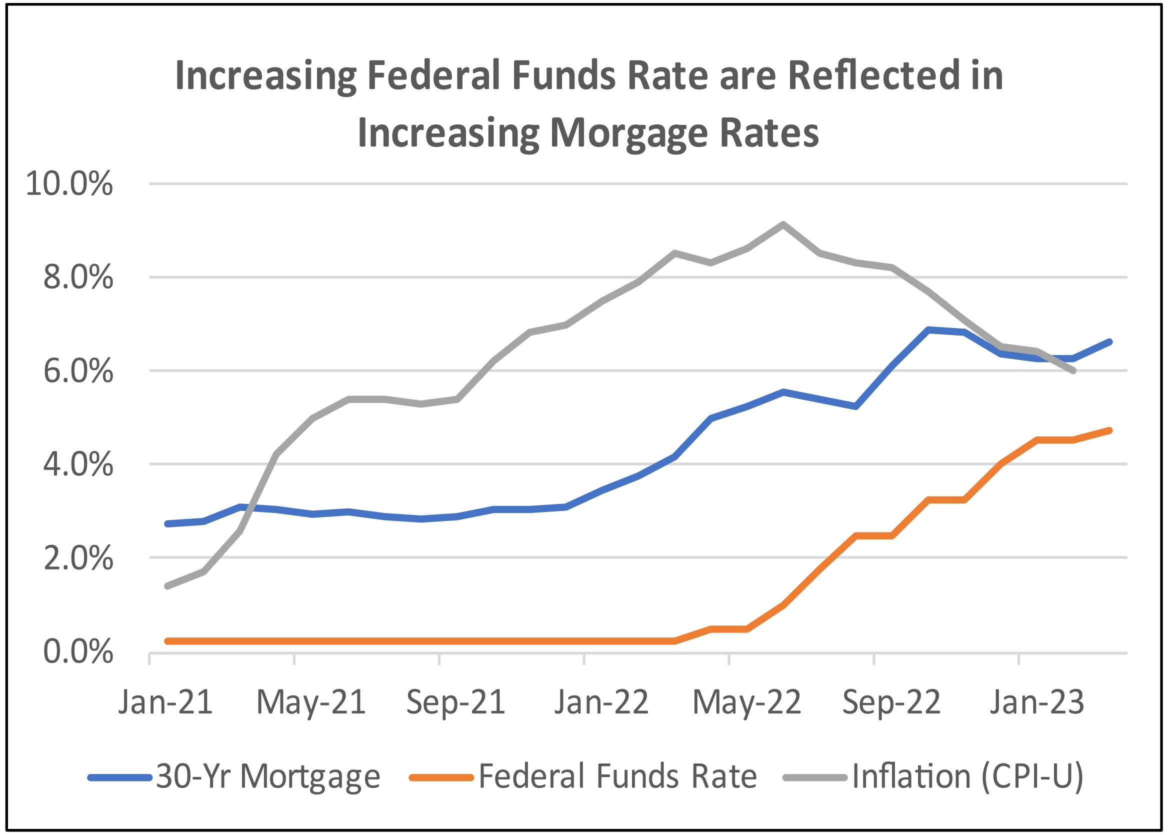
- In October of last year, annual inflation was still running at 7.7%. It had fallen from its peak of 9.1% in June, but was still quite high. As of February, inflation was down to 6.0%. Perhaps more importantly, this marked the eight consecutive month that inflation declined, and the rate is now at its lowest level since September of 2021.

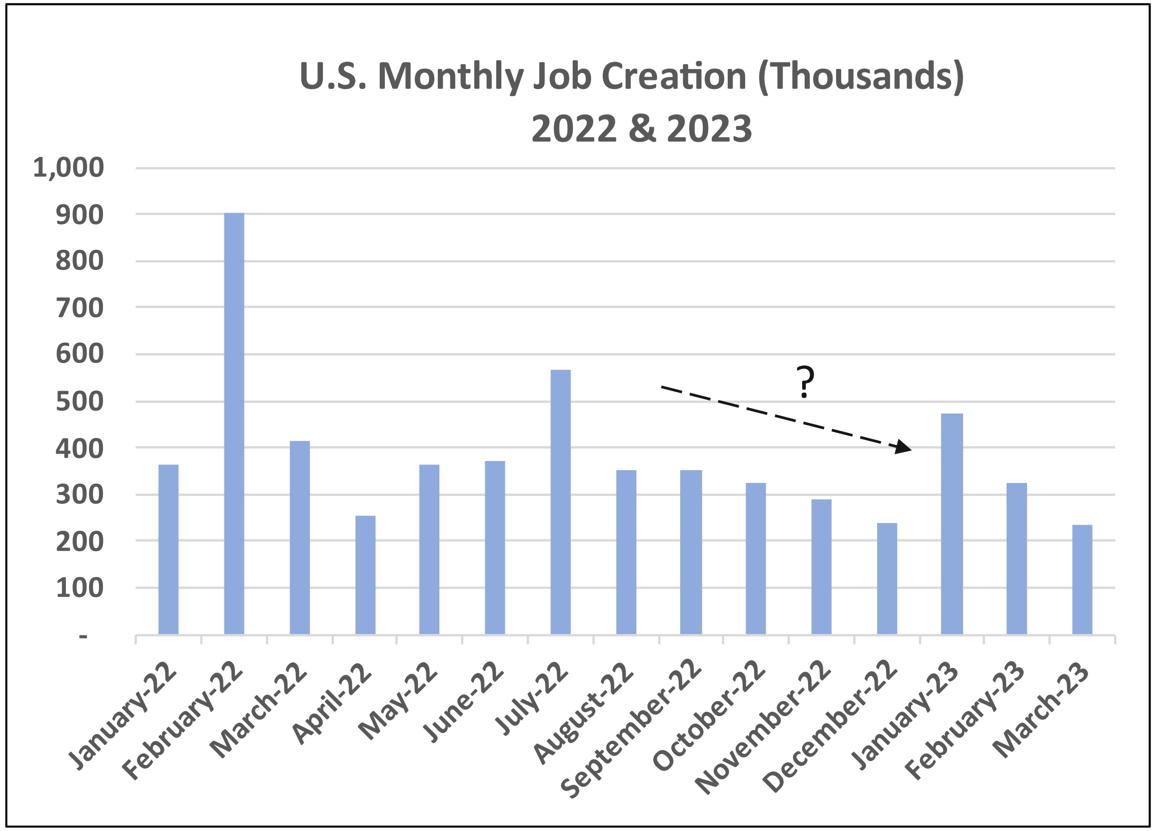
- This all said, risks remain:
  - The failure of SVB and Signature banks have highlighted significant financial stress in the banking system. This could affect access to capital and also reduce overall consumer confidence in the economy.
  - Higher interest rates have dramatically slowed real estate market activity, and tightening will slow business investment as well.
  - The “tight” labor market will continue to put upward pressure on wages, which in turn could drive a longer-term pattern of inflation.
  - Forecasts assume that congress will raise the debt ceiling. If not . . .





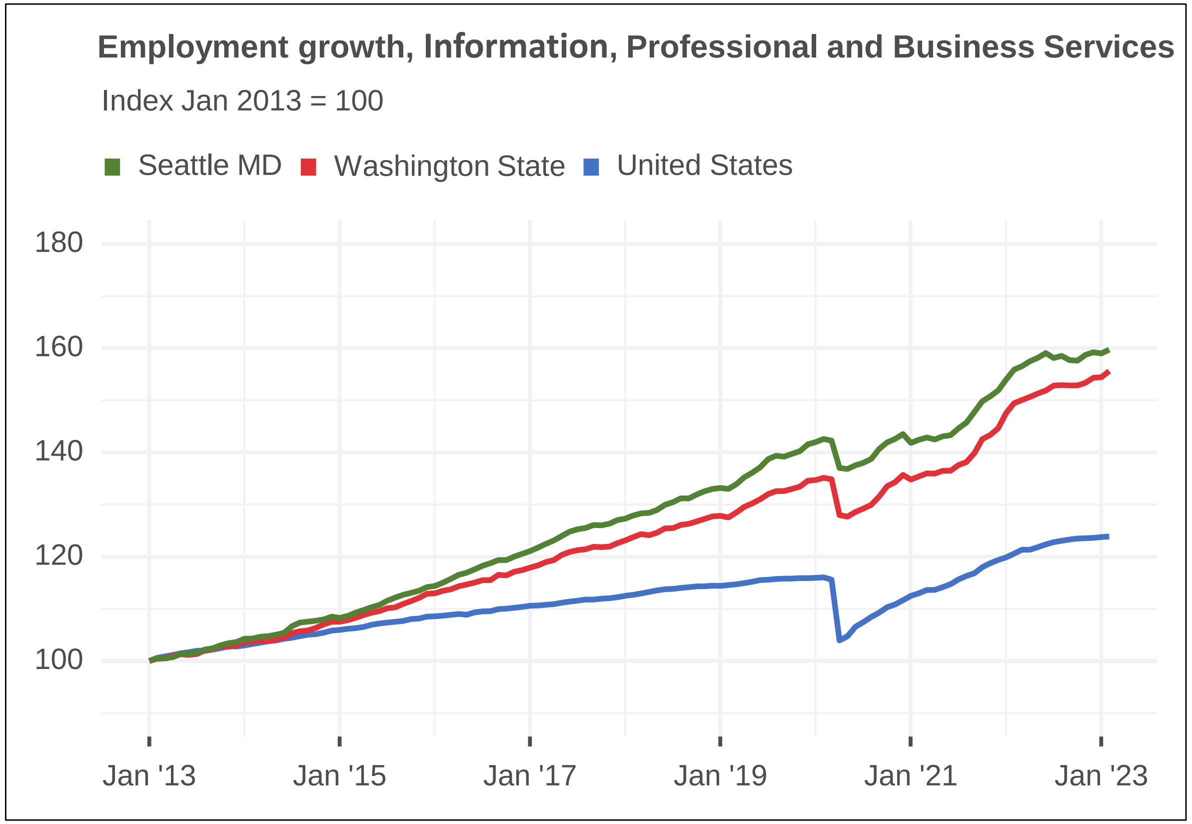
Federal Reserve Actions are Having An Impact on the Economy

