Office of Economic & Revenue Forecasts

2021 Year-End Revenue Report

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1. INTRODUCTION

This is the first of what will be regular quarterly reports from the Office of Economic and Revenue Forecasts (Forecast Office). The purpose of these reports will be to compare how actual revenues have performed relative to the most recent forecasts, as a way to track year-to-date revenue performance. The fourth quarter reports, including this one, will provide an opportunity to compare actuals versus forecast for the entire preceding year.

These reports will be completed 8 to 10 weeks following the end of each quarter. This time frame results from two factors: (i) the one-month grace provided to taxpayers to submit payments for taxes due in the previous month or quarter; and (ii) the time needed for the Forecast Office to work with the accounting team at the Department of Finance and Administrative Services to confirm the payment totals, and to prepare the report itself.

The reports will most specifically focus on the City's General Fund (GF), which includes the City's most flexible revenue streams, and which support the City's most basic general government purposes. Additional information is also provided regarding a selection of other revenue sources, which have more limited purposes, but which either fund general government functions, or specifically support transportation spending. Further details about each of these additional sources is provided later in the report.

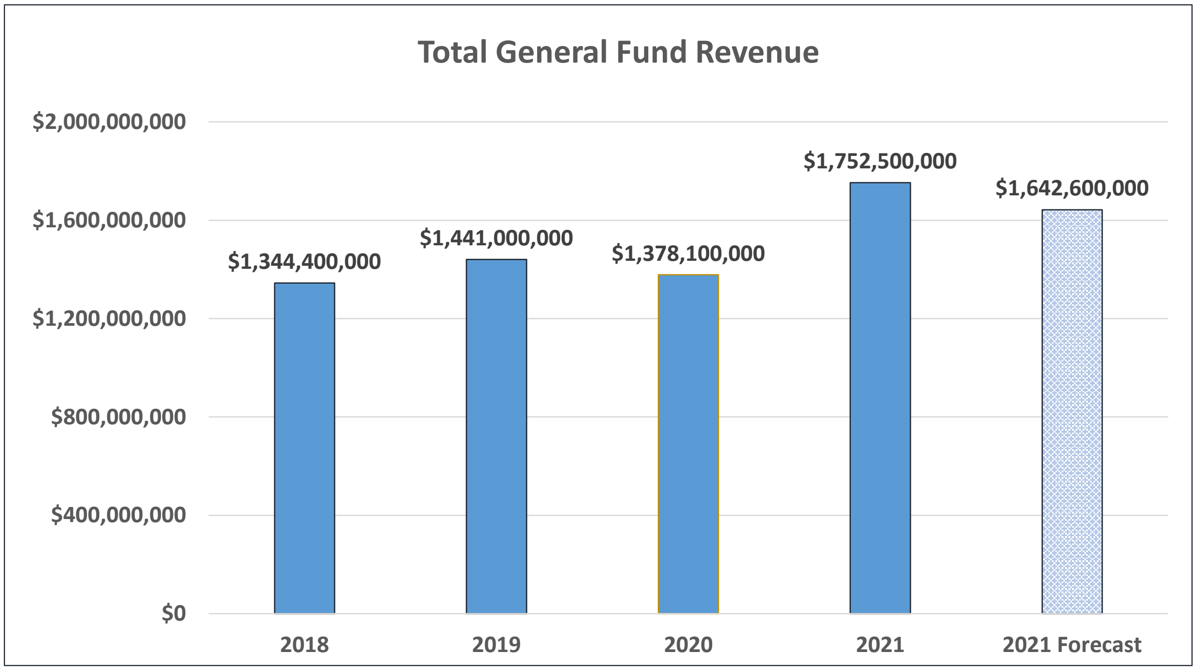
The year-end report will also include a comparison to the actual results from previous years, to provide information about how revenues are changing over time, not just relative to forecast. This particular report includes a comparison of 2021 and 2019. The goal of this comparison is to capture where particular revenue streams stand relative to their pre-pandemic, 2019 levels. The report also provides further context for the overall assessment of realized 2021 revenues by highlighting how both the local and national economic climate and outlook have evolved since the last forecast was developed.

