

**CITY OF NORTH BEND
ANNEXATION STUDY**

**FINAL REPORT
DECEMBER 2008**



| BERK & ASSOCIATES |

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CITY OF NORTH BEND

FISCAL ANALYSIS OF ANNEXATION

1.0 INTRODUCTION

1.1 Purpose of This Study

In 2008, the City of North Bend engaged Berk & Associates to study fiscal impacts associated with a potential multi-phase annexation. The goal of this analysis is to provide decision-makers at the City and key stakeholders including current City residents, residents of the annexation area and other affected jurisdictions with a more complete understanding of the fiscal implications of annexation. The study examines impacts both in terms of the costs the City would bear immediately upon annexation and in the longer term.

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

1. **Near-Term Operating Impacts:** What new operating costs and revenues would North Bend face if it were to annex the study area and provide levels of service similar to current services in existing City neighborhoods?
2. **Long-Term Fiscal Outlook:** How would the City's fiscal future look with and without annexation?
3. **Capital Needs:** What capital needs have been identified in the contemplated annexation area? What new capital revenues would North Bend generate to help cover those costs?

The remainder of this report is organized as follows:

1. Study Findings
2. Description of Annexation Model
3. Description of Fiscal Annexation Analysis
4. Capital Needs and Revenues
5. Demographics of Annexation Areas

2.0 STUDY FINDINGS

To examine the fiscal impacts of annexation, Berk & Associates uses a dynamic fiscal model to examine North Bend's long-term fiscal position both with and without annexation. Under this framework, the fiscal *impact* of annexation can be thought of as the manner in which annexation changes the City's underlying fiscal position.

Consistent with this approach, the following discussion begins with an examination of North Bend's baseline fiscal outlook (i.e. what does the fiscal picture look like for the City if one assumes that annexation will not happen). We then examine the fiscal outlook for a new, larger City of North Bend—a picture that assumes the City will pursue annexation.

When considering findings, it is important to bear in mind that modeled differences between operating costs and operating revenues are hypothetical. Presumably, if the City finds itself in a position where it has so-called "excess" resources, it would adjust its operations accordingly—using available resources to increase levels of city services, to invest in the City's capital infrastructure, and/or to reduce tax burdens.

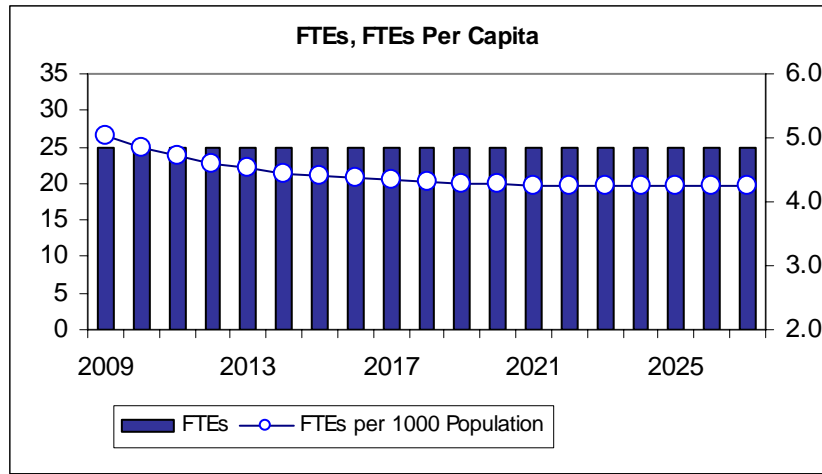
It is also important to bear in mind that the staffing levels and staffing distributions modeled here should be viewed as informational but not as an absolute prediction of future circumstances. For example, the model uses assumptions about the pace of future development to estimate how many planners or permit technicians the City of North Bend will need upon annexation. In fact, however, the City would only expect to fill those positions if and when the demand for their services has materialized. If the pace of development does not pick up, then regardless of what the model says, the City would probably not choose to add a given position.

2.1 Baseline Outlook for City of North Bend

Assuming no annexation, the City of North Bend is estimated to experience a small revenue surplus over the next 20 years. This trend is primarily due to the City's ability to keep staffing at a minimum while maintaining a high level of service to residents. As the City continues to see modest growth in population and commercial activity, largely stable City staffing will translate into economies of scale as they serve a larger constituency.

Exhibit 1 shows the City's expected Full Time Equivalent (FTE) employees for the next 20 years in blue, with the FTEs per capita shown in white. As the FTEs per capita decrease, so do City costs as they compare to estimated revenues.

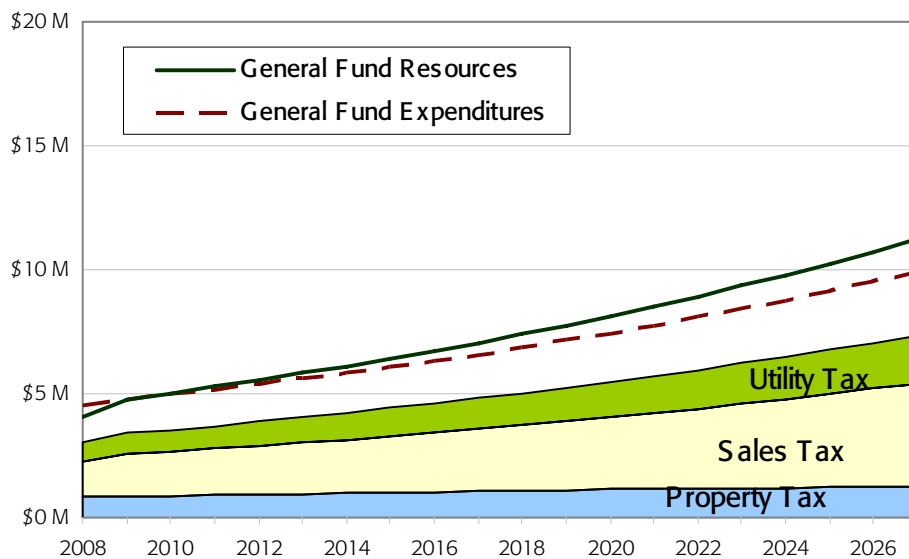
Exhibit 1 FTEs per Capita for the City of North Bend Assuming No Annexation



Source: Berk & Associates Analysis, 2008

Exhibit 2 shows the baseline model of North Bend’s estimated core revenues and expenditures in the long run, along with the City’s three main tax revenue sources. The exhibit shows that although property taxes are not expected to see marked growth in coming years (due to Washington State’s 101% property tax growth limit), underlying growth in sales and utility tax revenues, and the economies of scale in service delivery, are expected to allow the City to maintain fiscal strength.

Exhibit 2 Estimated Core Revenues and Expenditures for City of North Bend Assuming No Annexation

