Economic and Revenue Update

November 2, 2022

Office of Economic and Revenue Forecasts
&
City Budget Office

Presentation Outline

Part I: Update on economic developments since last meeting

Part II: Revised Economic Forecasts – changes at both the national and regional level

Part III: November Revenue Forecast – General Fund and other major general government revenues

Economic Update

Overall Economic Conditions Have Continued to Deteriorate

- Inflation has proven more persistent than anticipated.
  - Price increases not limited to food and energy, as "core" inflation has reached a 40-year high.

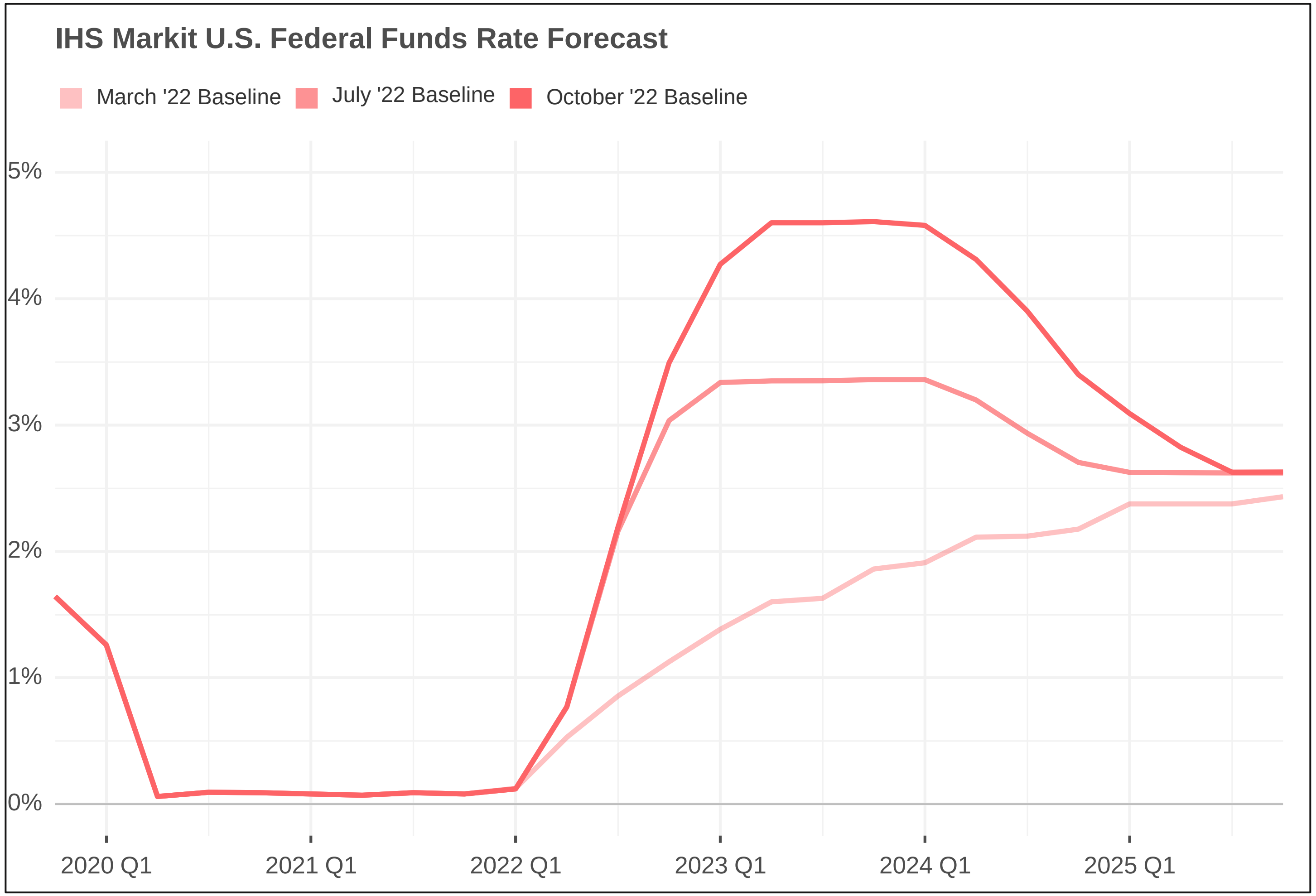
- Fed response has been swift and dramatic.
  - Fed has raised rates by 3% already this year, an additional 0.75% increase is expected this month and then a 0.5% increase in December.
  - Mortgage rates are at levels not seen in 10+ years.

- The war in Ukraine has escalated further, increasing political and economic uncertainty across Europe.

- Tangible economic impacts now apparent in US economy:
  - Housing starts dropped dramatically in September;
  - Hiring slowed at the national level in September, and anecdotal evidence indicates that the local labor market is also cooling; and
  - Declining stock values and falling home prices have reduced household wealth and thus reduced the resources available to sustain consumption.