Section 2 of the report focuses on the GF. Section 3 provides information about additional revenue streams that support general government functions, while Section 4 summarize results for several transportation-specific revenue sources. Section 5, the final component of the report, provides observations about how overall economic conditions have developed since the November forecast was finalized.

2. GENERAL FUND REVENUES

2.1 High-level Review of Final 2021 General Fund Revenues

As highlighted in the chart presented below, 2021 GF revenues performed well, both outpacing the final 2021 revenue forecast, which were delivered to the City Council in early November, and significantly exceeding 2019's pre-pandemic General Fund total.

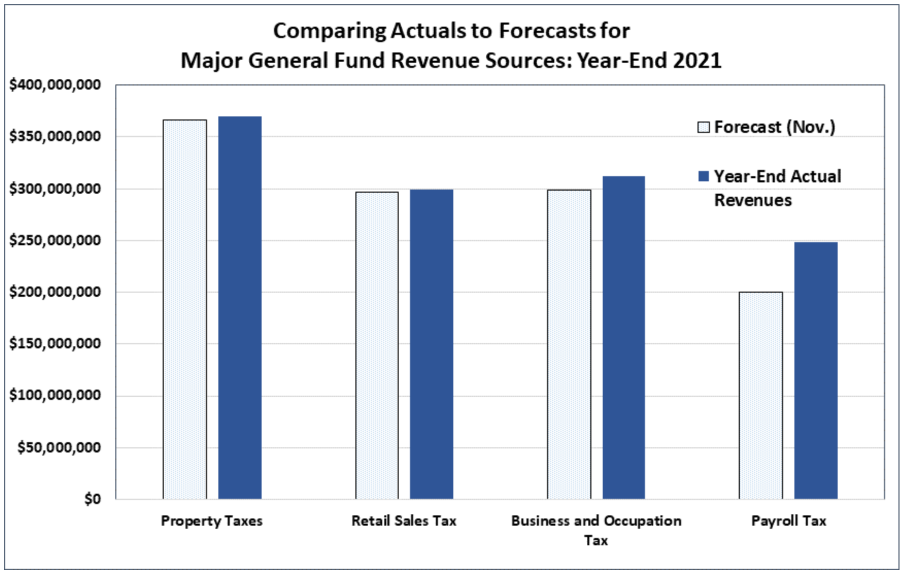


Comparing Actuals and Forecasts. As the chart above shows, actual 2021 revenues exceeded our November forecasts by more than $110 million, with actuals totaling $1.75 billion, compared to the $1.64 billion anticipated in last November's projections. This notable variance from the 2021 forecast is largely attributed to two sources, taxes and grant revenues. These are described more thoroughly below, but for context, it is only the tax revenue excess that provides new, additional resources. The grant revenues are all associated with existing or imminent expenditures and thus do not represent a net addition of new resources. Beyond these two large components, the remaining drivers of the $110 million in forecast variance are linked to modest deviations in a variety of different revenue streams. Further details about these other components are provided later in this report.

Comparing 2021 and 2019. Relative to pre-pandemic results, total 2021 General Fund revenues appear to show a dramatic turnaround. In 2019, GF revenues totaled $1.44 billion. In 2021, total revenues were $1.75 billion, reflecting an increase of just over $300 million. However, $250 million of this increase can be directly attributed to the new Payroll Expense Tax. And an additional $44.2 million can be attributed to use of the City's GF reserves to support 2021 spending. Transfers from these reserves are recorded as current revenues, although they represent the use of funds set aside in previous years. After accounting for these two factors, the GF revenues associated with existing taxes and fees have essentially recovered to 2019 levels, in nominal terms, but do not yet meaningfully exceed them. However, this certainly does not mean that the local economy has somehow returned to its pre-pandemic situation. As we detail later, the relative contributions of individual GF revenue sources have changed significantly since 2019, as the individual sectors of the local economy have experienced very different impacts from COVID. For example, while Sales and B&O tax have fully recovered and exceed 2019 levels, the pandemic's impact on the hospitality sector and overall downtown activity has significantly decreased the City's revenues from restaurants, hotels, and parking (both parking meters and the commercial parking tax).