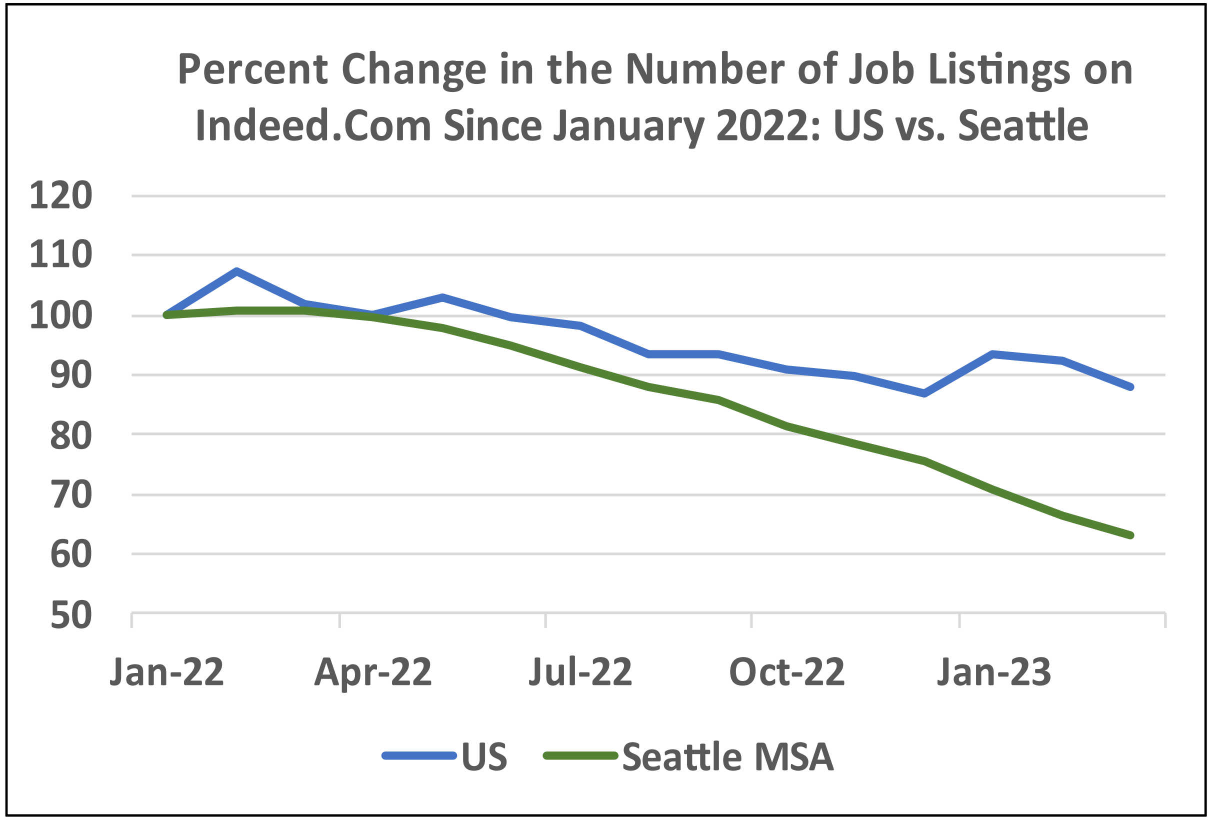




City of Seattle

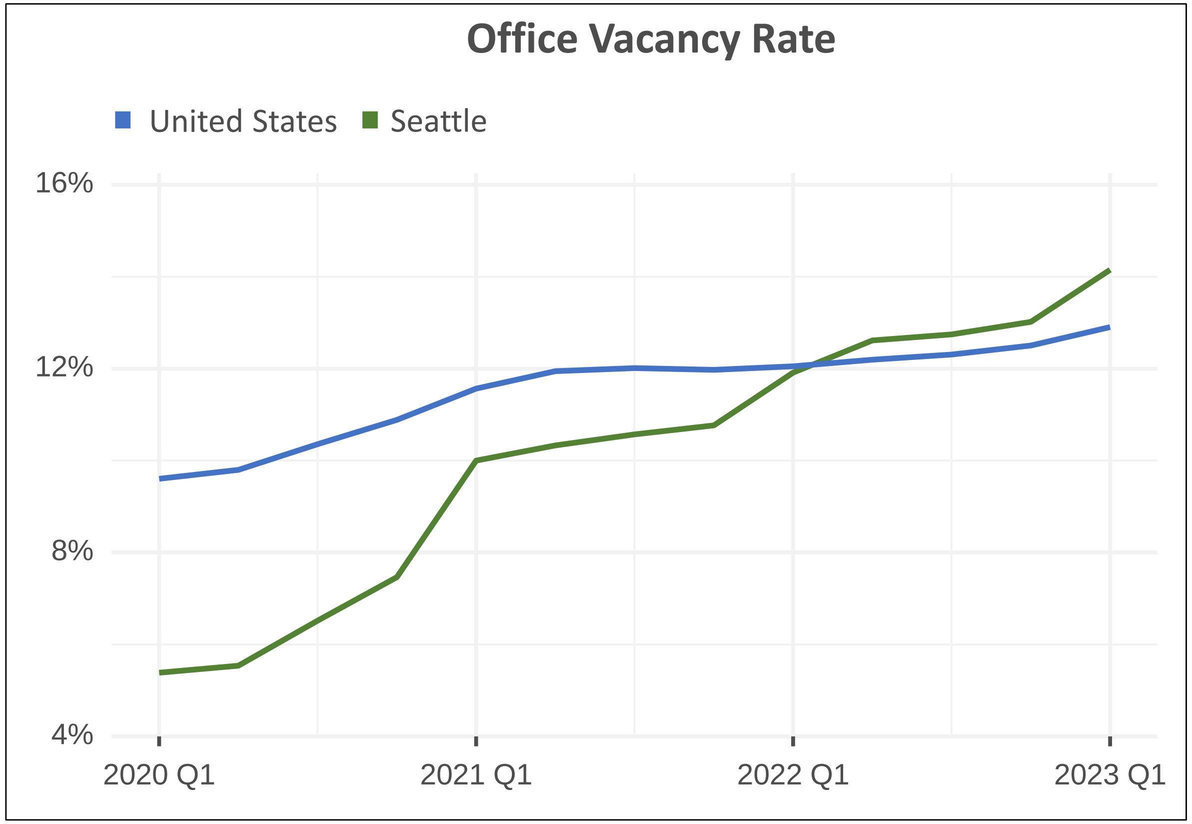
Recent Developments Also Highlight Risks Specific to the Local Economy