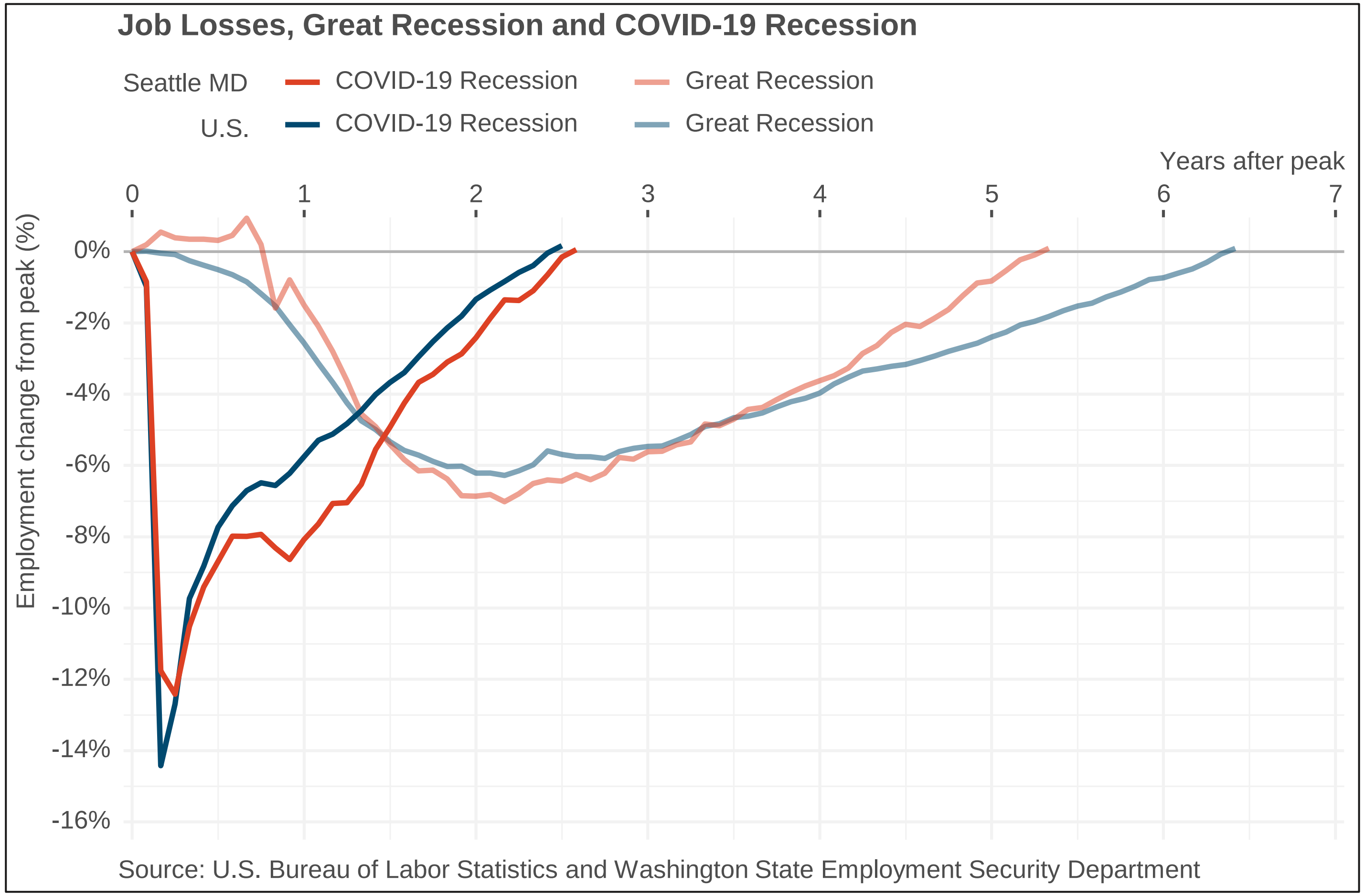
Significant Shift in Expectations about Fed Strategy

- General anticipation that Fed will maintain interest rates at elevated levels into 2024.
- Fed strategy is to cool overall demand and reduce inflationary pressure, with a specific focus on interest-sensitive components of the economy – e.g., housing and capital investment.
- Hope was that large rate increases earlier this year would have immediate impacts and lead to a “soft landing”. But with inflation pressures persisting, the Fed has accelerated pace and magnitude of interest rate increases.
- Length of slow-down will critically depend on how quickly inflation cools toward the Fed’s 2% target and interest rates can be reduced.



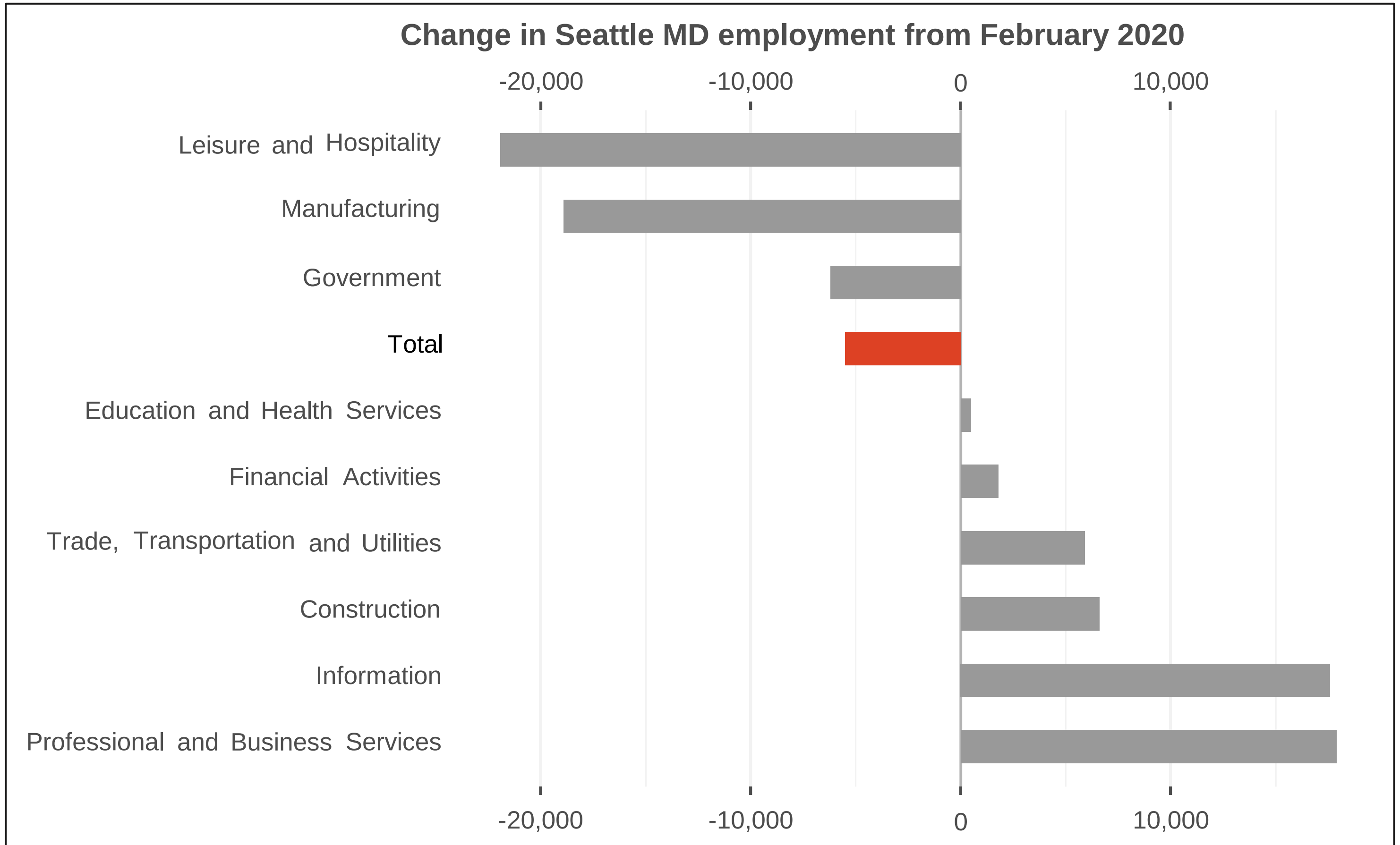
Employment Growth is Expected to Stall and Shift Toward Job Losses