2.2 Detailed Comparison of Actual 2021 General Fund Revenues to November Forecasts

The Forecast Office takes a direct role in developing forecasts for the largest, most economically dependent sources of GF revenues, including Property, Retail Sales, Business and Occupation (B&O) and Payroll tax. Together these sources accounted for more than $1.2 billion in 2021. The chart that follows provides a visual illustration of the variance between 2021 actuals and November forecasts for these sources.



The table below includes the data underlying this chart, but this visualization highlights that the November forecasts proved quite accurate with respect to Property, Retail Sales and B&O taxes, and that all forecast errors represented underestimates of the actuals. The final 2021 totals for Property and Retail Sales were each about 1% over forecast, providing a total of almost $6 million in unanticipated revenue. For B&O tax, the under-forecast was 4.8% and resulted in an additional $14 million in GF revenue. This somewhat larger forecast deviation in the B&O receipts can be attributed to a number of "non-current" payments, both delayed payments on past obligations and pre-payments of 2022 obligation. Our forecasting mechanisms really cannot anticipate these types of payments, so we remain confident in the underlying econometric models.

The most notable and significant variation from the November forecast was seen in the PET. Final 2021 revenues were $248 million, nearly 25% higher than the $200 million forecast. Payments were received from 325 employers, with more than 80% of the total revenue generated from the Information and Professional Services sectors. The additional $48 million represents "good news" from a revenue perspective, but obviously reflects a rather inaccurate forecast. By way of explanation, it is important to understand that prior to receiving the 2021 year-end payments in January of 2022, the City had no direct experience with this tax, and no direct knowledge of the tax "base". The tax "base" being the portion of City payrolls that are subject to the tax. Although the forecast team had access to general information about total payroll and employment in the City from the Washington State Employment Security Department, this information was not available with sufficient resolution to fully forecast what portions of payrolls would be subject to the tax. In addition, the pandemic-driven shift to "work from home" has had a confounding impact on the PET revenues generated in 2021. The payroll of individuals who previously commuted to locations out of Seattle, but instead worked from home, were potentially subject to the tax; while the payroll of those who no longer traveled from outside the city to Seattle workplaces were not. This latter dynamic is continuing to evolve, and these on-going developments clearly imply that 2021 will not be a "typical" year for the PET. Thus, we have learned a good deal about the PET tax base from the 2021 payments, but that knowledge will not be fully applicable in developing revised forecasts for 2022 and beyond.

The table below expands the comparison of forecasts to actuals to include a broader set of revenue sources that support the General Fund. As noted previously, the total deviation from forecast is a positive ~$110 million.

Comparing 2021 GF Actuals to the November Forecasts

Revenue Source	2021			
	Forecast (Nov.)	Year-End Actual Revenues	Forecast Variance - Dollars	Forecast Variance - Percentages
Property Taxes	$366,260,000	$369,560,000	$3,300,000	0.9%
Retail Sales Tax	$296,770,000	$299,410,000	$2,640,000	0.9%
Business and Occupation Tax	$298,230,000	$312,410,000	$14,180,000	4.8%
Business License Fees	$16,900,000	$16,650,000	($250,000)	(1.5%)
Payroll Tax	$200,140,000	$248,100,000	$47,960,000	24.0%
Public Utilty Taxes - City Light	$56,630,000	$52,880,000	($3,750,000)	(6.6%)
Public Utility Taxes - SPU	$118,770,000	$120,740,000	$1,970,000	1.7%
Private Utilty Taxes - Energy and Solid Waste	$17,300,000	$18,830,000	$1,530,000	8.9%
Private Utilty Taxes - Cable and Telephone	$27,010,000	$27,410,000	$400,000	1.5%
Parking Meters	$11,320,000	$11,010,000	($310,000)	(2.7%)
Court Fines	$16,140,000	$14,720,000	($1,420,000)	(8.8%)
Admission Tax	$8,350,000	$9,450,000	$1,100,000	13.2%
Remaining General Fund Revenues	$208,790,000	$251,280,000	$42,490,000	20.3%
Total General Fund Revenues	**$1,642,610,000**	**$1,752,450,000**	**$109,840,000**	**6.7%**