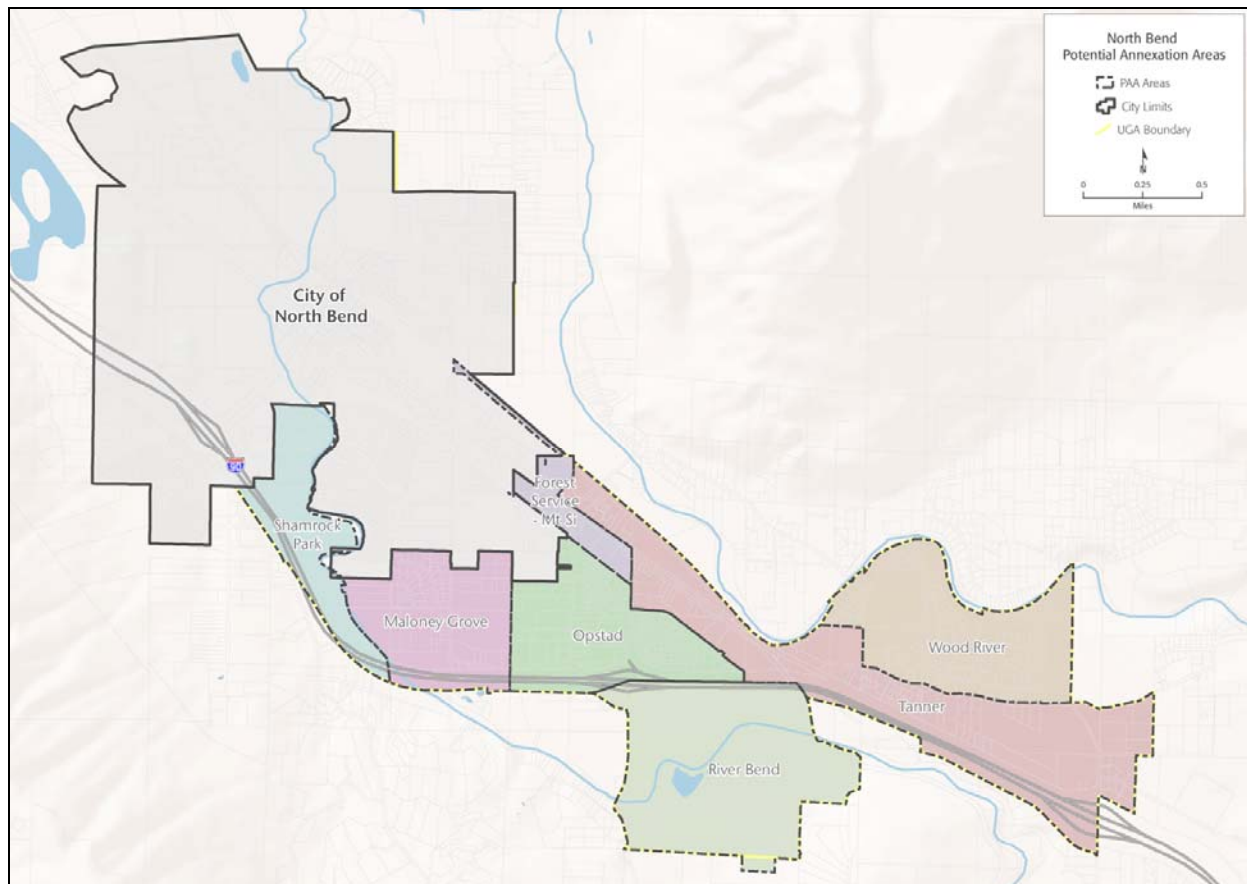


Source: Berk & Associates Analysis, 2008

2.2 Impact of Potential Annexation

Exhibit 3 below shows the five contemplated annexation areas that have been identified by the City. These areas, organized by neighborhood, include Shamrock Park, Maloney Grove, Opstad, Forest Service–Mt. Si, and Wood River. River Bend is shown as a potential area for annexation in the future, but is not considered in this analysis.

Exhibit 3
North Bend Potential Annexation Areas



Source: City of North Bend; Berk & Associates, 2008

This analysis assumes annexation will occur in two phases per the City of North Bend's Comprehensive Plan. Phase I includes the Mt. Si, Tanner, and Wood River neighborhoods and assumes annexation in January 2010. Phase II assumes annexation in January 2015 of the Shamrock Park, Maloney Grove, and Opstad neighborhoods.

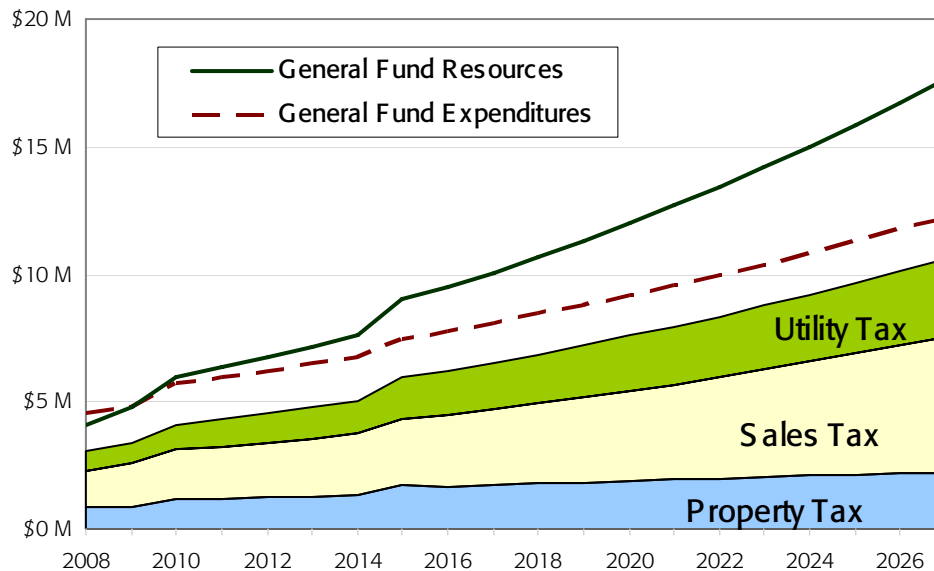
As **Exhibit 4** shows, the analysis suggests that annexation yields a net positive fiscal impact on the operations of the City of North Bend. With annexation of Phase I, the City sees an increase in the estimated revenue surplus when compared to no annexation. With annexation this surplus is estimated to be approximately \$200,000 in 2010, increasing to nearly \$900,000 by 2014. This is

compared to an estimated surplus of \$100,000 in 2010 without annexation, increasing to \$300,000 by 2014.

The estimated surplus with annexation increases with Phase II due to additional anticipated tax revenue with little increase in assumed costs to the City. The anticipated surplus with Phase II in 2015 is \$1.5 million, increasing through the study period to \$4.6 million by 2025. Without annexation the estimated surplus in 2015 is \$400,000, increasing to approximately \$1.2 million by 2025.

Although the City will not receive property taxes from the annexation areas for the regular property tax levy until the year after annexation, during the first year of annexation the City will receive revenues associated with the County Road Levy for the annexation area. Those total revenues are estimated to be approximately \$323,000 in 2010 for Phase I and \$334,000 for Phase II.

Exhibit 4
Estimated Core Revenues and Expenditures for City of North Bend,
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015

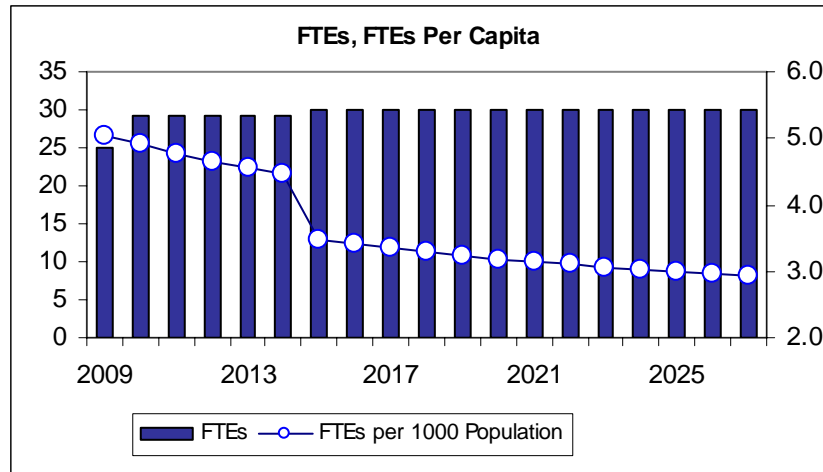


Source: Berk & Associates Analysis, 2008

The impact of annexation on an operating basis (including equipment costs but excluding facilities and infrastructure) appears to result in a positive net fiscal impact to the City largely because of *economies of scale*. The costs of serving the annexation areas generally decrease on per-resident basis as the City of North Bend becomes larger.

Exhibit 5 shows the City's expected Full Time Equivalent (FTE) employees and FTEs per capita shown for the next 20 years with annexation. The economies of scale discussed above are clear in the white FTEs per capita line when compared to the City without annexation shown in **Exhibit 1**.