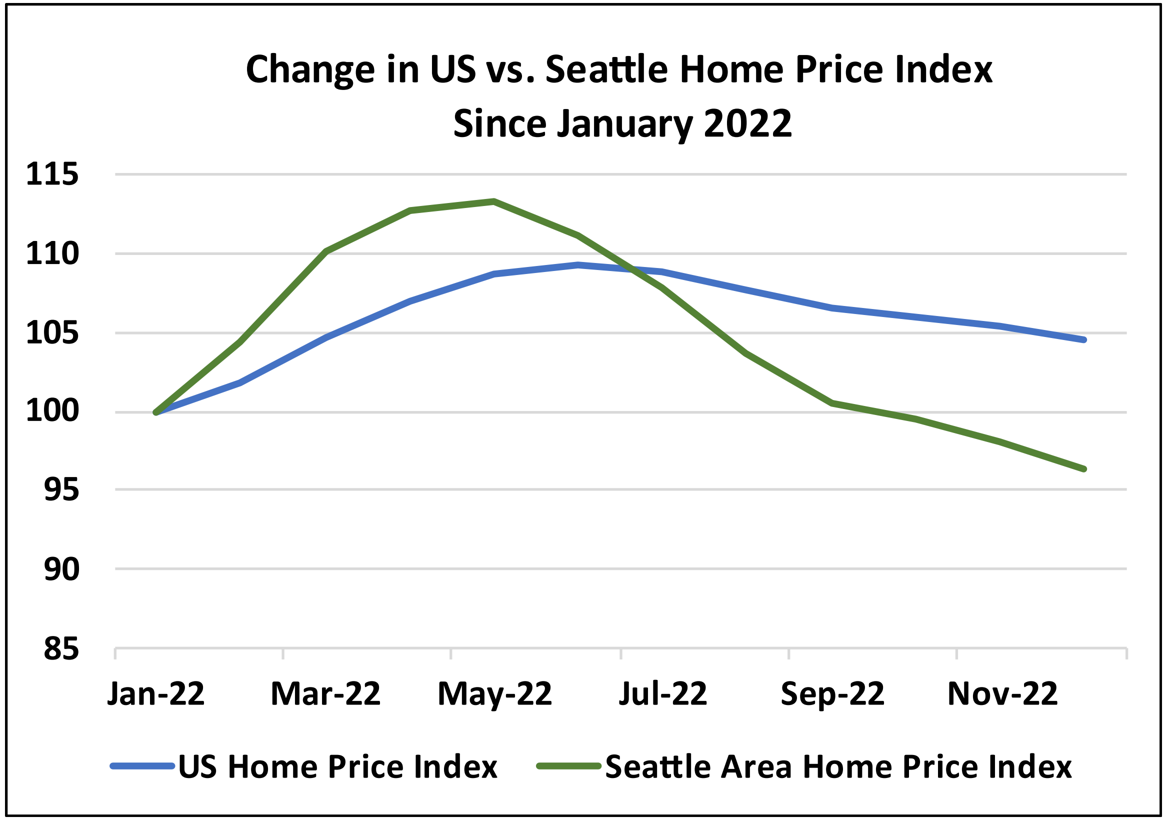




City of Seattle

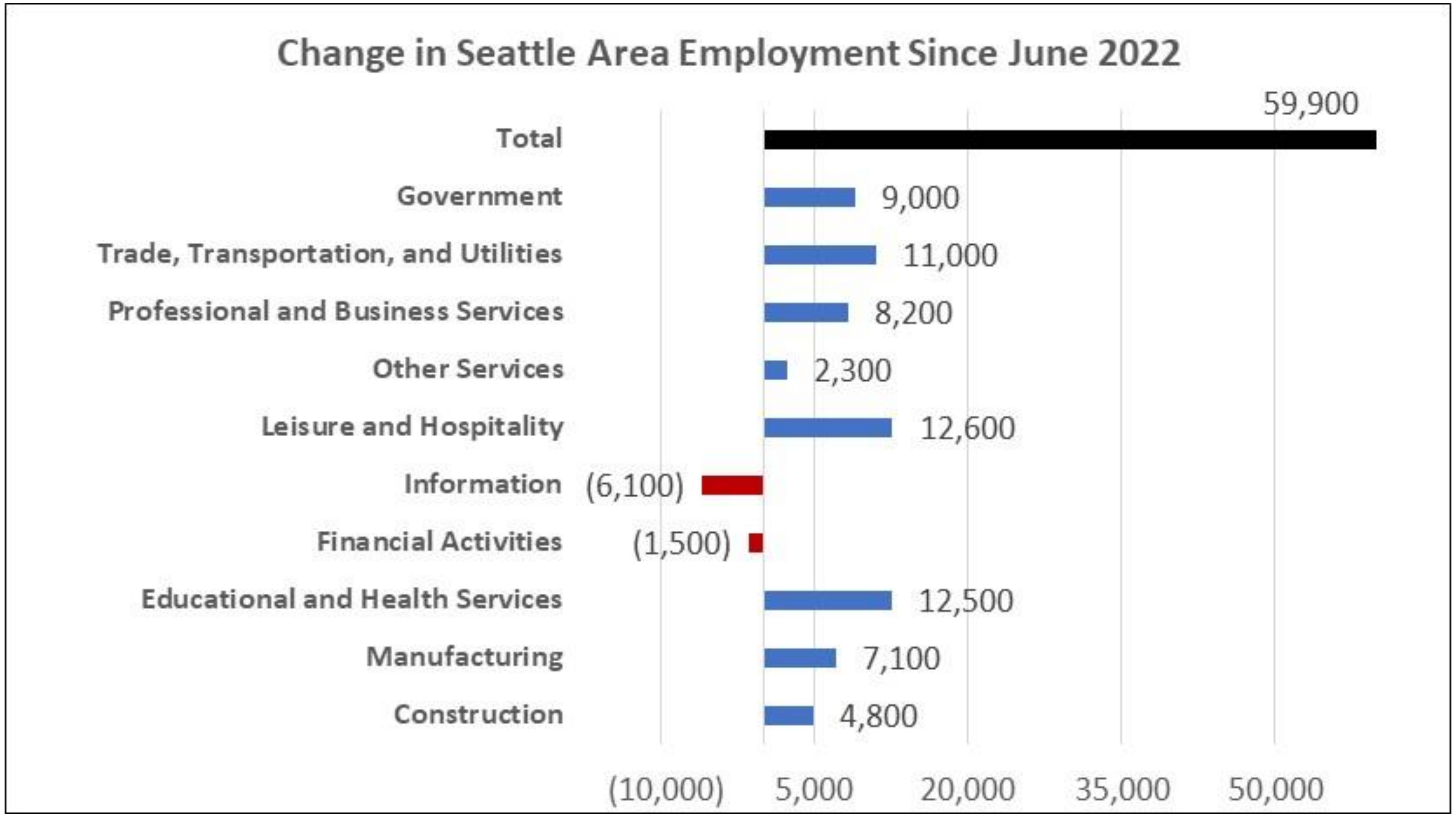
Recent Developments Highlight the Risks to the Local Economy (cont.)





Regional Employment Trends Vary Significantly by Sector

- The regional economy has added almost 60,000 jobs (3.4% growth) since June of last year.
- "Leisure & Hospitality" and "Educational and Health Services" have shown particular strength.
- In contrast, layoffs in the tech sector are reflected in job losses within "Information", and the relatively smaller contribution of "Professional and Business Services". These two sectors had driven employment gains over the previous 2 years.
- The impacts of increasing interest rates, and the resulting drop of credit-financed investments, is reflected in the loss of jobs in the "Financial Activities" sector.



Part 2

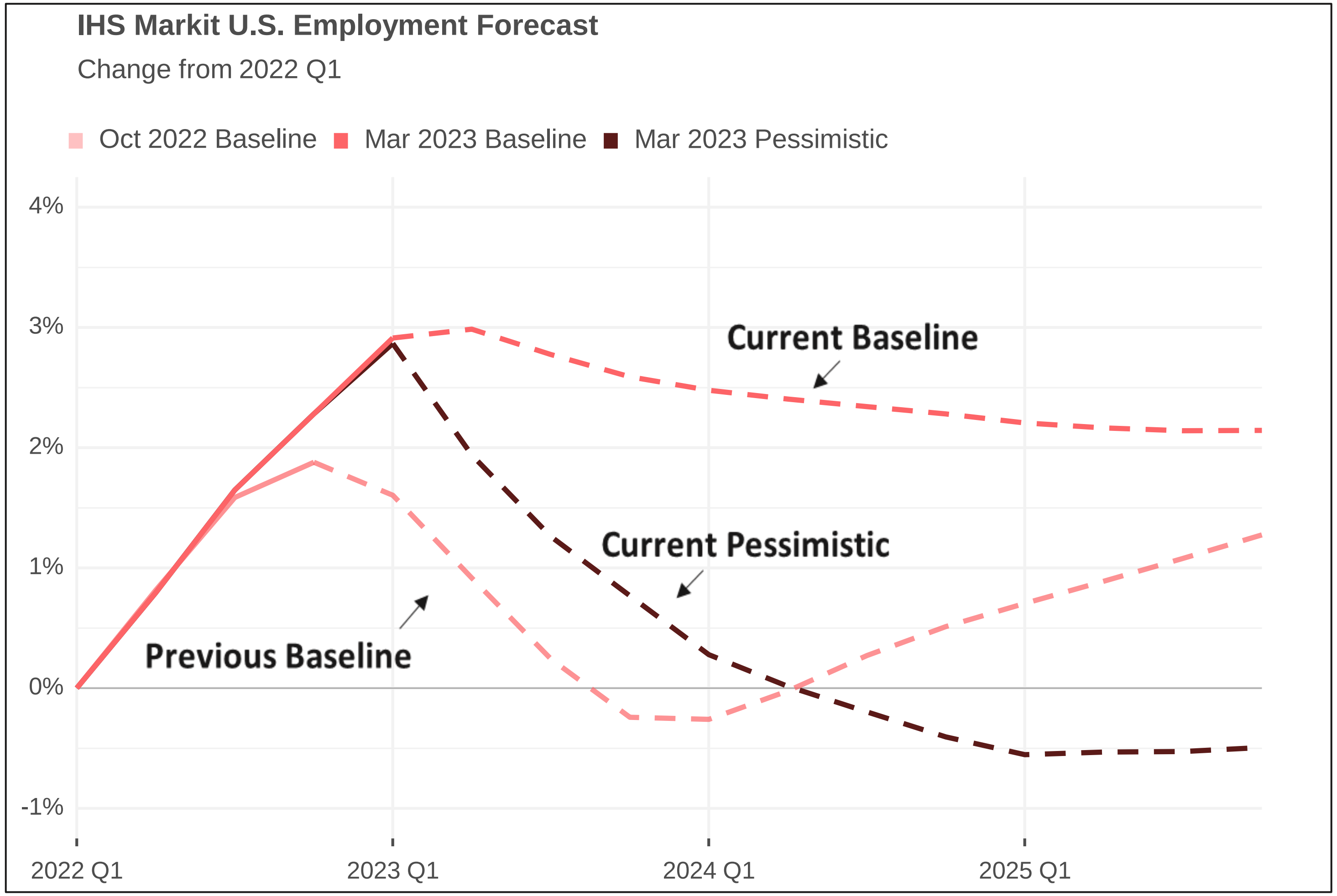
National and Regional Economic Forecasts - Looking Forward

Baseline National Forecast Now Anticipates a "Soft Landing"

- IHS Markit baseline forecast predicts an extended period of slow growth at the national level, but no longer a recession. Note that this forecast was prepared before the recent banking sector turmoil.

- The phrase "slow-cession" has been used to characterize this forecast. The baseline forecast is also consistent with the Fed's goal of a "soft landing" - cooling the economy w/o causing a recession. Total employment is expected to fall from its peak, but only modestly.

- However, note that the IHS's pessimistic forecast, to which they have assigned a probability of 25%, anticipates a significant employment decline in 2023 and tepid growth in 2024 and beyond. In this scenario, unemployment would peak at 6.1%, compared to 4.5% in the baseline scenario.