- Total employment at both national and regional level had reached pre-pandemic levels. Unfortunately, this is likely the near-term "high water" mark.
- Interest-rate led slow-down now expected to reverse hiring trends through at least the 2nd quarter of next year.
- Anecdotal evidence indicates that local hiring has begun to slow.
- National forecast indicates that the Professional & Business Services, Manufacturing, and Construction sectors will be hit the hardest .



Slowdown Will Hit Some Sectors Before Pandemic Recovery is Complete

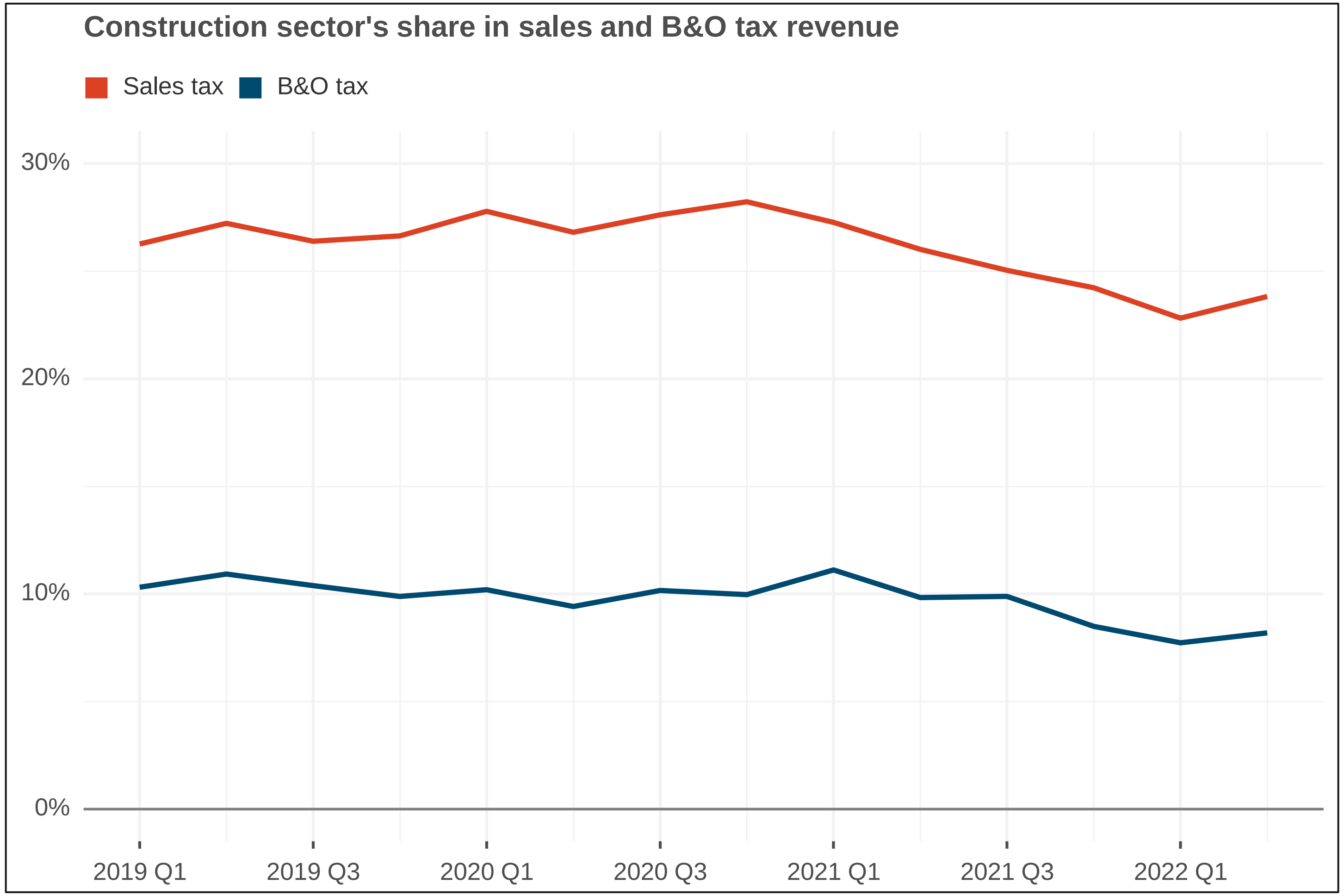
- The Leisure & Hospitality, and Manufacturing sectors have been slow to recover locally, and will now face new challenges.
- Construction sector employment has recovered past pre-pandemic levels, but faces significant risks given increasing interest rates and depressed demand for office space.
- Technology and Professional Services sectors have driven the local recovery, but anecdotal evidence indicates slower rates of hiring in this key sector.