This view highlights that many of these other revenue streams ended the year somewhat above forecast, but deviations were generally small in both dollar and percentage terms. A variety of factors explain the individual variances, but there was no evidence of systemic issues in forecast methodologies. The deviation relative to forecast in the catch-all category of "Remaining General Fund Revenues" is obviously an exception to the observation about deviations being relatively minor.

The revenues captured in this "catch all" category include some minor tax sources, license and regulatory fees, service charges, interest earnings and other miscellaneous revenue sources, and internal inter-fund transfers and federal, state and interlocal grants. The overall difference of $42.5 million reported above reflects the net impact of variations in all these components, some of which were above forecast and some below. Focusing for a moment on internal transfers, the actual transfer of revenues from the Emergency Fund and the Revenue Stabilization Fund was approximately $28 million less than was projected in the forecast. This is due to a series of changes and corrections during the budget process that ultimately reduced the transfer requirement, but that were not captured in the GF forecast as a revenue reduction. This was simply a reporting error, rather actual deviation from what was expected. On the other hand, grant revenues, specifically Direct Federal Grants, ended up approximately $50 million over the amounts captured in the revenue forecast. Changes in the allocation of grant dollars made late in the year and through the budget process were not reflected in the revised November revenue forecast. In terms of understanding how much additional revenue from 2021 may be available to support new spending, these grant revenues will not be available for general purpose, but rather to support specific grant-related and approved activities.

Setting the grant revenues aside and the misreporting of the Revenue Stabilization Fund transfer, the total 2021 GF forecast variance that could be available for general purposes totals about $75 - $85 million. This includes the $48 million in unanticipated PET, and approximately $25 - $35 million from other sources. However, existing financial policies require that a share of these revenue be directed toward the City's fiscal reserves before any other spending priorities are identified. The specific requirement is that 50% of the unanticipated GF balance be deposited into the City's Revenue Stabilization Account (AKA the "Rainy Day Fund). The unanticipated GF balance is calculated as the net of the incremental revenues represented here, less any offsetting expenditures. The amount of such expenditures is still being determined by the City Budget Office, and thus a full accounting of unspent and available 2021 resources cannot be provided until that work is complete.

2.3 Detailed Comparison of 2021 and 2019 General Fund Revenues to

A final accounting of 2021 GF revenues also provides an opportunity to assess where the City's key revenue streams stand, relative to their pre-pandemic levels at the close of 2019. Using the same revenue categories highlighted in the comparison to forecasts, the table below provides a comparable comparison to those final 2019 results.