Exhibit 5
FTEs per Capita for the City of North Bend
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015



Source: Berk & Associates Analysis, 2008

Not included in this analysis are any incremental costs of facilities for additional employees that are necessary to support the larger post-annexation city. Also not included are transition costs, such as hiring and training expenses for new staff. Although this analysis assumes full staffing on the first day of annexation, as well as all revenues expected to be received by the City, in reality there may be a transition period for bringing these new positions up to full productivity.

3.0 ANNEXATION MODEL

3.1 Land-Based Fiscal Model

An annexation fiscal model was developed for this project to allow for the estimation of revenues and expenses for both the existing City and a post-annexation City under different development and policy assumptions. In this model, factors in the land base (such as population, employment, and commercial activity) drive both demand for services and the tax base. 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 analysis assumes Phase I annexation in January 2010 and Phase II in January 2015 and examines costs and revenues in the annexation area through 2027. Analyzing the annexation over 20 years 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.

Economies of Scale

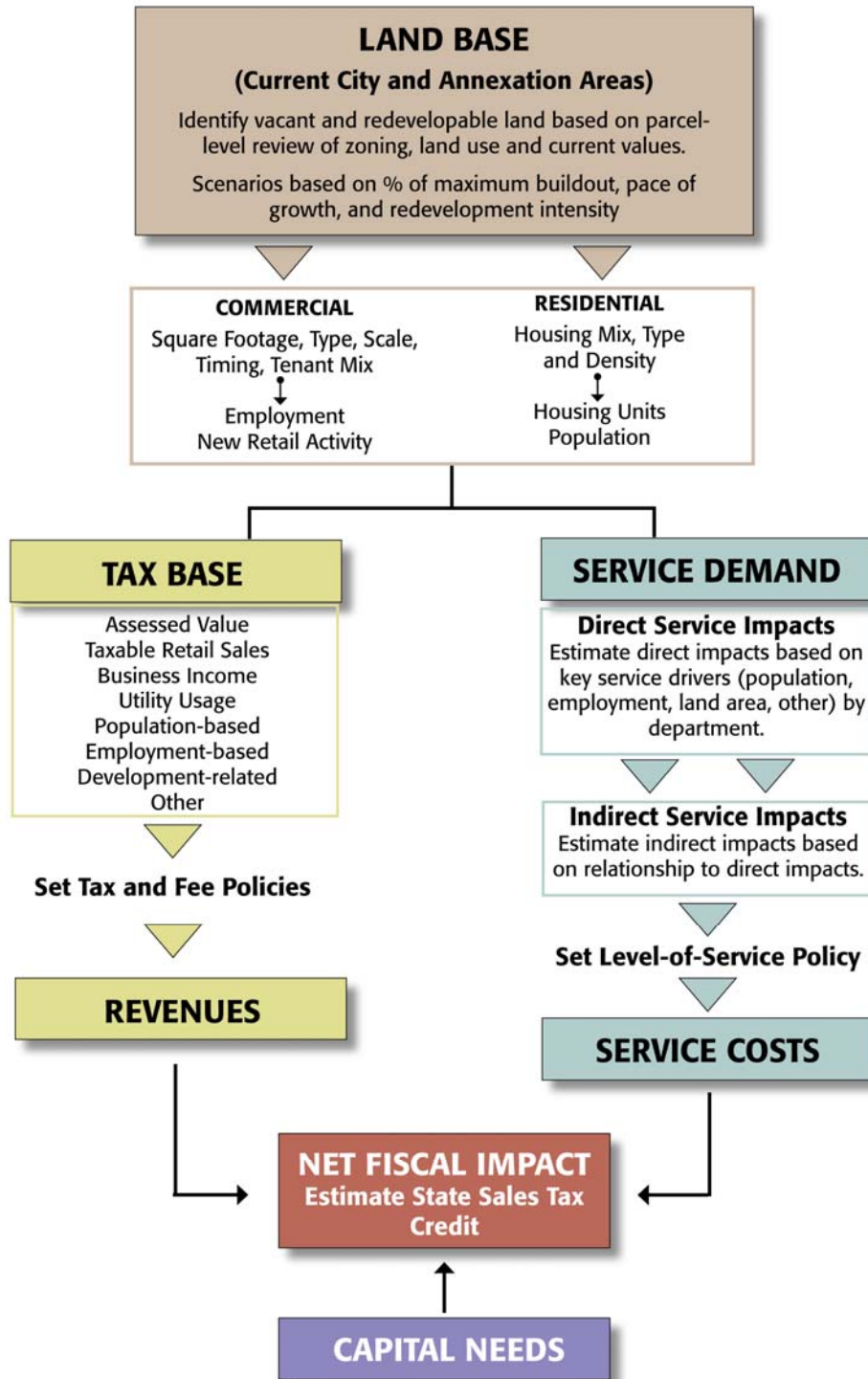
As discussed above, when thinking about annexation, it appears the City of North Bend will enjoy certain economies of scale in delivering City services. The City will not be required, for example, to hire a second City Administrator, or a second Finance Director. These savings mean that the average cost-per-resident of providing many city services will tend to decrease as the City of North Bend 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 Finance Director, nor is it expected to result in changes in other Finance Department staff).
- 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 6% (60% of a 10% demand increase equals a 6% increase in staffing demand).

Exhibit 6 describes the methodology of the model in a schematic beginning with the land base analysis that drives both anticipated costs and revenues to the City, resulting in the net fiscal impact of annexation.

Exhibit 6 Long-Term Fiscal Model Schematic



Source: Berk & Associates

3.2 Beginning Year Based on 2008 City Budget

The annexation model is based on 2008 budgeted expenditures and tax and fee structures, as outlined in the City of North Bend 2008 Budget, since it describes the most complete current estimate of the preferred state of operations for the City. Since a number of annexation impacts are based on the current level-of-service (LOS) or funding allocations in the City, it is important that any significant deficiencies in current operations be identified and addressed or somehow cured in the “base year” analysis. Not doing this could result in an extrapolation of an existing LOS deficiency onto the larger, post-annexation, City needs and understate the potential impact of annexation.

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 North Bend, includes functions and departments within the General and City Street Funds. The model does not include utility enterprise funds, since these funds are not tax-supported.

In North Bend’s budget, the City makes use of a more extensive fund accounting system. To the extent that these funds would be affected by annexation (e.g. Technology Division – Operating Fund), the costs and revenues are included within the model framework of estimating *core* costs of service, or capital costs and revenues. In instances when these funds are not expected to be affected by annexation (e.g. Economic Development Fund), no cost impact of annexation is estimated.

Capital cost implications are specifically included only for the equipment necessary to support the increasing staff levels associated with annexation. Capital cost implications related to facilities and new public infrastructure are excluded from the analysis, but a high-level estimate of the future capital-restricted revenues for the annexation area is provided.

3.3 Overarching Assumptions

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

- Phase I of the proposed annexation includes Mt. Si, Tanner, and Wood River neighborhoods and is assumed to take effect in January 2010. Phase II includes Shamrock Park, Maloney Grove, and Opstad neighborhoods and is assumed to take effect in January 2015.
- The model isolates the components of the City’s budget that are funded through general tax and fee revenues, which in the case of North Bend includes the City’s General and Street Funds. The model does not include utility enterprise funds, since these are fee-based and assumed to recover any additional costs through additional fees collected.
- This fiscal analysis includes cost and revenue estimates only for those taxes or services that would change upon annexation. Local services that would not change include water and sewer, schools, regional transit, health services, and regional parks.