Source: Washington State Employment Security Department. Seasonally Adjusted.

Revenue Risks Associated with Construction Slowdown

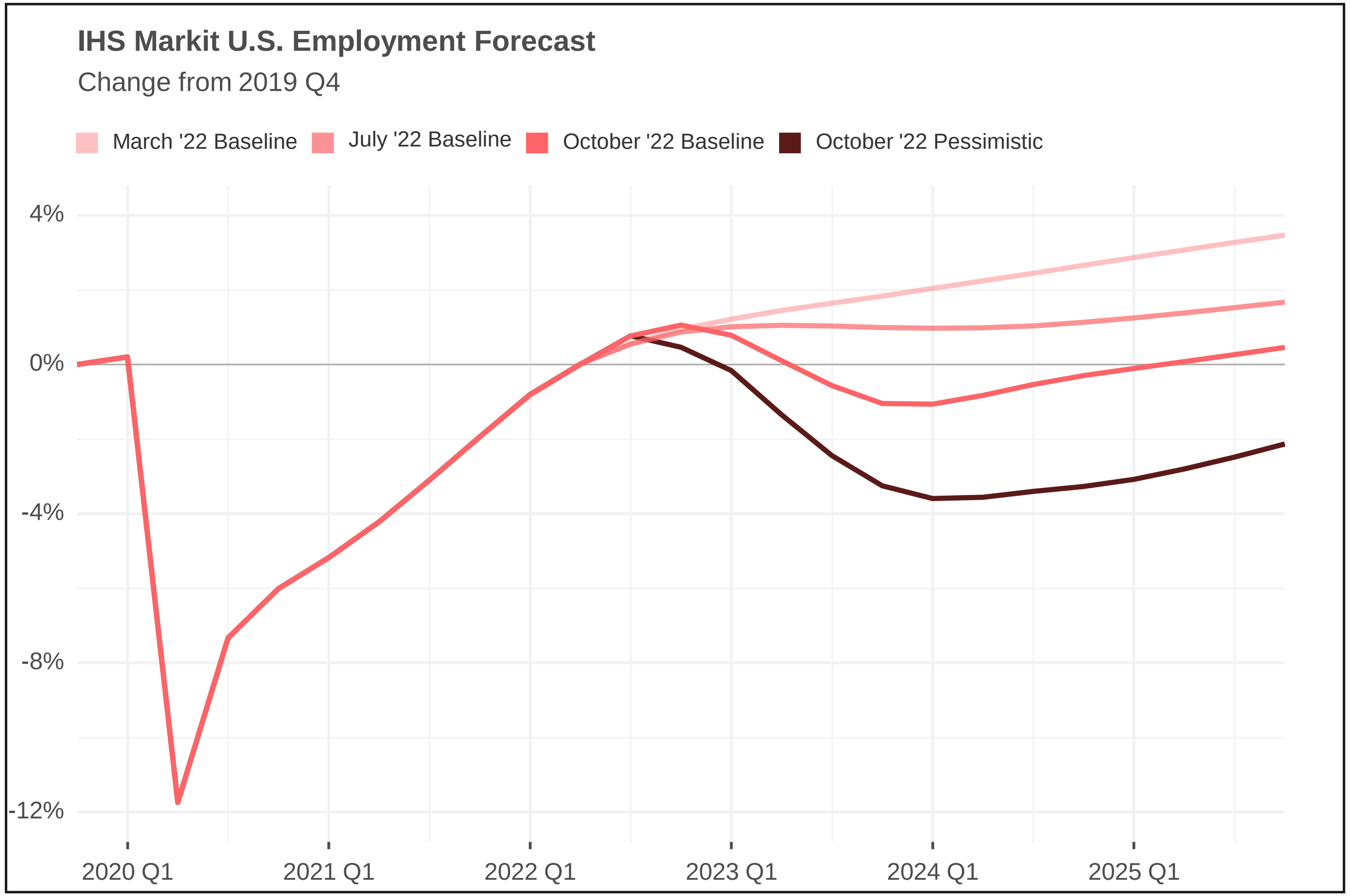
- Construction sector is responsible for a significant share of the City's largest revenue streams, contributing about $100 million to sales and B&O tax revenue in 2021. And value of new construction contributes to growth in property taxes.
- "Work from home" has already reduced demand for office space, and office vacancy currently in the Central Business District now exceeds 19%.
- Apartment vacancy, by contrast, is among nation's lowest. This should help encourage multi-family construction, but higher interest rates will increase development costs and vacancy rates have been increasing. YTD permit intake, particularly for larger multi-family projects, trails last year figures.