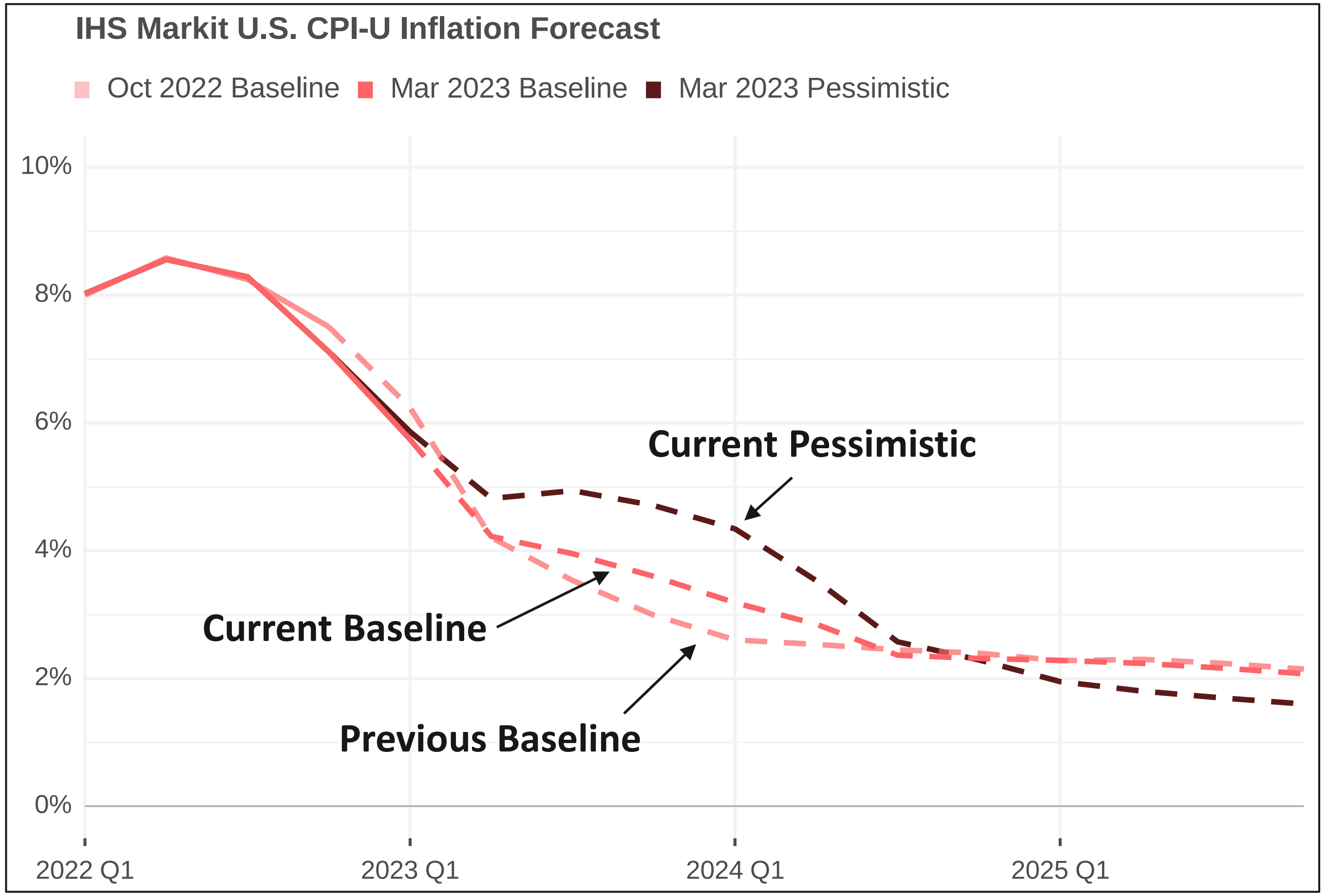


U.S. Inflation Forecast

- The new baseline forecast from IHS does not predict a significantly different pattern for inflation than what was anticipated last fall.

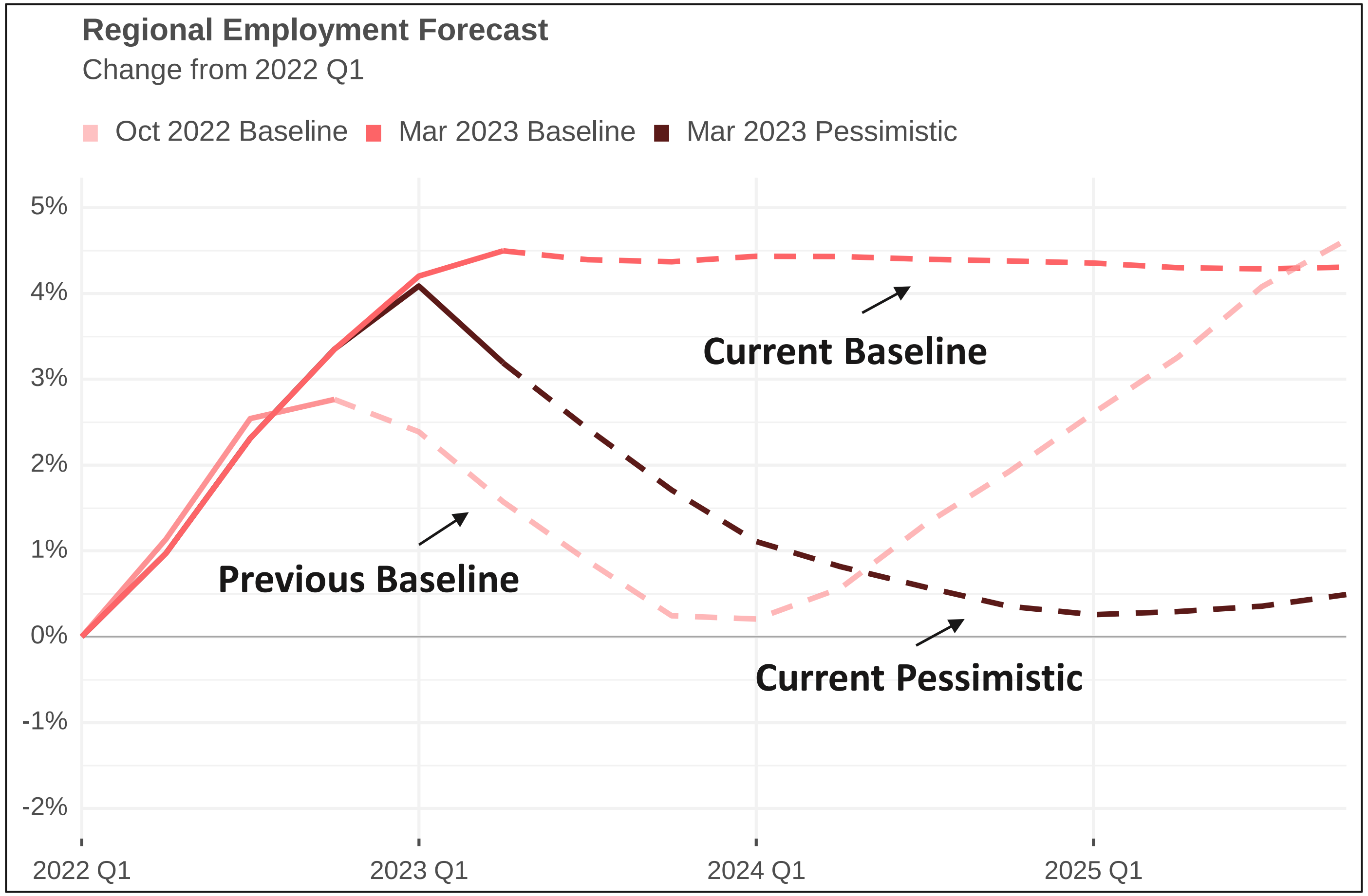
- General consensus is that the current pattern of declining inflation will continue through this year, with inflation reaching the Fed's target of 2%-3% by the middle of 2024.

- In contrast, the pessimistic national forecast anticipates that inflation remains elevated and does not fall until the economy begins to contract with the onset of a national recession. This scenario corresponds to escalating conflict in Ukraine, further supply chain disruptions, and commodity price escalation.