Comparing 2021 and 2019 General Fund Revenues

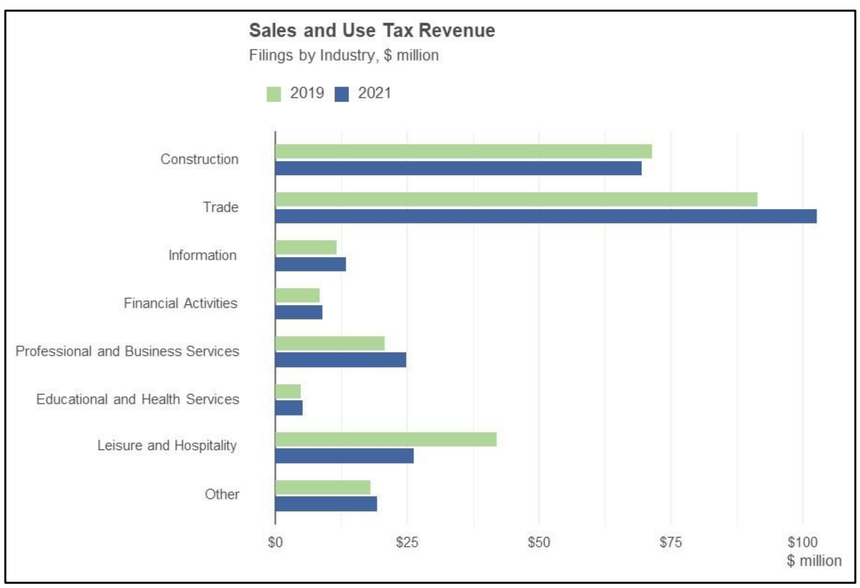
Revenue Source	2019 Year-End Actual Revenues	2021 Year-End Actual Revenues	Year/Year Difference in Dollars	Year/Year Difference in Percentages
Property Taxes	$326,820,000	$369,560,000	$42,730,000	13.1%
Retail Sales Tax	$291,960,000	$299,410,000	$7,450,000	2.6%
Business and Occupation Tax	$299,690,000	$312,410,000	$12,720,000	4.2%
Business License Fees	$17,820,000	$16,650,000	($1,170,000)	(6.6%)
Payroll Tax	$0	$248,100,000	$248,100,000	N/A
Public Utilty Taxes - City Light	$57,310,000	$52,880,000	($4,430,000)	(7.7%)
Public Utility Taxes - SPU	$116,090,000	$120,740,000	$4,640,000	4.0%
Private Utilty Taxes - Energy and Solid Waste	$15,270,000	$18,830,000	$3,570,000	23.4%
Private Utilty Taxes - Cable and Telephone	$31,870,000	$27,410,000	($4,460,000)	(14.0%)
Parking Meters	$38,300,000	$11,010,000	($27,290,000)	(71.2%)
Court Fines	$27,980,000	$14,720,000	($13,260,000)	(47.4%)
Admission Tax	$11,340,000	$9,450,000	($1,890,000)	(16.7%)
Remaining General Fund Revenues	$206,550,000	$251,280,000	$44,730,000	21.7%
Total General Fund Revenues	**$1,441,000,000**	**$1,752,450,000**	**$311,450,000**	**21.6%**

At first glance, these results appear to show a remarkable recovery from the pandemic, with total GF revenues more than $311 million above their 2019 levels, in nominal terms. However, $248 million of that total is directly attributable to the new PET, rather than a recovery of the revenue streams available in 2019. Another $45 million of the apparent recovery is associated with additional funding in the "Remaining GF Revenues" category. Further analysis of this difference reveals that there were a number of one-time contributions to the "Remaining GF Revenues" category in both 2019 and 2021 that can explain this difference. In 2021, the "Remaining GF Revenues" were increased significantly by a one-time, net transfer of more than $44 million from the City's fiscal reserves, and by more than $50 million in Federal COVID relief funding. At the same time, in 2019, this category included $24 million in Soda tax revenues, which were deposited into a separate fund starting in 2020, and $16 million from the one-time sale of assets. Setting aside the increases in PET and "Remaining GF Revenues", the nominal value of GF revenues has barely increased over 2019 levels. The modest growth that has been experienced is insufficient to compensate for the impacts of inflation since 2019, and thus from a perspective of the services the City can fund, 2021 revenues were still below their 2019 levels.