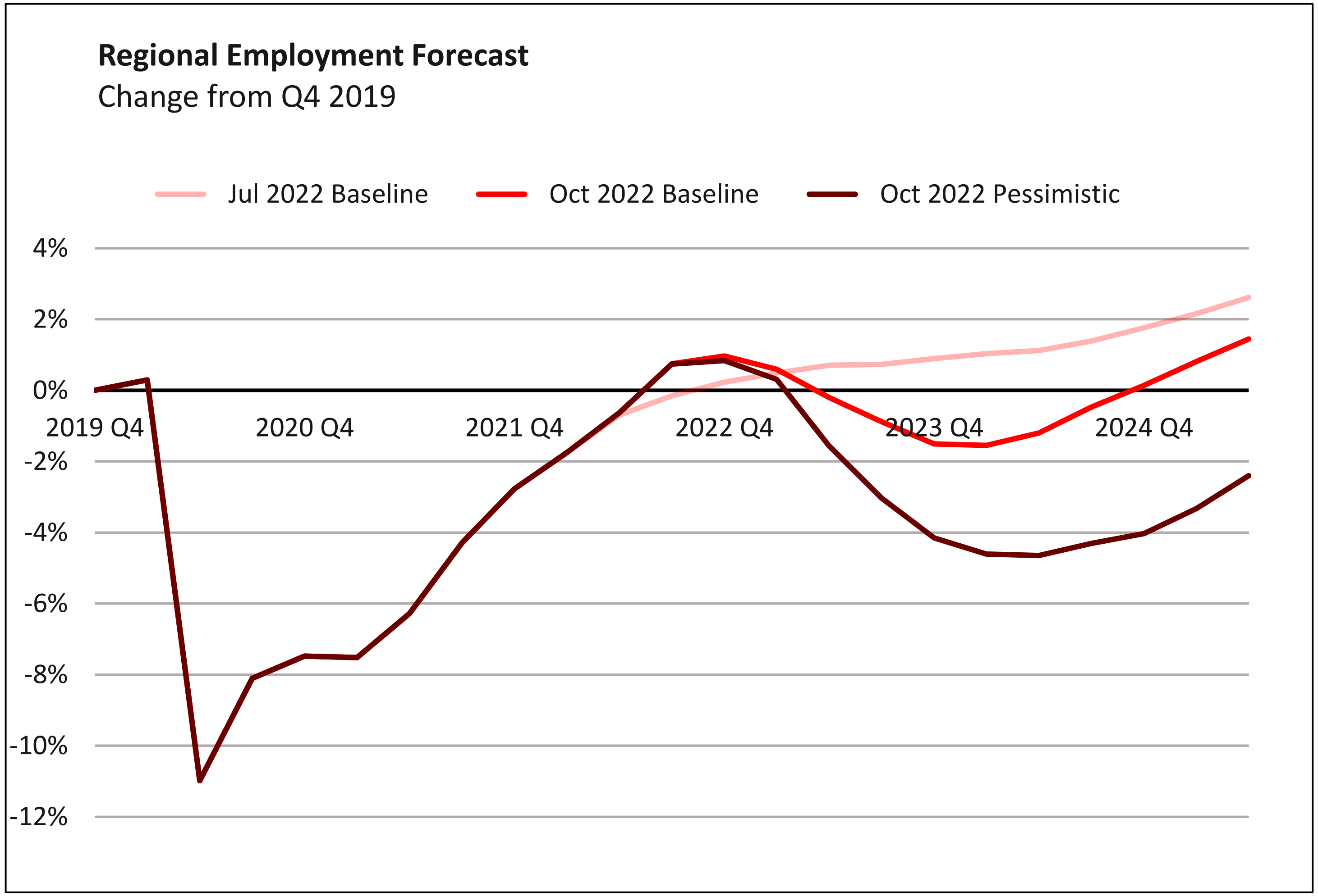
National and Regional Economic Forecasts

National Forecast Predicts A Mild Recession in 2023

- In August, national forecast anticipated modest, 0.9% GDP growth in 2023. The latest revision anticipates that GDP will drop by 0.5%.
- The slow down is expected be short, with recovery beginning in the 2nd half of next year, but GDP growth of only 1.3% is forecast for 2024.
- As the economy slows, employment will decline, with the total job count dropping by approx. 2% before beginning a slow recovery.
- National employment not projected to reach most recent highs until 2026.