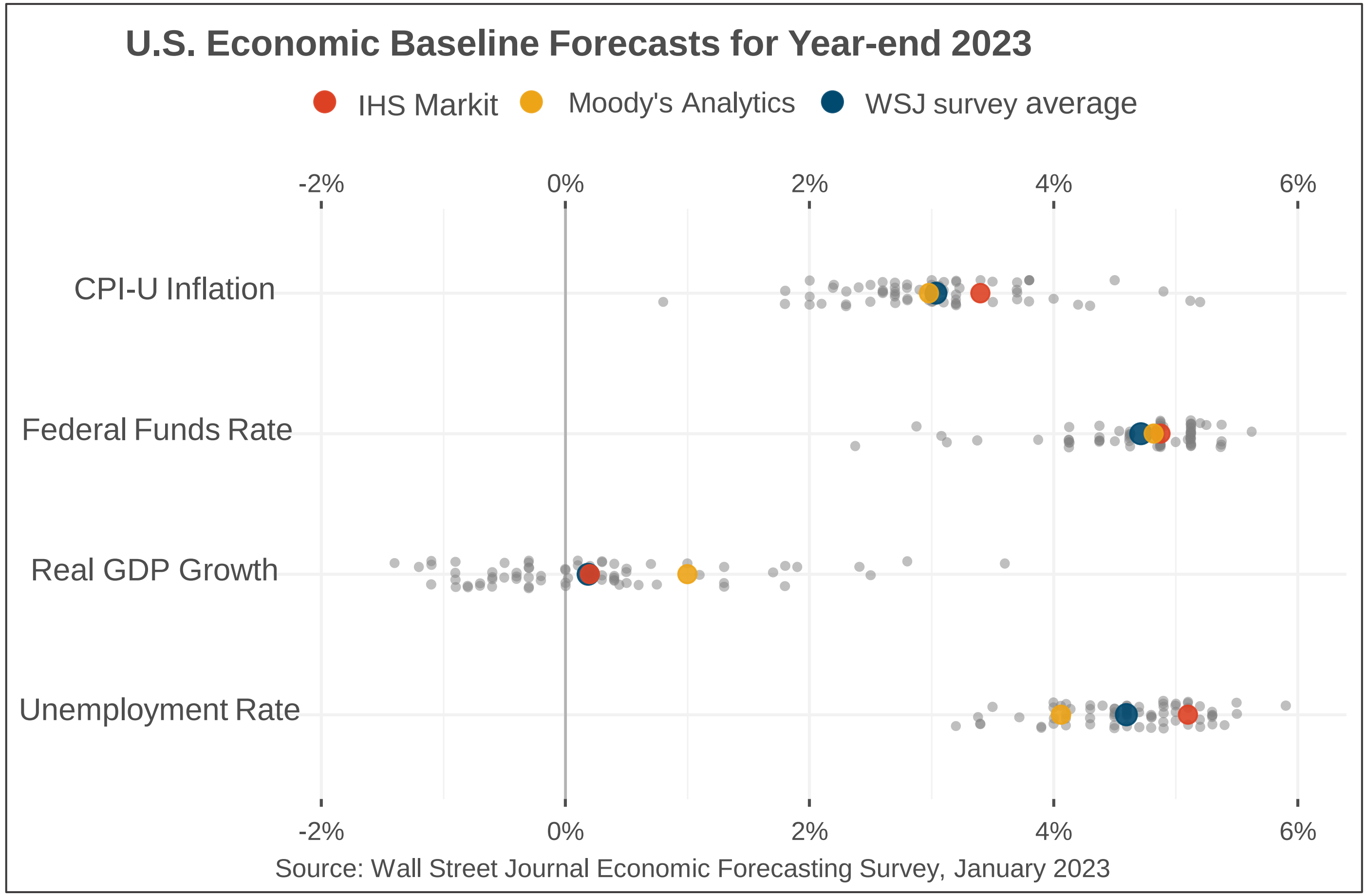
Regional Forecast: Stronger Near-Term, Weaker Long-Term

- Consistent with the national forecast, the near-term regional forecast reflects unexpectedly strong job growth in the first quarter of 2023.
- Rather than a short, mild recession as was forecast in November, the current baseline forecast anticipates that employment levels will grow into the 2nd Qrtr of this year before reaching a level that will be sustained for the next 2-3 yrs.
- Looking forward, employment is expected to grow in some sectors, but job reductions in areas such as information and construction will offset these anticipated gains. The net impact will be almost no gain in employment until 2026.
- The pessimistic forecast represents a shift into a short and mild recession that would nevertheless wipe out nearly all of last year's job gains.



Which Forecast is Most Appropriate?

- The IHS Markit baseline forecast is generally consistent with the mid-range of national forecasts.
- The IHS Markit baseline predictions for inflation and the peak federal funds rate are essentially equal to the average of national forecasts, and marginally more pessimistic than the Moody's forecasts.
- IHS Markit's baseline forecast for unemployment is somewhat higher than both the Moody's forecast and the average of other forecasters. In this sense, the baseline forecast can be seen as somewhat conservative, relative to others.



Economic Scenario Recommendation

Key Observations

- While regional economic performance has generally been better than we anticipated last fall, the prospects for longer-term regional growth have been cooled by the significant slow-down in the technology sector. Both these developments – near-term strength and longer-term weakness - are reflected in the new baseline regional forecast.

- The IHS Markit forecasts, which are a key input to the Forecast Office's regional modeling, are consistent with the general consensus of economic forecasters, if not slightly conservative.

- As highlighted in the next section of this presentation, the Forecast Office has been able to separately model potential downturns in both the JumpStart Payroll Tax and REET revenues, so the use of the baseline regional forecast is not inconsistent with negative trends we have seen in both of these important revenue sources.

Conclusion

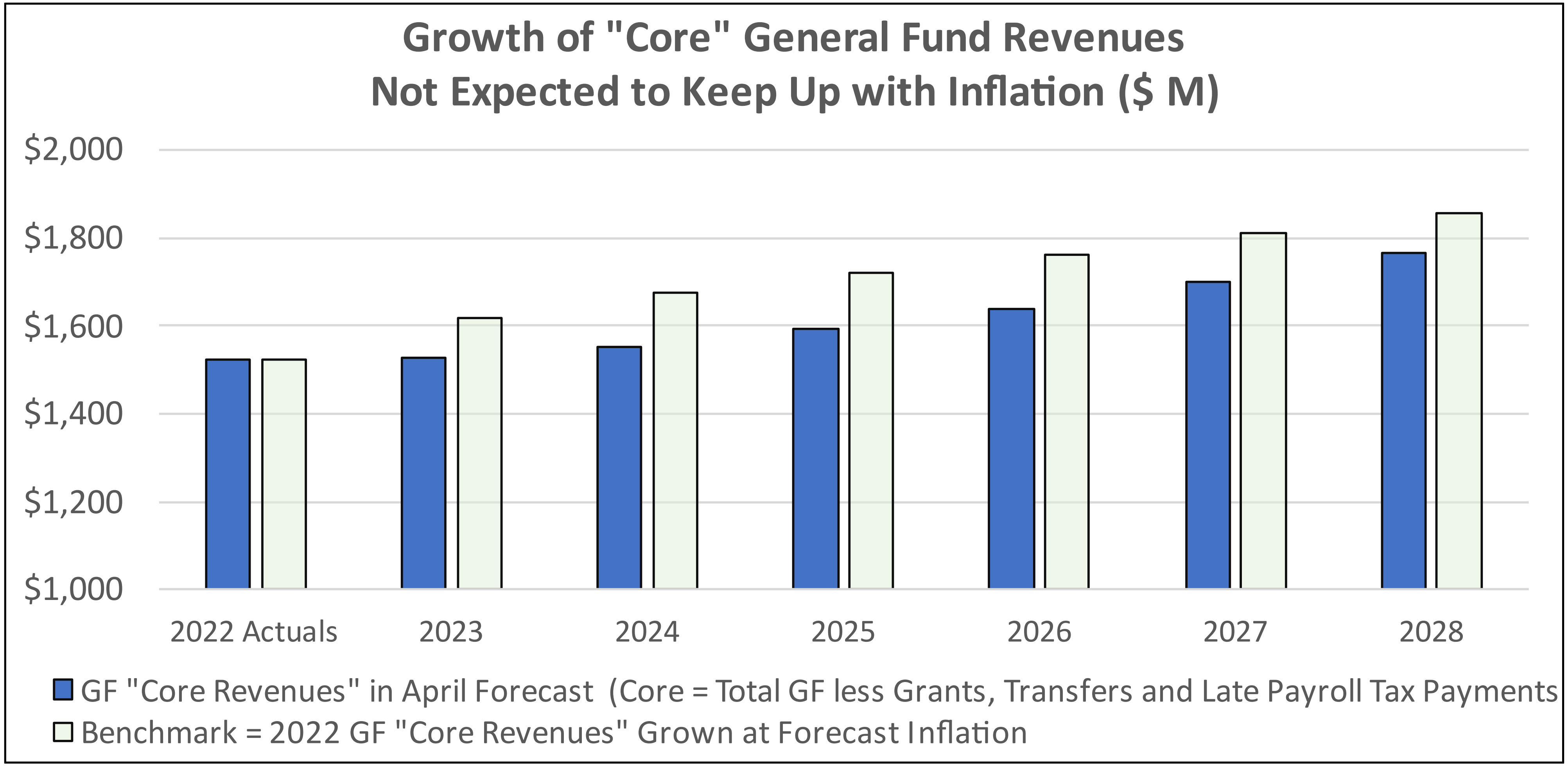
<u>Given these observations, the Forecast Office recommends using the baseline economic scenario for the April 2023 Forecast</u>.

Part 3: Revenue Forecast

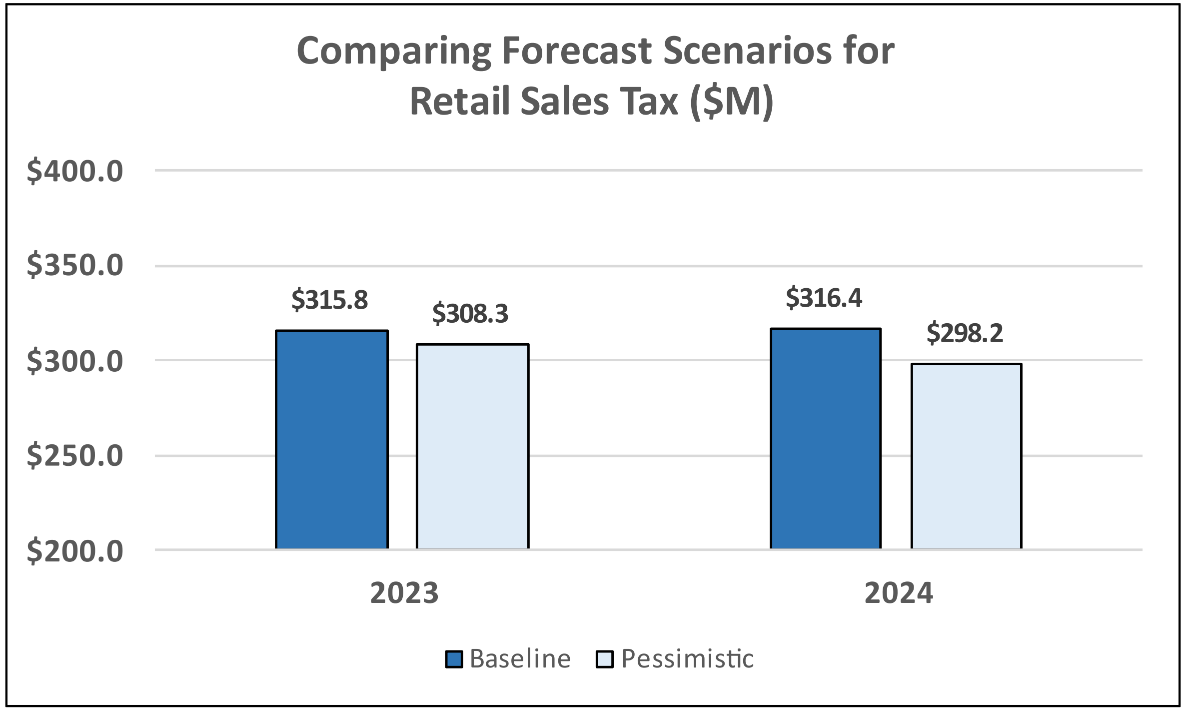
General Fund Revenues – 2023 and 2024 ($ '000)