- The current level of service, staffing and expenditures in North Bend are the benchmarks for forecasting comparable levels of service, staffing and costs in the annexation areas (as defined in the City's 2008 budget).
- For most departments this analysis assumes that all initial annexation-related FTEs are hired and are in place for the date of annexation. However, the annexation transition period could include contracting with service providers while the City builds up its own staffing capabilities. While the analysis does make estimates of FTE needs at annexation and through the study period, actual decisions regarding hiring and staffing will be made by the Council during each budget cycle, based on City priorities and actual demand.
- Cities that have undertaken annexations in the past have found that there is a surge in demand for services after annexation. This study's methodology of directly estimating demand for services that will be introduced upon annexation for key expense categories will produce a more accurate forecast than a simple population-driven forecast, but it does not attempt to address transition or "ramp-up" costs, nor does it address surges in demand that the City might see in the first few months after annexation.
- The need to support capital investments and infrastructure development in the annexation areas is difficult to accurately estimate given the information available. Over time, the type and quality of capital facilities in these areas are expected to be aligned with those provided with the rest of the City.
- The future changes in service demands and City revenues are a function of explicit assumptions regarding growth and development, inflation factors, and the assumption of maintaining current levels of service and continuation of current tax and fee policies.

4.0 FISCAL ANNEXATION ANALYSIS

4.1 Land-Based Analysis

The buildable lands inventory done by the City in 2006 was the main basis for determining existing development capacity in North Bend. The annexation model used by Berk evaluates four land uses: single-family residential, multi-family residential, commercial, and industrial, and breaks these uses into four development categories: Pending Development, Vacant, Partially Used, and Redevelopable.

Some aspects of the buildable lands methodology were modified, specifically Redevelopable lands, for use in our model. One reason for this was that the buildable lands analysis had "deficiency regarding redevelopable parcels in [commercial/industrial] zoning districts" (2006 Buildable Lands Inventory Methodology). The City's buildable lands analysis also did not differentiate between the Partially Used or Redevelopable parcels that our model uses. An overview of the methodology is below:

Buildable Lands Methodology

Pending

- Parcels with building permits for new dwelling units or commercial/industrial structures issued since the 2006 buildable lands analysis.

Vacant

- Parcels deemed vacant in the buildable lands analysis that were equal to or greater than the minimum lot size allowed by the zoning.

Partially Used (parcels with development capacity, in addition to existing structures)

- Residential zoned parcels (LDR, CR, and HDR) deemed redevelopable in the buildable lands analysis greater than 0.5 acres that were also twice the minimum lot size allowed by the zoning.
- Commercial zoned parcels (DC, NB) deemed redevelopable in the buildable lands analysis greater than one acre.
- Mixed-use or industrial zoned parcels (IC, IMU, EP-1, and EP-2) did not have a Redevelopment category in the buildable lands analysis. Single family was considered Redevelopable, however this did not constitute much and was all located in the EP-1 and EP-2 zones. To address this, we used aerials in GIS to visually inspected buildable parcels twice the minimum lot size that were not included as vacant, to see if any had the potential for additional development. None met these criteria, so no mixed-use or industrial parcels were deemed partially used.

Redevelopable

- Residential zoned parcels with at least one dwelling unit, greater than or equal to 0.5 acres, with an improvement to land value ratio less than 1:2 that are not included as vacant or partially redevelopable.
- Commercial and Industrial zoned parcels with an improvement to land value ratio less than 1:2 not included as vacant or partially redevelopable.

Development Assumptions

The development assumptions discussed in this section are for annexation in two phases defined as follows:

- Phase 1 (2010): Mt. Si, Tanner, Wood River
- Phase 2 (2015): Shamrock Park, Maloney Grove, Opstad

To create the development assumptions for the annexation model we used the following tools:

- Available buildable lands developed from the methodology above
- Historical permit data in the annexation areas
- Input from City staff regarding levels of development expected upon annexation
- Information from City staff regarding expected development in the moratorium area once the moratorium is lifted

Analysis using the above information resulted in the expected buildout *for the full twenty-year study period* for each area as shown in **Exhibit 7 Exhibit 8** below. Subtracted units or square feet under the “Redevelopable” category are existing buildings expected to be torn down and replaced by new development. In some cases, these are residential units anticipated to be replaced by commercial square footage. Therefore, there are instances where more housing units are subtracted than are being added. If an area is not listed it is not expected to have development activity under that category.

Exhibit 7 Development Assumptions for Residential Housing Units

	Total HU Capacity	% Build-out	Total HU through 2027	Net Units Added	Avg Units Added per Year
Current City					
SF Housing Units - Added	750	100%	750	686	20
SF Housing Units - Subtracted	64	100%	64		
MF Housing Units - Added	5	100%	5	5	0
MF Housing Units - Subtracted	0	n/a	0		
Shamrock Park					
SF Housing Units - Added	165	100%	165	165	7
SF Housing Units - Subtracted	0	n/a	0		
Maloney Grove					
SF Housing Units - Added	459	70%	322	322	15
SF Housing Units - Subtracted	0	n/a	0		
Opstad					
SF Housing Units - Added	452	70%	316	316	14
SF Housing Units - Subtracted	0	n/a	0		
Mt Si					
SF Housing Units - Added	147	50%	73	73	3
SF Housing Units - Subtracted	0	n/a	0		
Tanner					
SF Housing Units - Added	5	50%	3	-22*	-1
SF Housing Units - Subtracted	48	50%	24		
Wood River					
SF Housing Units - Added	383	50%	191	191	9
SF Housing Units - Subtracted	0	n/a	0		

* Net negative units result when existing units are rebuilt as a different land use type.

Exhibit 8 Development Assumptions for Commercial Square Footage

	Total Capacity (SF)	% Build-out	Total Comm SF through 2027	Net SF Added	Avg SF Added per Year
Current City					
Retail - Added	1,126,765	15%	169,015	162,481	6,492
Retail - Subtracted	43,557	15%	6,534		
Office - Added	606,720	30%	182,016	174,980	6,991
Office - Subtracted	23,454	30%	7,036		
Industrial - Added	5,334,728	5%	266,736	266,736	11,022
Industrial - Subtracted	0	n/a	0		
Mt Si					
Retail - Added	41,825	30%	12,547	12,547	570
Retail - Subtracted	0	n/a	0		
Office - Added	97,592	10%	9,759	9,759	444
Office - Subtracted	0	n/a	0		
Industrial - Added	0	n/a	0	0	0
Industrial - Subtracted	0	n/a	0		
Tanner					
Retail - Added	440,387	30%	132,116	130,131	5,915
Retail - Subtracted	6,617	30%	1,985		
Office - Added	1,027,571	20%	205,514	202,426	9,201
Office - Subtracted	15,441	20%	3,088		
Industrial - Added	7,916,891	10%	791,689	788,066	35,821
Industrial - Subtracted	36,235	10%	3,624		

Source: Berk & Associates analysis, 2008

Note: Only the neighborhoods shown contain buildable commercial property.

In total, the annexation areas are projected to accommodate approximately 1,000 new housing units through the analysis horizon, which will lead to an additional population of 2,700 for a total 2027 population of 4,300. In the meantime, the current City is projected to accommodate approximately 690 new housing units through 2027, which will lead to an additional population of nearly 1,200, for a total of 5,900. At this pace of development and assuming annexation, the total City of North Bend is projected to have 10,200 people in 2027.

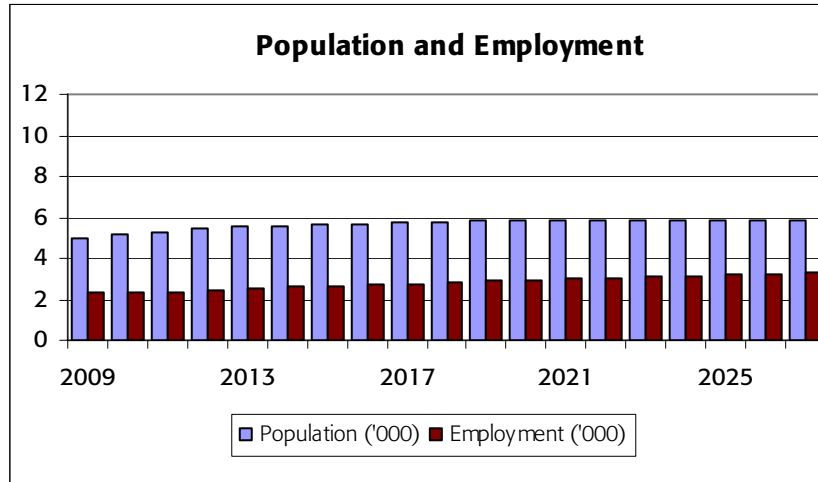
In terms of commercial uses, the estimated new building square feet are allocated 30% to retail and 70% to office-type uses, based upon the approximate current distribution in the City and contemplated annexation area. These parcels are projected to develop into a possible 604,000 square feet and 355,000 square feet of retail and office activity by 2027 for the City and annexation areas, respectively.