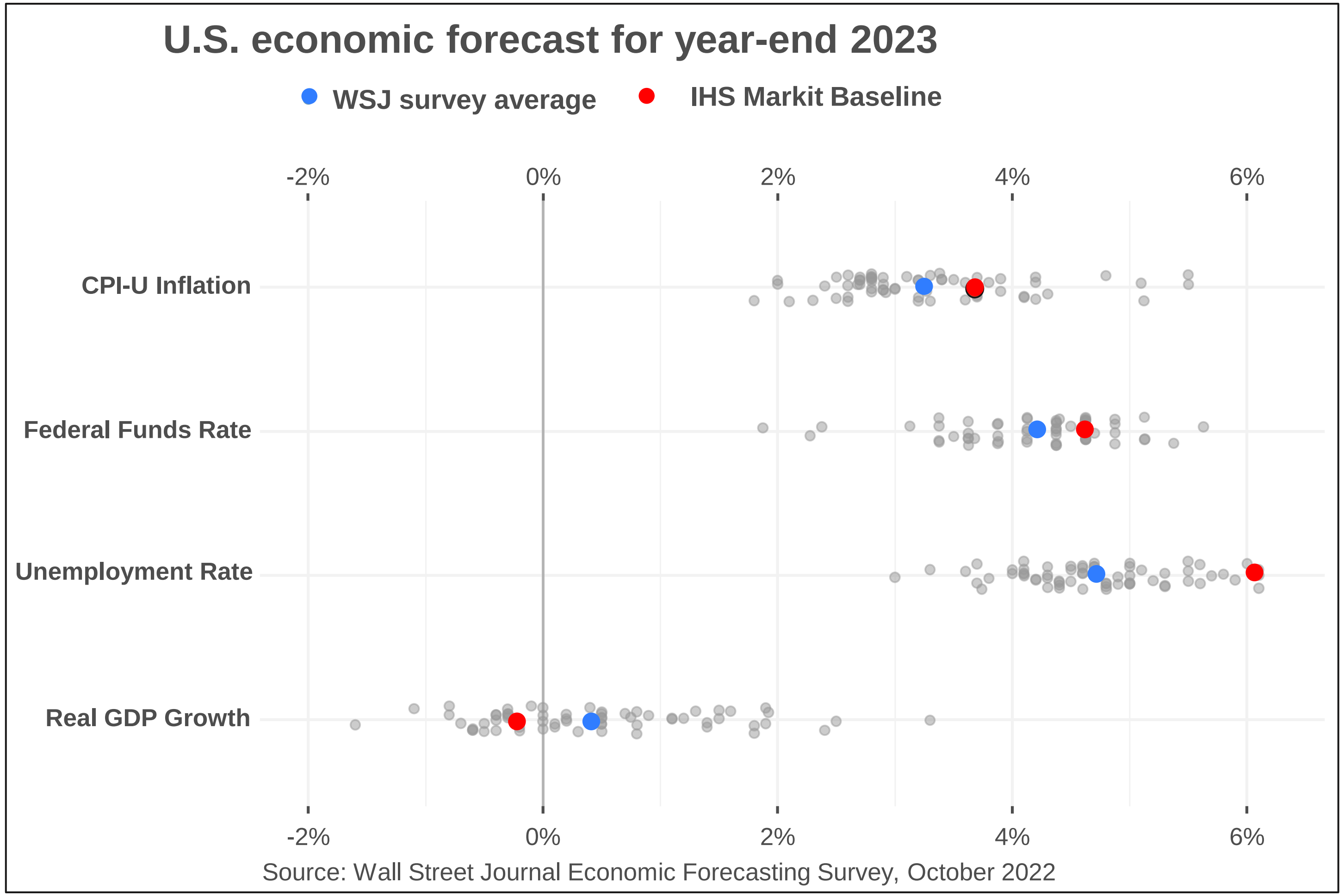


Forecasting a Comparable but Somewhat Shorter Regional Downturn



- Regional downturn is projected to have a comparable impact on employment, with regional payrolls dropping by ~2% from the current high.
- Recent announcements regarding near-term hiring slowdowns and layoffs at major technology firms and other employers indicate that regional labor has already begun to soften.
- From an employment perspective, the regional economy is forecast to recover more quickly than the national economy. Regional employment expected to return to existing levels by early 2025.
- At the regional level, the pessimistic scenario would involve job losses of 5% from current levels, and they would not recover until 2026.

Putting the IHS Markit National Forecast in Some Context



- The Wall Street Journal (WSJ) conducts a regular survey of academic and business economists regarding economic forecasts.
- Relative to other national forecasts, IHS Markit's current baseline forecast is relatively "conservative" in terms of its predictions for key economic variable.
- Forecasts for inflation and interest rates are somewhat higher on average, and GDP growth lower.
- IHS Markit's current conservativeness is most evident in its employment forecast.

Economic Scenario Recommendation

- Economic conditions have been deteriorating over the past two to three months, notably faster than was anticipated in the August forecast.
- Hopes for a "soft landing", in which inflation could be brought under control without a slowdown that would negatively affect employment, have faded.
- The emerging consensus among national forecasters, including IHS Markit, is that a modest slowdown is likely, with the risk of a deeper downturn if Russia's war against Ukraine escalates, supply disruptions worsen due to the war or other factors, and consumer expenditures decline as output and income drop.
- IHS Markit's most recent baseline forecast has shifted notably since both its August and September update, incorporating the expected impacts of more persistent inflation and further aggressive interest rate responses from the Fed. Further exogenous shocks due to the conflict in Europe or further disruptions resulting from the COVID 19's ongoing impacts in Asia and elsewhere are possible, but remain speculative.
- In this context, the Forecast Office recommends using the baseline economic scenario for the November Forecast.

Revenue Update

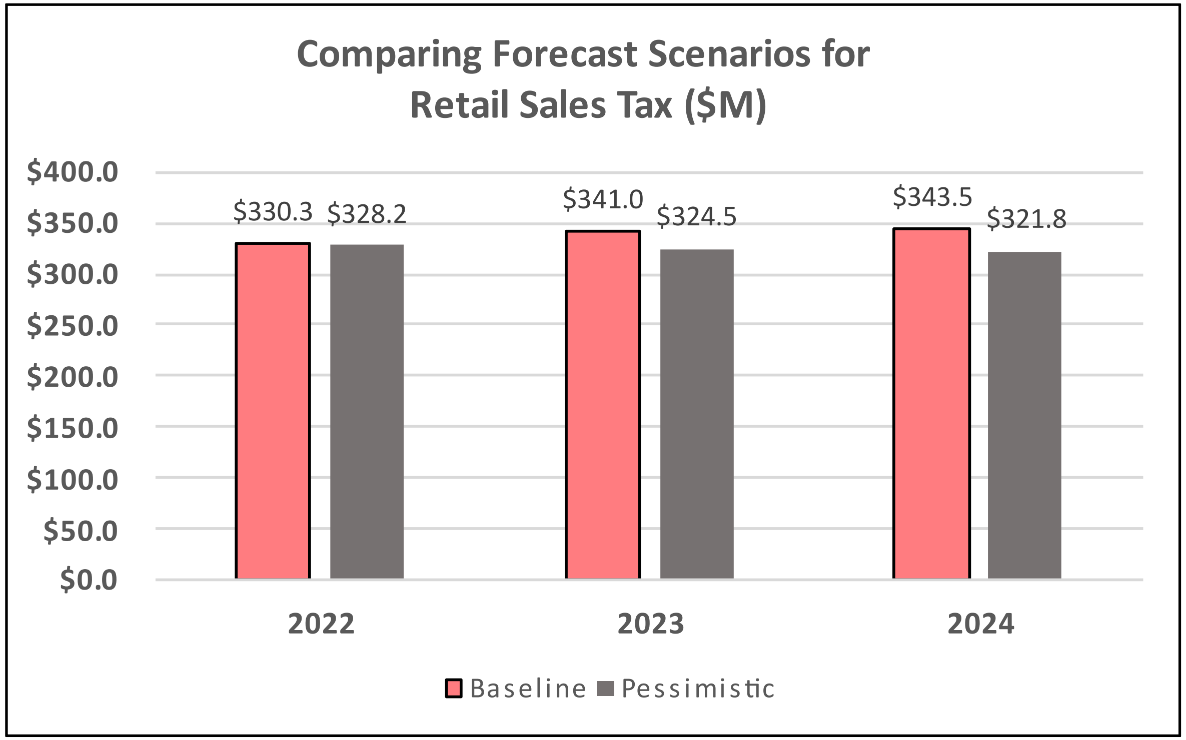
General Fund Revenues – 2022, 2023, and 2024