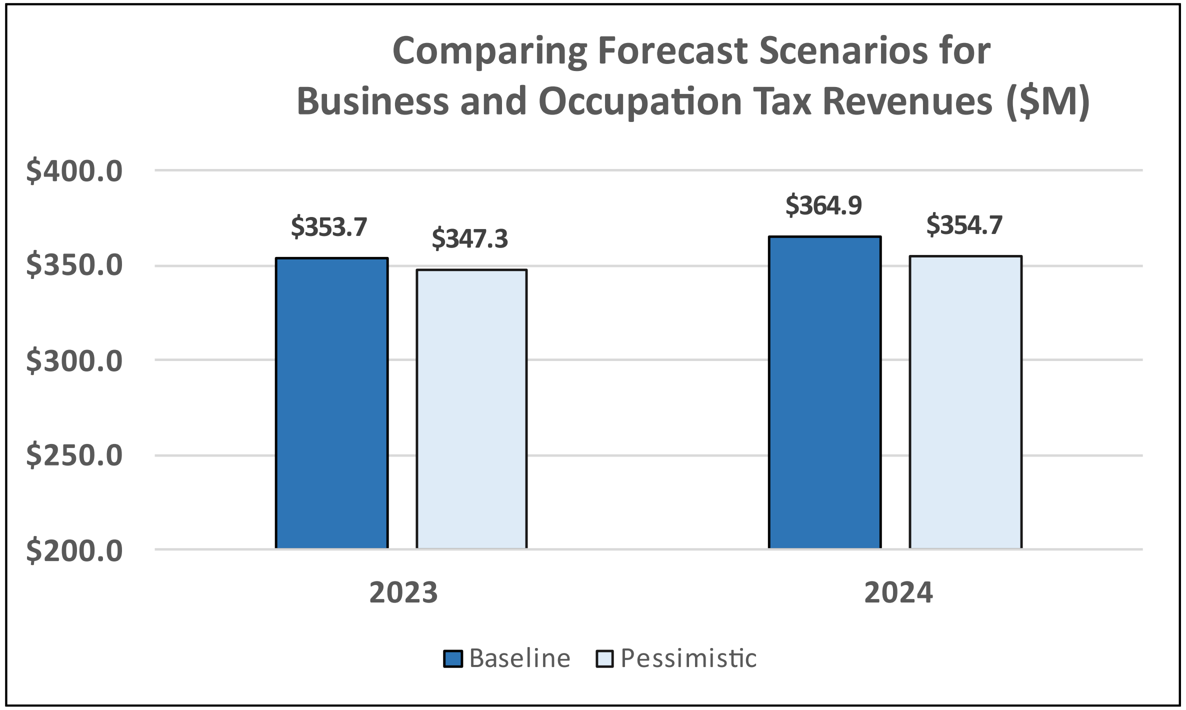
	2022	2023			2024			Total
Revenue Source	**2022 Actuals**	**2023 - Adopted Budget**	**2023 - April Forecast**	**Diff: April vs. Adopted**	**2024 - Endorsed Budget**	**2024 - April Forecast**	**Diff: April vs. Endorsed**	**2-Year Total Difference**
Property Tax (Including Medic One Levy)	$371,770	$380,477	$378,210	($2,267)	$386,627	$383,428	($3,199)	**($5,466)**
Retail Sales Tax	$331,220	$332,994	$343,794	$10,800	$339,827	$344,692	$4,865	**$15,665**
Business & Occupation Tax	$331,580	$334,960	$353,735	$18,775	$344,132	$364,886	$20,754	**$39,529**
Utility Tax - Private	$41,850	$40,924	$42,134	$1,210	$38,190	$39,249	$1,059	**$2,269**
Utility Tax - Public	$192,850	$191,149	$191,910	$761	$196,958	$198,416	$1,458	**$2,219**
Other City Taxes	$14,540	$13,959	$13,662	($297)	$14,838	$13,529	($1,309)	**($1,606)**
Parking Meters	$23,860	$37,957	$36,927	($1,030)	$44,463	$43,339	($1,124)	**($2,154)**
Court Fines	$13,220	$19,747	$14,695	($5,052)	$24,330	$16,523	($7,807)	**($12,859)**
Revenue from Other Public Entities	$18,640	$18,494	$19,494	$1,000	$18,761	$19,151	$390	**$1,390**
Grants	$23,120	$23,414	$51,300	$27,886	$10,927	$12,691	$1,764	**$29,650**
Fund Balance Transfers	$151,010	$111,008	$117,260	$6,252	$94,700	$94,700	$0	**$6,252**
Service Charges & Reimbursements	$132,530	$69,778	$69,810	$32	$71,899	$70,106	($1,793)	**($1,761)**
Licenses, Permits, Interest Income and Other	$50,940	$48,588	$62,840	$14,252	$48,858	$59,585	$10,727	**$24,979**
Payroll Tax - Late 2021 Payments	$44,980	$0	$2,164	$2,164	$0	$0	$0	$2,164
Total	**$1,742,110**	**$1,623,449**	**$1,697,935**	**$74,486**	**$1,634,510**	**$1,660,295**	**$25,785**	**$100,271**
Difference w/o Grants				**$46,600**			**$24,021**	**$70,621**

Long-Term Forecast of “Core” General Fund Revenues



How Do Forecasts Vary Across Economic Scenarios?





- The most significant differences between the Baseline and Pessimistic scenarios are reflected in Retail Sales and B&O taxes.
- Note that the divergence between the baseline and pessimistic scenarios is significant and increases from 2023 to 2024, consistent the pessimistic regional forecast, which anticipates deteriorating economic conditions over both 2023 and 2024.
- For the GF as a whole, the pessimistic forecast is $27M lower in 2023 and $48M lower in 2024, for a biennial total of $75M less revenue than in the baseline forecast.

Summary of Selected General Government Revenues

	2022		2023				2024			Total
Revenue Source	**2022 Actuals**		**2023 - Adopted Budget**	**2023 - April Forecast**	**Diff: April vs. Adopted**		**2024 - Endorsed Budget**	**2024 - April Forecast**	**Diff: April vs. Endorsed**	**2-Year Total Difference**
General Government Revenues:										
Payroll Tax^	$253,060		$294,120	$263,260	($30,860)		$311,466	$279,740	($31,726)	**($62,586)**
Admission Tax*	$21,650		$21,430	$22,020	$590		$22,153	$22,820	$667	**$1,257**
Sweetened Beverage Tax	$20,240		$20,390	$20,930	$540		$20,700	$21,247	$547	**$1,087**
Short-Term Rental Tax	$9,870		$9,430	$10,290	$860		$10,077	$11,374	$1,297	**$2,157**
REET	$91,420		$68,060	$55,020	($13,040)		$68,646	$59,962	($8,684)	**($21,724)**
Transportation-Specific Revenues:										
Trans. Ben. Dist. - Sales & Use Tax	$51,950		$52,250	$53,780	$1,530		$53,359	$53,881	$522	**$2,052**
Trans. Ben. Dist. - Vehicle License Fee	$15,980		$17,650	$18,260	$610		$19,890	$20,615	$725	**$1,335**
Commercial Parking Tax	$37,660		$45,030	$48,380	$3,350		$47,051	$47,276	$225	**$3,575**
SSTPI - School Zone Speed Enforcement	$8,470		$14,840	$11,270	($3,570)		$14,061	$11,050	($3,011)	**($6,581)**

^ This represents the total of 2022 tax obligations. And additional $45M of late 2021 payments were deposited in the GF in 2022, per City ordinance which directs all 2021 obligations to the GF.
*A change in share or Ad Tax revenue generated at Climate Pledge Arena, increases the revenue available to the City by ~$900K in 2023 and $1.5M in 2024.

JumpStart Payroll Expense Tax Forecast

Key Observations

- Actual revenues fell from $293M in 2021 to $253M in 2022. The November forecast for 2023 revenues was $294M.
- The majority of revenues are generated from relatively few firms, concentrated in the technology sector. This sector has been significantly affected by the shift to hybrid work, and is also one where a significant share of compensation is tied to stock values.
- Although the available data are limited, an empirical analysis shows a correlation between tax payments and two key factors: (i) changing stock values; and (ii) evolving "work-from-home" practices.
- The Forecast Office continues to work with ESD and Seattle IT to develop a data-sharing agreement that will significantly enhance the econometric tools we can deploy for the JumpStart Payroll Tax forecasts.