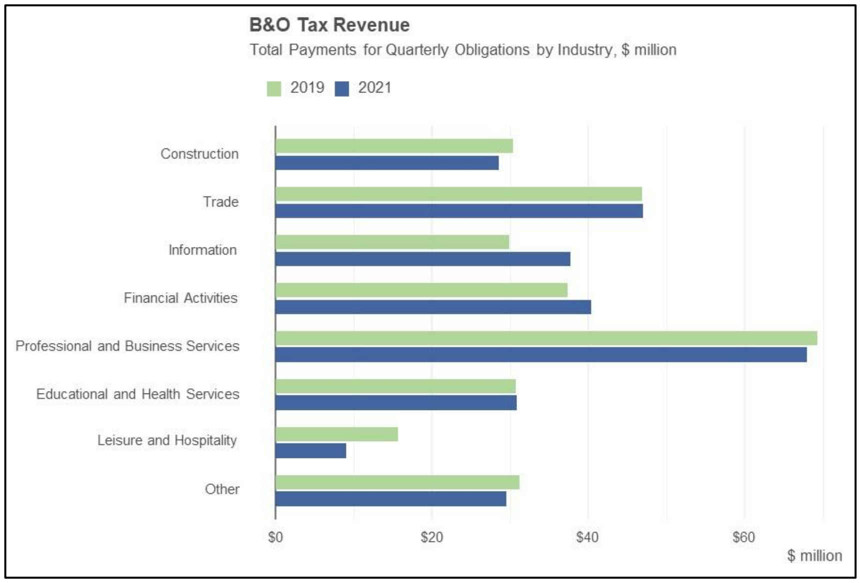
Nonetheless, the overall recovery of GF revenues since 2019 has been strong, and the differential rates of growth seen in each individual revenue stream offer insights into both the City's overall taxing structure and the uneven recovery of some sectors versus others. For example, the strong growth in property taxes is not related to the pandemic at all. The 13.1% increase is partly a result of the voter-approved increase in the County-wide Emergency Medical Services property tax levy, and partly due to the basic structure of property taxes in Washington State. The new EMS levy increased City revenues by more than $14 million. And per State law, base property tax revenues can increase each year by up to 1% plus the value of new construction. This 1% limit and opportunity for revenue growth from new construction holds even if underlying property values decrease. Property tax rates are adjusted to provide the additional 1% in revenue, whether property values increase or decrease. Thus, in Washington State, property taxes provide a steady, dependable revenue stream through most economic shocks.

In contrast, the dramatic decrease in the revenues associated with Parking Meters and Court Fines, much of which are parking fines, clearly demonstrate that the pandemic continues to have a significant negative affect on some, previously significant, revenue streams. The decline in admission tax revenues relative to 2019 is further evidence of ongoing pandemic impacts. Other declines, such as those seen in some of the utility tax revenue streams are likely not linked to the pandemic. The decrease in utility tax revenues associated with telephone and cable reflect a long-term shift in technology toward internet alternatives, and the apparent decline in City Light utility taxes is mainly the result of one-time refunds for previous overpayments.

While both Retail Sales and B&O taxes have increased since the 2019, the charts presented here show how the composition of which industries are responsible for these payments has evolved over the period of the pandemic, and again highlight the differential impact COVID as had across economic sectors.



For Retail Sales tax, note that both the Construction and Leisure & Hospitality sectors still lag their 2019 performance. For construction the relative decline is small, less than 3%. However, the impact to taxable sales in the Construction and Leisure &Hospitality has been a decline of more than 37%. The near-term easing of COVID restrictions should help performance in 2022, but how quickly the sector will recover is unclear. All other sectors show some growth in sales relative to 2019, with the largest increases in Trade and Professional & Business services.



The pattern observed in B&O tax revenues is comparable. In 2021, B&O payments from both the Construction and Leisure & Hospitality sectors fell short of their 2019 levels. Slight declines were also experienced in Professional & Business Services, and the "Other" category, but growth in the Information and Financial Activities sectors offset these decreases. Bottom-line, the major technology firms operating in Seattle, including Amazon, Microsoft, Google, and Facebook, have maintained strong growth through the pandemic, and have help buoy the City's GF revenues through what otherwise could have been a much larger fiscal challenge.