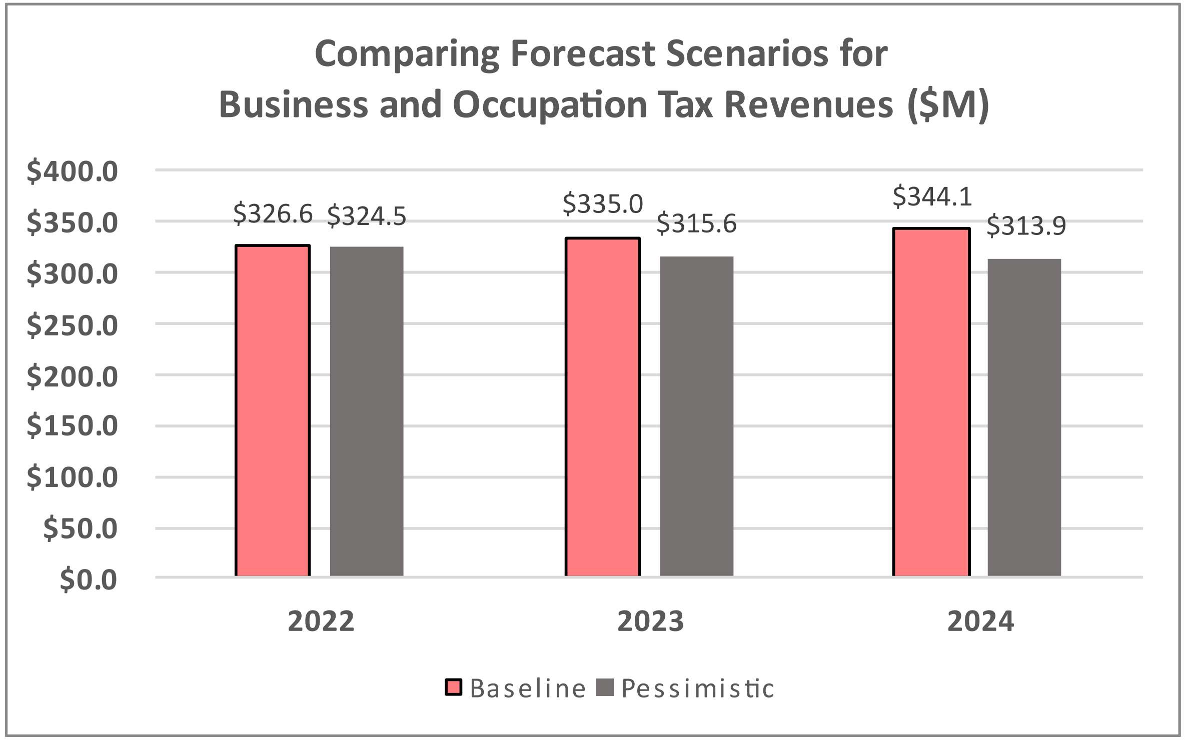
General Fund	2022			2023			2024			Total
Revenue Source	2022 - Revised per Proposed	2022 - November Forecast	Diff: Nov. vs. Proposed	2023 - Proposed Budget	2023 - November Forecast	Diff: Nov. vs. Proposed	2024 - Proposed Budget	2024 - November Forecast	Diff: Nov. vs. Proposed	3-Year Total Difference
Property Tax (Including Medic One Levy)	$371,630	$371,630	$0	$381,800	$380,480	($1,320)	$388,750	$386,630	($2,120)	**($3,440)**
Retail Sales Tax	$326,080	$329,640	$3,560	$337,480	$332,990	($4,490)	$346,230	$339,830	($6,400)	**($7,330)**
Business & Occupation Tax	$326,900	$326,620	($280)	$339,800	$334,960	($4,840)	$354,110	$344,130	($9,980)	**($15,100)**
Utility Tax - Private	$41,660	$42,920	$1,260	$40,750	$40,920	$170	$38,050	$38,190	$140	**$1,570**
Utility Tax - Public	$184,360	$184,360	$0	$191,150	$191,150	$0	$196,960	$196,960	$0	**$0**
Other City Taxes	$14,350	$14,800	$450	$15,600	$15,360	($240)	$16,460	$16,090	($370)	**($160)**
Parking Meters	$23,850	$24,310	$460	$34,630	$37,960	$3,330	$42,120	$44,460	$2,340	**$6,130**
Court Fines	$12,810	$12,810	$0	$19,760	$19,760	$0	$24,340	$24,340	$0	**$0**
Revenue from Other Public Entities	$18,410	$17,920	($490)	$18,270	$17,780	($490)	$18,540	$18,040	($500)	**($1,480)**
Grants	$59,800	$59,800	$0	$23,000	$23,000	$0	$10,520	$10,520	$0	**$0**
Fund Balance Transfers	$155,910	$155,910	$0	$97,140	$97,140	$0	$95,530	$95,530	$0	**$0**
Service Charges & Reimbursements	$100,470	$99,460	($1,010)	$40,700	$40,700	$0	$42,120	$42,120	$0	**($1,010)**
Licenses, Permits, Interest Income and Other	$73,270	$77,500	$4,230	$75,200	$78,590	$3,390	$77,150	$79,510	$2,360	**$9,980**
Payroll Tax - Late 2021 Payments	$41,900	$43,400	$1,500	$0	$0	N/A	N/A	N/A	N/A	**$1,500**
Total	**$1,751,410**	**$1,761,060**	**$9,650**	**$1,615,280**	**$1,610,790**	**($4,490)**	**$1,650,880**	**$1,636,350**	**($14,530)**	**($9,370)**
Annual Growth	17.17%	17.8%		(7.8%)	(8.5%)		2.2%	1.6%		

Understanding the Forecast Changes for Individual GF Revenues

- **Parking Meters:** With paid occupancy now having recovered to 2019 levels, the improved forecast relative to the Proposed is due entirely to more aggressive rate increases than projected, the latest coming in late October. Based on demand, 18 of the 32 parking areas around the City saw a rate increase, with many time periods increasing by $1, though most by the typical $0.50 increment. Six areas saw a decrease in October, which suggests that a new normal of occupancy is probably getting closer citywide. Still, rates citywide remain 30% below their pre-pandemic level, with an average of $1.81 citywide versus $2.60 in 2019.
- **Interest Earnings:** Increases to forecast over the Proposed Budget are due to faster growth in investment earnings rates and higher cash balances than projected. Recent expectations for continuing federal funds rate increases have led to higher forecasted short- and medium-term fixed investment earnings rates.