There are also some vacant and redevelopable parcels in the Tanner neighborhood currently zoned as industrial. These parcels are estimated to account for an additional 788,000 square feet of light industrial activity in the annexation areas by 2027.

This pace of commercial and industrial development is projected to lead to approximately 1,000 new jobs added by 2027 in the City and 1,600 jobs in the annexation areas, for a total of approximately 5,170 jobs within the new City boundaries.

Exhibit 9 demonstrates the pace of population and employment growth in the City of North Bend, assuming that no annexation occurs.

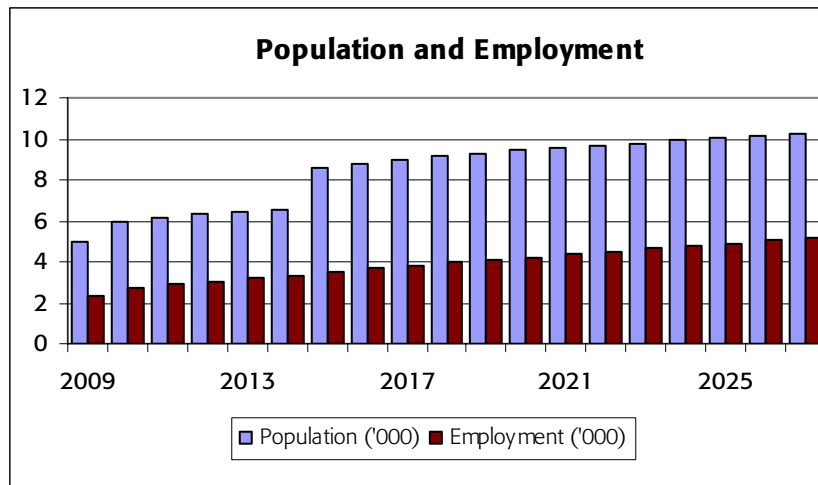
Exhibit 9
Projected Population and Employment Growth for City of North Bend,
Assuming No Annexation



Source: Berk & Associates Analysis, 2008

Exhibit 10 shows projected population and employment growth for City of North Bend and potential annexation areas based on the development assumptions described above.

Exhibit 10
Projected Population and Employment Growth for City of North Bend,
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015



Source: Berk & Associates Analysis, 2008

4.2 Operating Revenue Analysis

Tax and fee revenues are estimated based on the changes in the components of the City’s tax base resulting from annexations and growth. Components of growth which could influence revenue streams over time include population, employment, base inflation in certain components of the tax base, or land use changes. 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 11** shows estimated revenues for the City, assuming Phase I annexation in January 2010 and Phase II in January 2015.

Exhibit 11
Estimated Revenues for North Bend,
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015
(Numbers in Millions)

	2008	2010	2015	2020	2025
Sales Tax	1.48	1.93	2.64	3.53	4.74
Property Tax/Road Levy	0.83	1.20	1.70	1.89	2.13
Utility Taxes	0.77	0.98	1.62	2.15	2.78
B&O Tax	0.54	0.96	1.72	2.73	4.14
Criminal Justice Sales Tax	0.11	0.15	0.26	0.33	0.42
Gas Tax	0.07	0.09	0.14	0.15	0.16
Building Permits	0.06	0.32	0.41	0.51	0.62
Liquor Board Profits and Excise Tax	0.06	0.07	0.13	0.17	0.21
Gambling Tax	0.05	0.05	0.06	0.07	0.08
Planning and Plan Check Fees	0.04	0.10	0.13	0.16	0.19
Fines and Forfeits	0.03	0.04	0.07	0.09	0.12
Other Charges	0.03	0.04	0.06	0.07	0.09
Business Licenses and Permits	0.02	0.03	0.04	0.06	0.08
Recreation Charges	0.01	0.01	0.02	0.02	0.03
Grants & Other Intergovernmental	0.01	0.02	0.03	0.03	0.04
Total	4.09	6.00	9.01	11.97	15.84

Source: Berk & Associates analysis, 2008

Key Revenues

Retail Sales Taxes

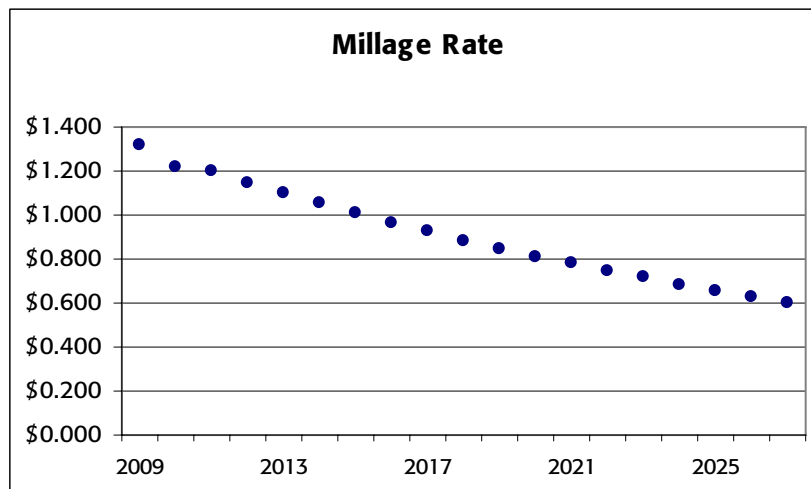
One of the key revenue sources that cities rely on is retail sales tax. While there is modest retail activity currently in some of the neighborhoods in the contemplated annexation areas, there is some additional development capacity that could materialize into new retail establishments, primarily in the Tanner neighborhood, with a modest amount in Mt Si as well. This retail development is estimated to generate approximately \$200 of taxable retail sales per square foot, and the office portion approximately \$25 per square foot. The other light industrial development is also estimated to generate sales of approximately \$25 per square foot. These per square foot estimates are based on an overall average for "typical" retail activity. Actual sales tax impacts could be higher or lower depending on the actual types of tenants that might locate in these areas.

Of the sales tax currently collected in the City and the potential annexation areas, a 1% "local option" accrues to local jurisdictions. If the transaction location is within a city like North Bend, 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 housing, such as telephone services or deliveries of fuel oil or propane, and with recent changes in sales tax sourcing rules, a wide variety of purchases that are delivered to homes.

Property Taxes

In future years, the base assessed value is expected to revalue at an annual rate of 2% above inflation. Additional assessed value will be added to the area through development. The property tax levy (the amount that the City can collect) is limited to 1% above the previous year limit, plus the value of new construction in the previous year multiplied by the previous year's levy rate. Since property values are expected to increase by more than the rate of inflation, the levy is assumed to grow more slowly than the value of the property in the City. This will reduce the City's levy rate over time. The result of this gradual reduction in the City's general property tax rate is shown in **Exhibit 12** below. Assuming the City does not pursue a voted levy-lid-lift, the future millage rate depends entirely on the future assessed value in the current City and the value of new construction activity.

**Exhibit 12
North Bend Projected Property Tax Millage Rate
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015**



Source: Berk & Associates analysis, 2008

Because of the method for calculating a city's property tax levy (1% of the previous year's levy plus taxes on new construction), the amount of new construction in a city is an important factor in the city's property tax growth. A typical 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.