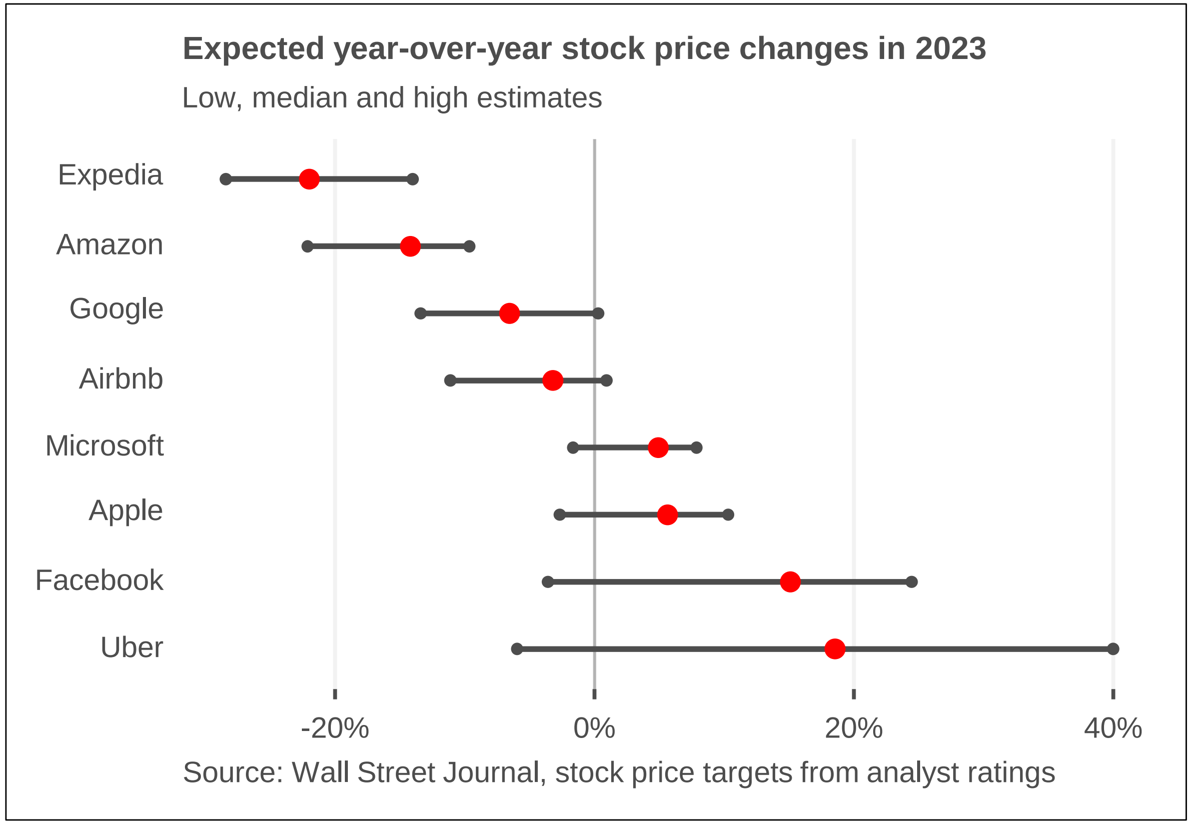
Forecasting Approach

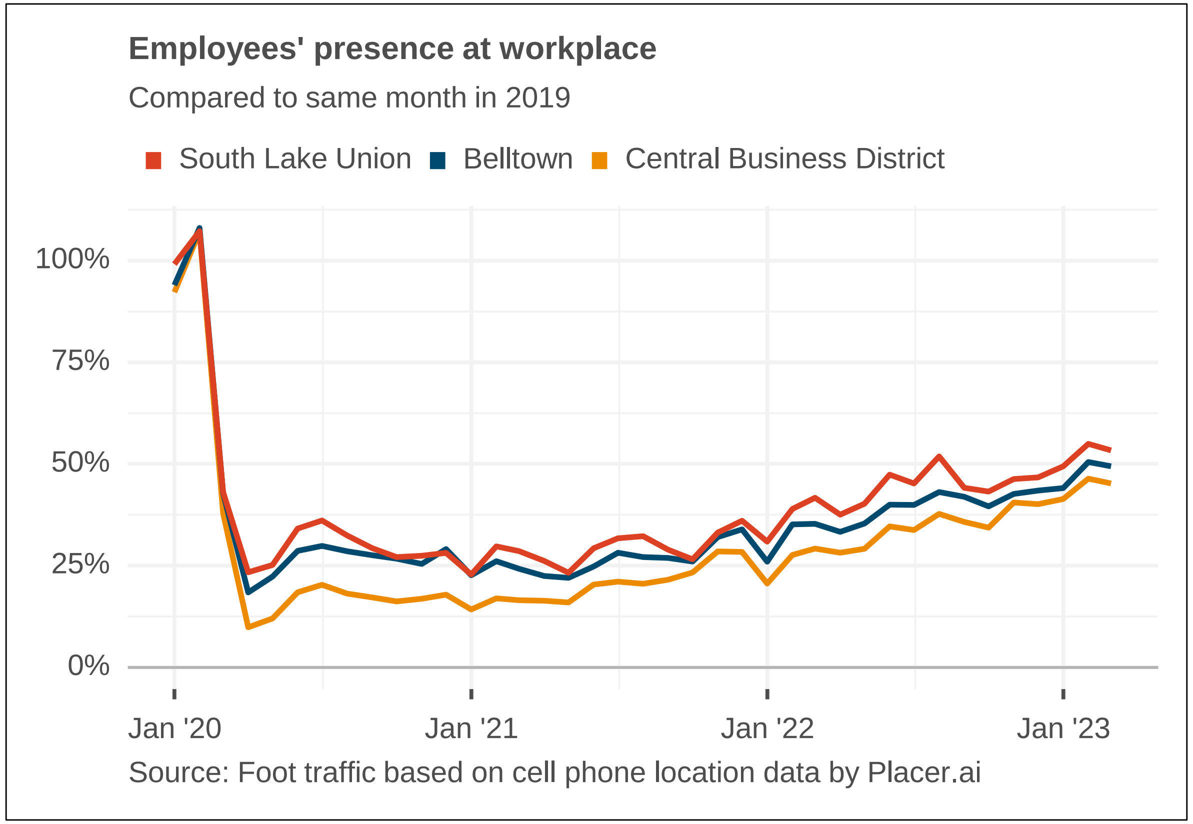
- Estimated a model that formally links revenues to both stock values and in-office head counts.
- Forecasts then require a prediction of both stock value and work-from-home practices. Stock value estimates have been derived from a range of stock analyst forecasts, and office head counts from recently observed behavior.
- These inputs were used to develop the 2023 forecasts. For 2024 and beyond, the 2023 base is predicted to increase at a rate equal to payroll growth in the "Information" and "Business & Professional Services" sectors, as forecast in our regional economic model.

Results

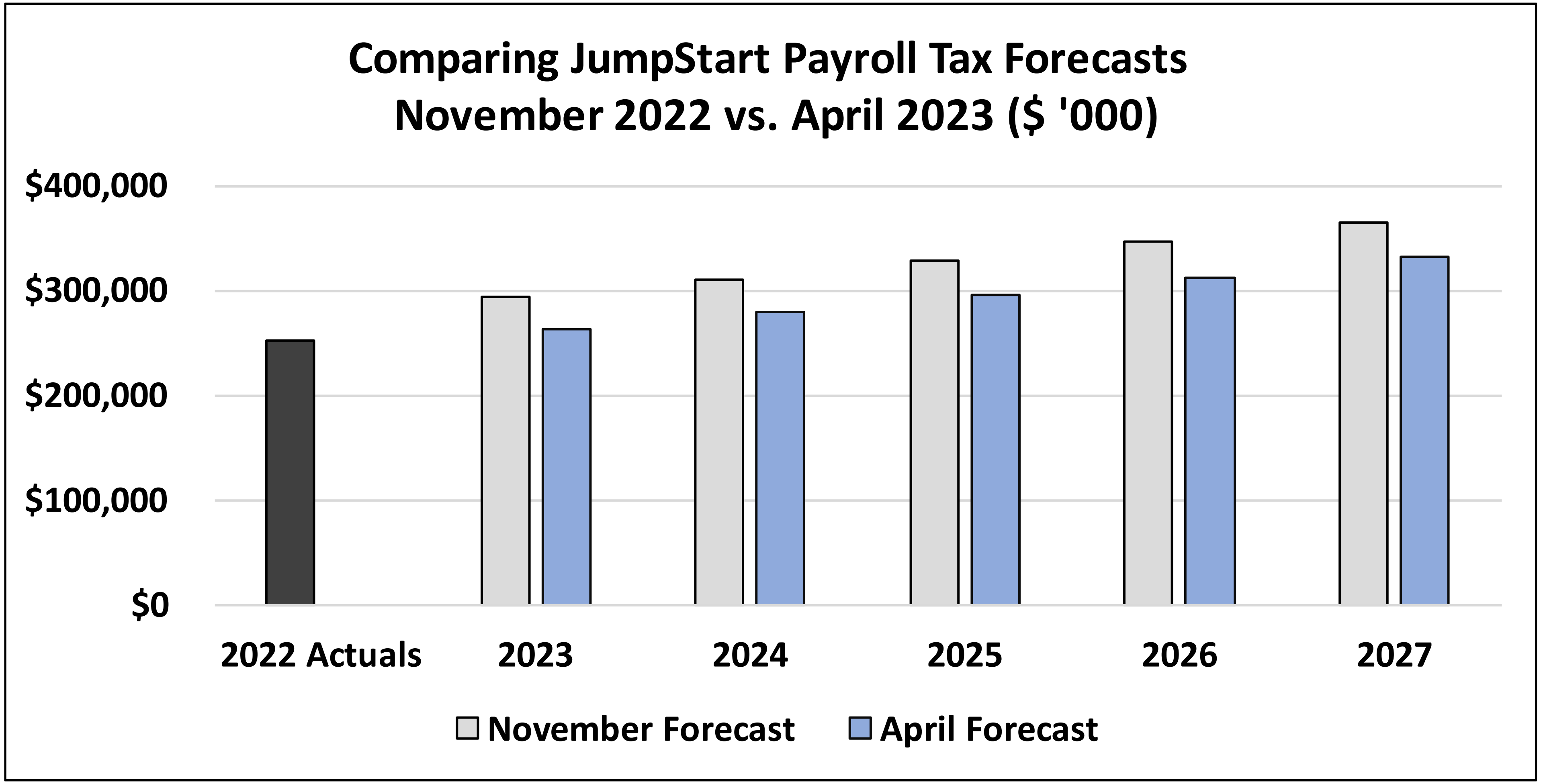
- The revised forecast 2023 forecast is $263M, which is a obviously a significant reduction from the $294M previously forecast. The 2024 forecast has been reduced from $311M to $280M.