How Do Forecasts Vary Across Economic Scenarios?





- The most significant differences between the Baseline and Pessimistic scenarios are reflected in the forecasts for Retail Sales and B&O taxes.
- Note that the divergence between the baseline and pessimistic scenarios is significant and grows over time.
- The cumulative 3-year difference for Retail Sales tax is $40 million and B&O Taxes it just over $50 million; implying a cumulative $90+ million difference over this year and the coming biennium.

Summary of Selected General Government Revenues

	2022			2023			2024			Total
Revenue Source	**2022 - Revised per Proposed Budget**	**2022 - November Forecast**	**Diff: November vs. Proposed**	**2023 - Proposed Budget**	**2023 - November Forecast**	**Diff: Nov. vs. Proposed**	**2024 - Proposed Budget**	**2024 - November Forecast**	**Diff: Nov. vs. Proposed**	**3-Year Total Difference**
General Government Revenues										
Payroll Tax	$279,640	$279,640	$0	$294,120	$294,120	$0	$311,470	$311,470	$0	**$0**
Admission Tax	$20,350	$20,350	$0	$21,430	$21,430	$0	$22,150	$22,150	$0	**$0**
Sweetened Beverage Tax	$21,770	$20,700	($1,070)	$21,980	$20,390	($1,590)	$22,530	$20,700	($1,830)	**($4,490)**
Short-Term Rental Tax	$9,050	$9,630	$580	$9,310	$9,430	$120	$9,950	$10,080	$130	**$830**
REET	$106,600	$95,260	($11,340)	$94,760	$68,060	($26,700)	$94,660	$68,640	($26,020)	**($64,060)**
Transportation-Specific Revenues										
Trans. Ben. Dist. - Sales & Use Tax	$51,030	$51,620	$590	$52,910	$52,250	($660)	$54,350	$53,360	($990)	**($1,060)**
Trans. Ben. Dist. - Vehicle License Fee	$15,480	$15,480	$0	$15,690	$15,690	$0	$15,910	$15,910	$0	**$0**
Commercial Parking Tax	$37,870	$37,560	($310)	$46,110	$45,030	($1,080)	$49,130	$47,050	($2,080)	**($3,470)**
SSTPI - Parking Infraction Penalties	$12,720	$12,720	$0	$14,840	$14,840	$0	$14,060	$14,060	$0	**$0**

Understanding the Forecast Changes for Other Individual Revenues

- **JumpStart Payroll Expense Tax:** See slide 21 (second slide following)

- **Sweetened Beverage Tax:** Although the change in economic forecast is projected to have a negative effect on the sweetened beverage tax revenues, the main cause of these large reductions is due to our failure to correctly reflect the effects of changing the 2021-2022 accrual period from 30 days to 60 days on the forecast base for 2022-24.

- **Real Estate Excise Tax (REET):** See next slide

- **Transportation Benefit District (TBD) Sales Tax:** This revenue source in general tracks the regular retail sales tax and so the November forecast revision mirrors the update for the regular sales tax.

- **Commercial Parking Tax:** The worsening economic outlook in 2023 and 2024 will further slow (but not reverse) the recovery of commercial parking activity from its pandemic low compared to August expectations. However, the rate increase in 2023 will still result in revenues recovering more quickly than the tax base.

REET has been revised down substantially in this Forecast

- IHS Markit forecasts for the housing market changed dramatically in recent weeks, as interest rates rose faster and higher than expected.
- The housing forecast "whipsawed" from optimism in July to pessimism in October:
  - In July, IHS Markit predicting a 26+% increase in housing prices for 2023, relative to 2021. In October, that forecast was revised down to just 10% above 2021 levels.
  - Similarly, the forecast of 2023 home sale volume, measured relative to 2021, which was predicted to be a 14.8% decline as of July, has now been slashed to 35.5% below 2021 level.
- The swing up in July, followed by the swing down in October has led to similar pattern in our REET forecasts between August and November.
- Increasing interest rates will have the same general impact on commercial markets – lower prices and fewer transactions.

City of Seattle

JumpStart Payroll Expense Tax – Update

Update on Payments to Date

- Payments for 2021 now total $292 million, including $43 million in late payments.
- Through the end of September, 2022 payments total $116 million. This total reflects payments for the 1st and 2nd quarter.
- Third quarter payments are incomplete and only represent estimated payments, not firm tax obligations.
- Final, year-end payments, which will "true-up" for final 2022 obligations, are due at the end of January.

Forecasts

- The forecast was revised modestly downward in August, based on (i) the revised totals for 2021; (ii) emerging economic trends; and (iii) the pattern of payments we saw in the first and second quarter estimated payments (2Q payments were lower than 1Q).
- The following factors suggest revenues may fall short of our most recent forecast, but we don't have a basis for a quantitative update:
  - Earnings reports indicate that revenues in the tech sector are falling short of expectations.
  - Stock values have been falling in tandem, and this will affect the value of stock-related compensation.
  - Hiring in the technology sector appears to be slowing and there are anecdotal examples of layoffs.

Recommendation

- Currently, we do not have sufficient information to develop a further forecast revision, and 3rd quarter payments will not be definitive.
- Forecasts for 2022-2024 remain unchanged, but funding decisions should recognize there is a high risk of missing these projections.

Questions?