Both the current City of North Bend and portions of the potential annexation areas had a temporary construction moratorium in effect until mid 2008. Current economic conditions notwithstanding, the model anticipates that there has been some build up of demand due to the moratorium and that with the lifting of the moratorium there will be slightly more rapid development in the near term, with some moderation in the pace of development over time. Construction rates are based on development assumptions for parcels that are vacant, redevelopable, or already planned or permitted by King County. For the City of North Bend, the projected average rate of construction in the City is estimated at approximately 3.5% of assessed value in 2009, slowing to 0.5% by 2025. The potential annexation areas are slightly higher starting around 6.5% and slowing to approximately 2.0% by 2025.

Due to lags associated with annexation and the initial levying of the City's regular levy on annexed areas, the model assumes that the City will not begin to receive property tax revenues from the Phase I annexation until 2011 and the Phase II until 2016. For the first year of annexation however, the City will receive revenues associated with the County road levy. These revenues are estimated at \$323,000 for Phase I annexation in 2010 and \$334,000 in 2015 for Phase II. The road levy revenues must be limited to transportation-related expenses. To offset this bump in transportation revenues and absence of General Fund revenues, the City would have flexibility to adjust the portion of General Fund subsidy currently allocated to the Street Fund.

Utility Taxes

The City of North Bend imposes a franchise fee on cable services at a rate of 5.0% and utility taxes on cable, electricity, natural gas, telephone, sewer, and garbage services, all at a rate of 6.0%. Because these taxes are paid by both residences and businesses, revenues are projected based upon a per capita number for population and employment.

B&O Tax

The City of North Bend levies a B&O Tax on businesses located within the city boundaries at a rate of 0.2% of gross business income (GBI). For projections of GBI, a State average of GBI per employee was applied to the total estimated jobs projected by the model each year for the current City and annexation areas. Jobs within the model are estimated based on current estimates of land use, with future additions based on assumptions about the pace and nature of development.

4.3 Operating Cost Analysis

Ongoing Costs

The fiscal model 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 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 City Administrator).
- **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, an Administrative Assistant may be related to growth in another position within the same department.
- **Indirect (by Department).** These positions are driven by staffing levels of one or more departments. For instance, a Mechanic position is related to total new staffing levels in all departments that have vehicles.

General Assumptions

- Annual salary and wage escalation is assumed to be 4.0%, while annual benefits are assumed to grow at a rate of 5.0%. These assumptions account for the possibility of gradual increases in overall salary and benefits costs above inflation due to a number of factors, including: step increases, competition for labor resources with larger cities, and expected continuation of benefit cost increases primarily related to health care costs.
- No facility impacts or related costs estimated
- Eight new park acres added with annexation, four with Phase I and four with Phase II

Impacts to City Staffing

Phase I of annexation is estimated to increase City staffing by approximately 4.4 Full Time Equivalents (FTEs), or 18%. There are currently 24.8 City FTEs paid for by the General and Street Funds. With growth within the City this number is anticipated to increase slightly to 24.9 in 2010. With the additional 4.4 FTEs from annexation, staffing in 2010 is expected to approximately 29.3 FTEs. This staffing is not expected to change again until Phase II of the annexation in 2015 which is estimated to add approximately 1.2 additional FTEs for a total of 30.5 for the City.

Exhibit 13 below displays staffing levels by year for each department, with current staffing on the left and full staffing for annexation and City growth assumed in 2010, 2015, 2020, and 2025. 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 discussion with City staff and reflects current staff planning for post-annexation needs.

Exhibit 15 shows the estimated costs by department, with current costs per the 2008 City Budget on the left and estimated costs in five-year increments beginning in 2010 to the right.

Exhibit 14
City of North Bend Staffing Funded by General Fund and Streets Fund
(in Full Time Equivalents)
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015

	Current (2008)	2010	2015	2020	2025
Parks	7.2	7.2	7.7	7.7	7.7
Econ Dev	4.5	5.5	5.5	5.5	5.5
City Council	3.9	5.2	5.2	5.2	5.2
Finance	2.9	2.9	2.9	2.9	2.9
Administration	2.2	3.3	3.4	3.5	3.5
Law Enforcement	2.0	2.0	2.0	2.0	2.0
Streets	1.7	2.6	2.6	2.6	2.6
Central Services	0.2	0.3	0.3	0.3	0.3
Engineering	0.2	0.3	0.9	0.9	0.9
Total	24.8	29.3	30.5	30.6	30.6

Source: City of North Bend, Berk & Associates

Exhibit 15
Estimated Department Costs Funded by General Fund and Streets Fund,
Assuming Phase I Annexation in 2010, Phase II Annexation in 2015
(Numbers in Millions)

	Current (2008)	2010	2015	2020	2025
Law Enforcement	1.37	1.65	2.12	2.62	3.25
Fire	0.74	1.03	1.54	1.92	2.41
Econ Dev	0.55	0.72	0.88	1.07	1.30
Parks	0.47	0.51	0.66	0.81	0.99
Streets	0.40	0.64	0.75	0.88	1.05
Finance	0.37	0.41	0.49	0.60	0.73
Administration	0.24	0.34	0.43	0.53	0.66
Legal	0.21	0.22	0.27	0.32	0.38
City Council	0.06	0.09	0.11	0.14	0.16
Central Services	0.02	0.02	0.03	0.03	0.04
Engineering	0.01	0.02	0.11	0.14	0.17
Total	4.45	5.66	7.40	9.06	11.14

Source: City of North Bend, Berk & Associates

Key Operating Costs

Law Enforcement

The City of North Bend currently contracts with the King County Sheriff's Office to provide police services within the City limits. With the increase in land area through annexation, the City will need to

pay for services to the larger area. The current contract requires the City to pay \$1,071,254 in 2008, which is anticipated to increase to \$1,169,836 by 2010. Based on analysis of the call volumes within the annexation areas, the additional costs are expected to be \$146,468 with Phase I in 2010 (a 13% increase in current City costs) and \$77,065 with Phase II in 2015 (a 5% increase in current City costs). The resulting total cost in 2010 is estimated at \$1,316,604 and \$1,717,419 in 2015.

Fire Services

The City of North Bend is located in Fire District 38 and currently contracts with Eastside Fire and Rescue (EF&R) to provide its fire services. The City's fire services are conducted out of a station located within the current city boundaries. The cost to the City in 2008 is \$694,700 for these services. For 2009 and beyond, annual increases in station costs will be apportioned based on the City's percent of assessed value within the Fire District and added to the existing contract cost. For this analysis, the assumed annual increase in station costs is 5.0% based on recent historical cost increases.

The contract with EF&R states the following protocol for annexations:

- North Bend shall assume a portion of District 38's responsibility for the station costs in a dollar amount equal to \$1.00 per \$1,000 of assessed value of the annexed area.
- The above sum will be added to the year's apportioned contract cost.
- Subsequent years will use the new portion of assessed value to distribute station cost increases.

Using the above methodology, Phase I of the annexation is expected to increase fire contract costs by an estimated \$211,858 (28% of current City costs) in 2010. Adding that to the estimated 2010 current City cost of \$750,861 results in a total cost of \$962,718 for the year. Phase II of the annexation is estimated to increase costs by \$263,612 (29% of current City costs). The total estimated cost for the City in 2015, including Phase I of the annexation, is \$1,183,868, resulting in a total anticipated cost of \$1,447,480.

5.0 CAPITAL COSTS AND REVENUES

There are likely to be more needs for infrastructure capital than there will be capital resources coming from the contemplated annexation areas. This situation is comparable to the base City situation and unless there are significant immediate capital infrastructure needs in the annexation areas, then the long-term funding situation is unlikely to be dramatically different than the status quo.

The model 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. The model does not estimate capital needs and costs, as these are difficult to estimate.