Key Inputs to the JumpStart Payroll Tax Forecast



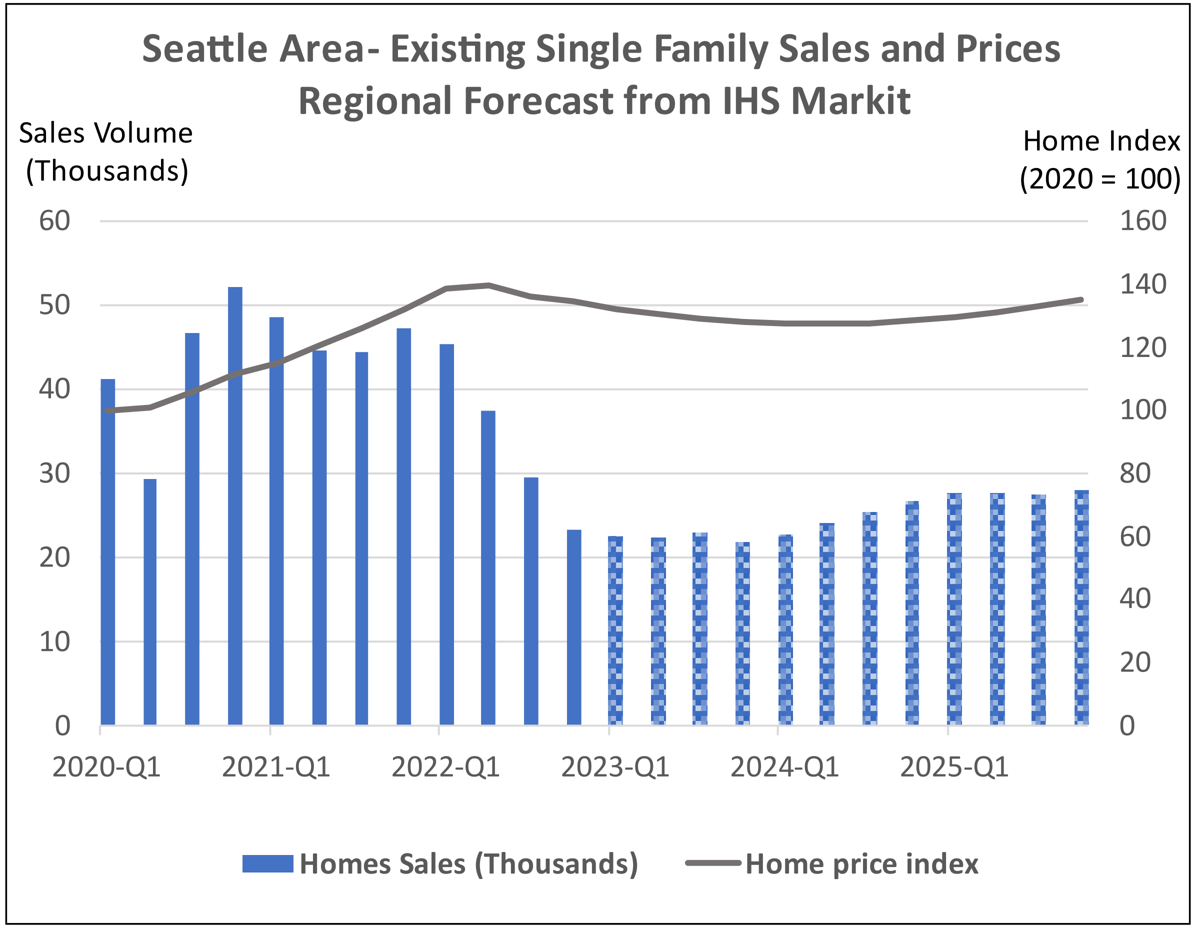


Long-Term Forecast of JumpStart Payroll Tax Revenues

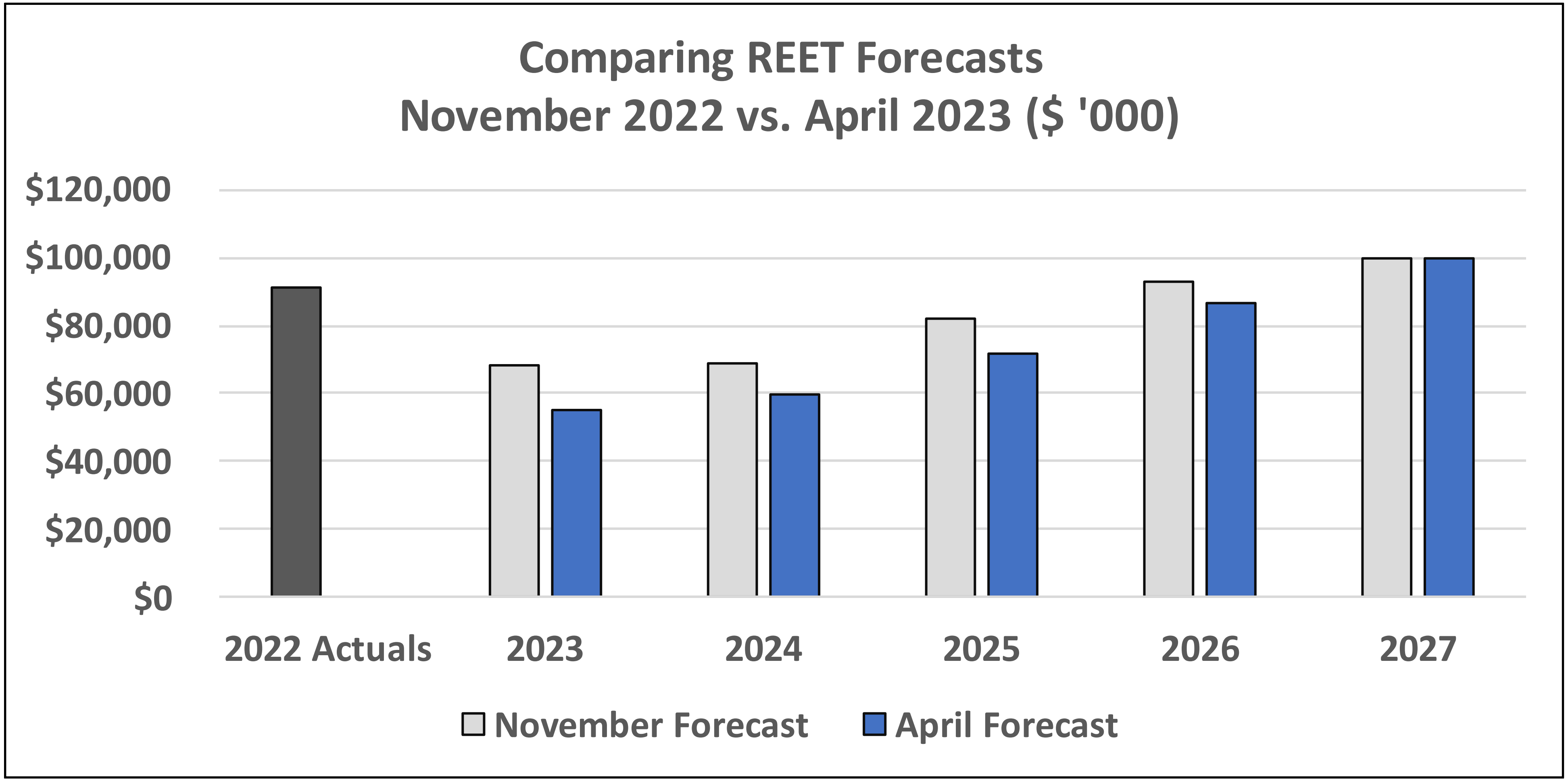


Understanding the Downward Revision in the REET Forecast

- Increased interest rates have reduced the volume and value of both residential and commercial real estate transactions.
- Commercial transactions have also been affected by uncertainty in the market for office space. There has not been the sale of a building worth more than $100M since May of last year.
- REET revenues fell dramatically in the latter part of last year, leading to a downward revision of the 2023 forecast from $95M to $68M, as part of the November revenue update.
- Per the chart to the right, the volume of residential sales is not expected to rebound significantly within the next three years, even as prices hold relatively steady. This represents a downward shift relative to the previous regional forecast.
- In addition, the initial results for January, February, and March have fallen short of the revised November forecast. This has all led a further downgrade of the near-term forecast:
  - The 2023 forecast has been reduced from $68M to $55M; and
  - The 2024 forecast has been reduced from $69M to $60M.
- The longer-term forecast forecasts have also been revised downward but to a lesser extent, as real estate activity is expected to recover over the longer run.
- Both the State and County revenue updates include significant reductions in their REET forecasts.



Long-Term Forecast of REET Revenues



Questions?