5.1 Capital Needs and Costs

Identified Capital Needs in the Annexation Area

If the City of North Bend annexes the contemplated annexation area, the City would conduct an assessment of capital needs in the area. Presumably, this assessment would look at needs for roads and sidewalks, surface water, parks, and other potential investments, all with an eye to the City of North Bend's design requirements and overall service goals.

In the absence of a full capital assessment, available data on capital needs is limited to projects that have been identified as part of King County's capital planning process. Overall, identified needs in the annexation area are significant.

Roads Capital Needs

Exhibit 16 below summarizes capital needs in the annexation area. These needs include nearly \$15 million in unfunded roads projects included in King County's 2007 Transportation Needs Report (TNR) with another \$14 million in a King County CIP funded project. These projects are located in the vicinity of the annexation area, but many may fall inside or outside the boundaries of an annexation depending on precisely how the boundaries are defined.

Exhibit 16 Transportation Needs in the North Bend Area, 2007

King County Identified Projects			
Location	CIP Funding	Type	Cost
Mount Si Bridge #2550A On MT SI Rd Crossing Middle Fork Snoqualmie River	Funded	Bridge	\$13,910,000
SE 149th St / 442 Ave SE From 437 Pl SE to 443 Ave SE	Unfunded	Pedestrian	\$450,000
Clough Creek (Kimball Creek) Bridge #909B SE 141st St Crossing Clough Creek	Unfunded	Bridge	\$990,000
Mt Si Rd From SE North Bend Way To End of route	Unfunded	Guardrail	\$11,000
Middle Fork Rd From 468th Ave SE To 496th Ave SE	Unfunded	Guardrail	\$11,000
436th Ave SE & SE North Bend W	Unfunded	Safety	\$254,000
Mt Si Rd & 432nd Ave SE	Unfunded	Operational	\$640,000
468th Ave SE & SE 140 St	Unfunded	Operational	\$180,000
436 Ave SE/Cedar Falls Rd From I-90 To Wilderness Rim	Unfunded	Operational	\$7,149,000
Mt Si Rd From 452 Ave SE To 800' E	Unfunded	Operational	\$362,000
428th Ave SE/NE 12 St From Reinig Rd To North Bend Way	Unfunded	Pedestrian	\$788,000
Mt Si Rd From North Bend Way To NW Corner of Section 8	Unfunded	Pedestrian	\$3,156,000
SE 140th St/Middle Fork Road From North Bend Way To Old Gravel Pit	Unfunded	Pedestrian	\$1,052,000
Mt Si Rd & 432nd Ave SE	Unfunded	Safety	\$300,000
King County Identified Total			\$29,253,000

Source: King County Roads Division, Department of Transportation

Stormwater Management

Currently, King County's capital improvement plan has not identified any capital needs for surface water management facilities in any of the potential annexation areas.

With the assistance of King County Stormwater Services, Berk & Associates reviewed stormwater drainage complaints that were reported in the annexation areas from 1997 to 2008. The incidents are summarized in Exhibit 17. Over the time period, 96 complaints were received. The most common complaint was drainage issues, with one third of the complaints (32 of 96).

Exhibit 17 Stormwater Complaints

Year	Complaints
1997	13
1998	5
1999	10
2000	10
2001	8
2002	9
2003	11
2004	10
2005	4
2006	9
2007	7
Total	96

Source: Berk & Associates, King County Stormwater Services

Berk mapped these complaints, but there were no geographic concentrations indicating specific problem areas that would need to be addressed if the area was annexed to the City.

5.2 Capital Revenues

The model estimates two major sources of capital funding - Real Estate Excise Taxes (REET) and the portion of Gas Tax revenues the City is currently using for capital expenditures.

Exhibit 18 Estimated Capital Revenues for North Bend Assuming Phase I Annexation in 2010, Phase II Annexation in 2015

	Current	2010	2015	2020	2025
REET	0.24	0.49	0.78	1.05	1.42
Gas Tax	0.03	0.04	0.06	0.07	0.07
Total	0.27	0.53	0.85	1.12	1.49

Source: Berk & Associates analysis, 2008

Real Estate Excise Tax (REET)

If North Bend were to annex the contemplated annexation 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 project—a list that includes improvements to roads and roadways, but excludes investments in parks.

Since the 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 high, and during softer real estate markets, revenues are low. For the purposes of this analysis, it is assumed that 9.0% of residential property and 4.5% of commercial property turn over in any given year. Based on Berk & Associates' analysis of the rate of property transactions in the annexation areas, we estimate that the City of North Bend could expect to receive \$122,000 in REET revenues in 2010 from the annexation areas in Phase I, for a total of \$487,000 million in the whole City, and \$151,000 from the annexation areas in Phase II, for a total of 781,700.

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 (including North Bend) have continued to allot approximately one third of gas tax revenues to their capital program. It is assumed going forward that this will not change.

Based on Berk & Associates' analysis of the per capita gas tax distributions, we estimate that the City of North Bend could expect to receive approximately \$6,000 in gas tax revenues for capital in 2010 from the annexation areas in Phase I, for a total of \$44,000 in the whole City, and approximately \$14,600 from the annexation areas in Phase II for a total of \$63,700 in 2015.

6.0 DEMOGRAPHICS OF THE ANNEXATION AREAS

The Washington State Office of Financial Management (OFM) estimates population of North Bend at approximately 4,700 in 2007. In comparison, the contemplated annexation areas contain approximately 1,600 people. **Exhibit 19** presents some key statistics for each of the potential annexation areas.

Exhibit 19 Key Estimated Statistics for Contemplated Annexation Areas, 2007

	Current City	Shamrock Park	Maloney Grove	Opstad	Mt Si	River Bend	Tanner	Wood River
SF Housing Units	1,172	71	80	172	15	664	36	169
MF Housing Units	566	-	-	-	-	-	39	-
Population (2007)	4,705	202	228	490	43	1,844	165	469
Land Area (Sq Miles)	3.1	0.2	0.3	0.4	0.1	0.6	0.8	0.4
Taxable AV (In millions)	592.3	23.8	29.0	61.5	8.2	173.6	56.2	84.1

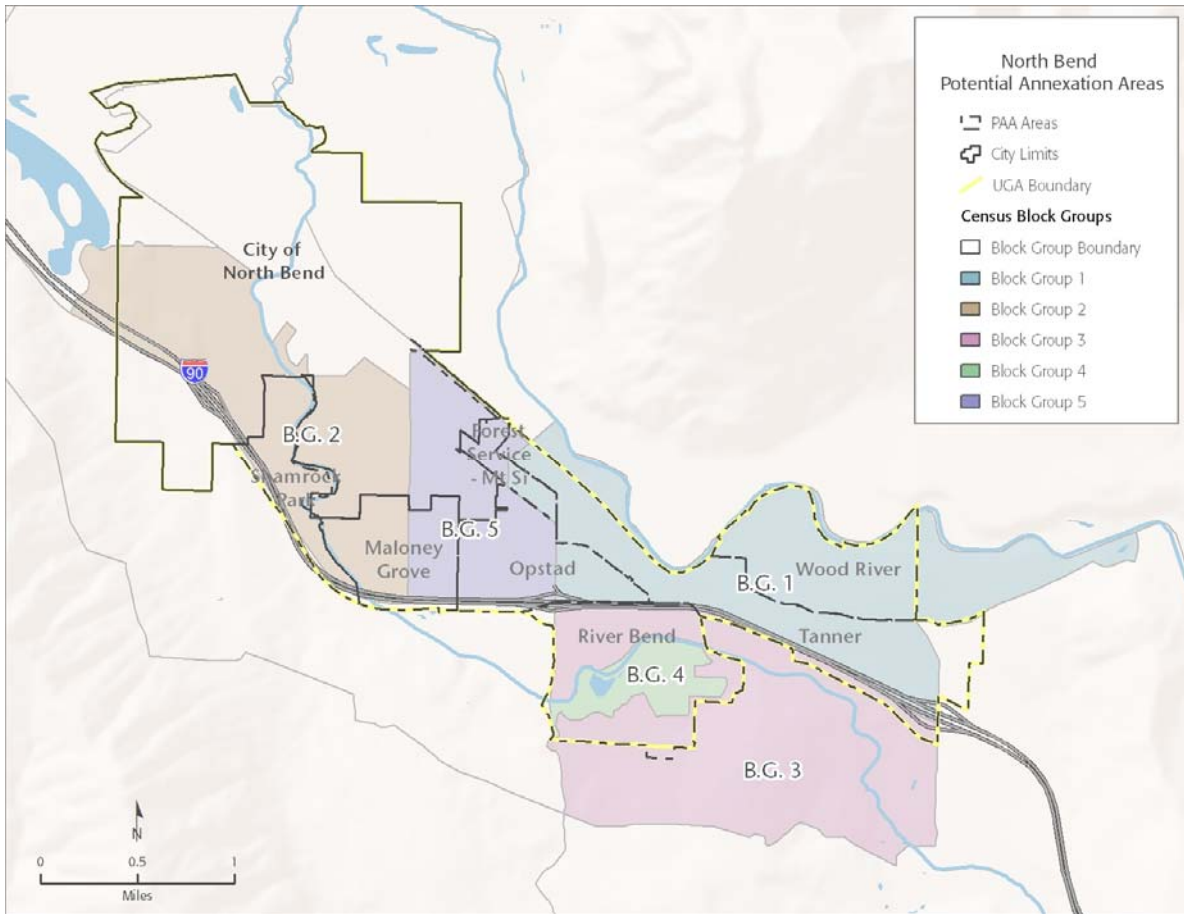
Source: Office of Financial Management, 2008; Berk & Associates analysis, 2008

Since census boundaries do not coincide well with North Bend's annexation area boundaries, we present detailed demographic data in terms of Census block group geography rather than annexation areas. **Exhibit 20** shows how the block groups in question correspond to the Potential Annexation Areas, and **Exhibit 21** depicts the statistics for these areas.

- Block group one covers a number of the PAAs, including parts of Forest Service - Mt. Si, Opstad, and all of Tanner and Wood River.
- Block group two includes Shamrock Park and parts of Maloney Park and the City of North Bend.
- Block group three includes a part of River Bend, while block group four is completely contained within River Bend.
- Block group five includes a portion of the City of North Bend, Opstad, Maloney Grove, and Forest Service – Mt. Si.

Exhibit 20

PAA and Census Block Groups



Source: King County, 2008; US Census Bureau, 2000; Berk & Associates, 2008

Exhibit 21

Key Statistics for Corresponding Census Block Groups, 2000

	Current City		Census Block Group									
	Number	Percent	1		2		3		4		5	
			Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Population	4,893		1,184		1,734		1,040		943		762	
Average Household Size	2.53		2.83		2.95		3.02		2.77		2.58	
Housing Tenure												
Occupied	1,841		418		588		344		340		295	
Owner	1,079	58.6%	359	85.9%	489	83.2%	315	91.6%	305	89.7%	261	88.5%
Renter	762	41.4%	59	14.1%	99	16.8%	29	8.4%	35	10.3%	34	11.5%
Vacant	48		14		4		7		5		14	
Median Income	\$61,534		\$66,800		\$75,614		\$77,228		\$68,125		\$57,639	

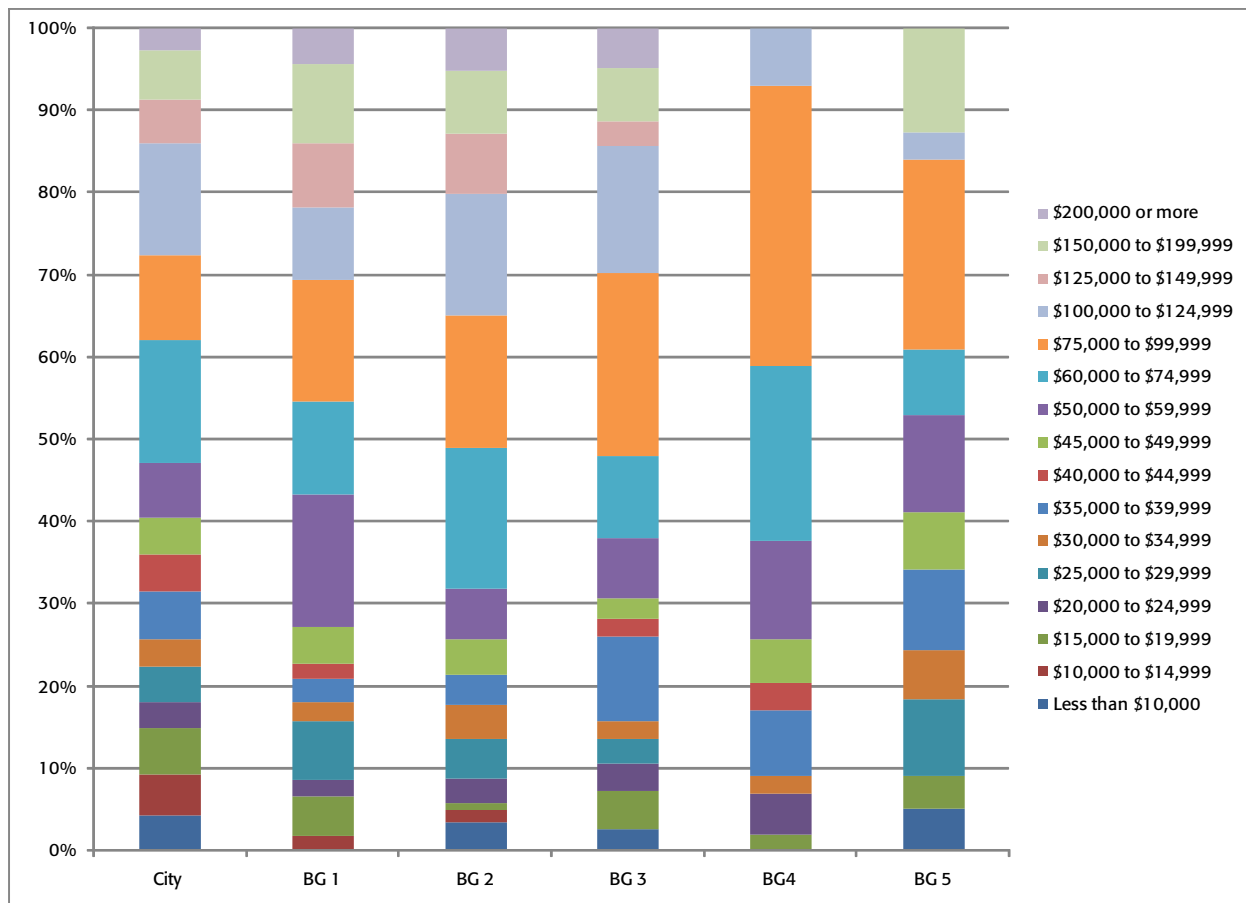
Source: US Census Bureau, 2000; Berk & Associates, 2008

Overall, the census data show that the demographics among areas do not display marked differences. When compared with the current City of North Bend, however, the areas sometimes differ markedly. Key areas of commonality and contrast include:

- North Bend is much more weighted towards renter-occupied housing than any of the contemplated annexation areas. In 2000, more than 40% of households were renters. In the contemplated annexation areas, that share ranged from a low of 8% to a high of 14%.
- Generally, the average household size is higher in the annexation area than in the City. Block group five is the only one with a similar average household size at with 2.58 people per household.
- All the block groups, with the exception of block group five, have median household incomes higher than the \$61,534 median household income for the City.

Exhibit 22 below shows the distribution of income ranges for the City of North Bend compared to the five Census block groups. Overall, the block groups tend to have a higher percentage of households in the income ranges (\$75,000 and up) than the City.

Exhibit 22
Income Distribution for North Bend and Census Block Groups



Source: US Census Bureau, 2000; Berk & Associates, 2008