3. REVIEW OF SELECT NON-GENERAL FUND REVENUES AVAILABLE FOR GENERAL GOVERNMENT PURPOSES

The previous section of this report focused on revenues that are directly deposited in the City's General Fund, and available to spent on any general governmental purpose. These represent only a portion of the total revenues that support the City's general government services, and there are several additional targeted sources worthy of attention. This section of the 2021 Year-End Revenue Report focuses on three of specific revenue sources that fall into this category:

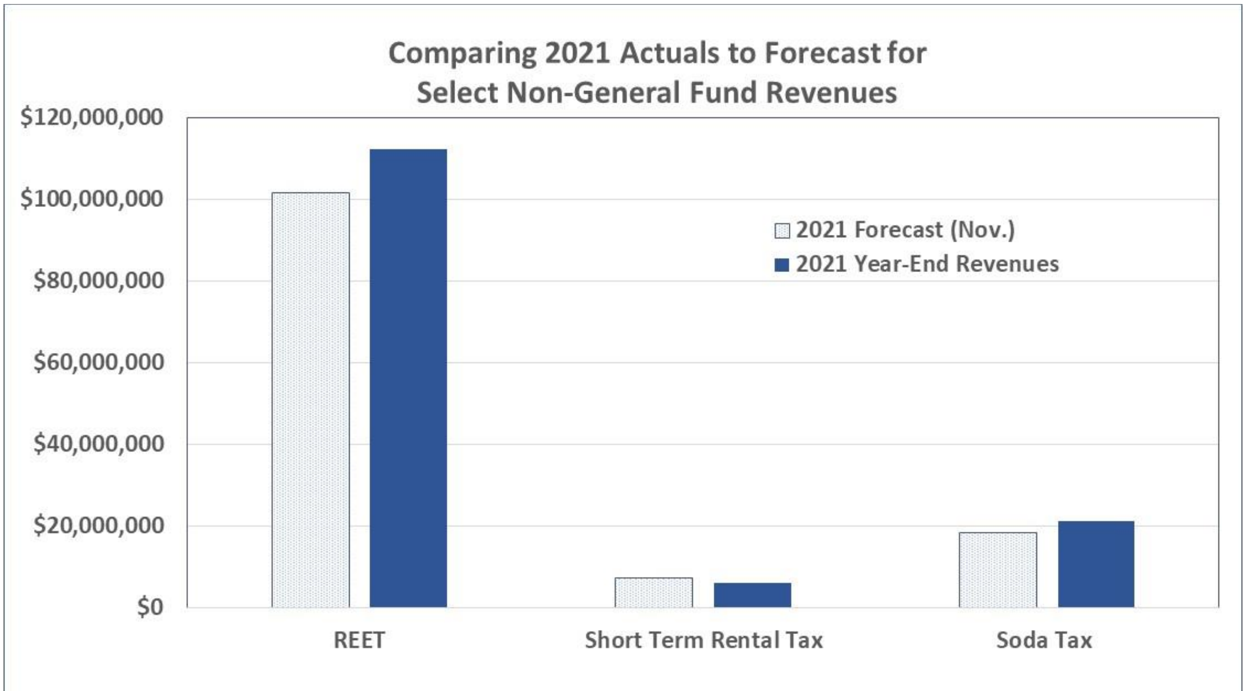
REET (Real Estate Excise Tax). REET revenues are generated by a 0.5% tax on real estate transactions within the City. These revenues have historically been limited by state law to be used only for a limited set of capital purposes. That list of eligible uses was recently expanded to include affordable housing.

Short-Term Rental Tax. The short-term rental tax imposes a 7% tax on transactions for short-term "vacation" rentals, such as those available from Airbnb and VRBO. There are no specific state restrictions on the use of these revenues, but the City has chosen to use these tax proceeds to fund both its Equitable Development Initiative and general affordable housing invests.

Soda (Sweetened Beverage) Tax. As of 2018, distributors of sweetened beverages are liable for a tax of $0.0175 per fluid ounce of sweetened beverage delivered for sale in Seattle. The City has dedicated the resulting revenues to funding educational programs and food access initiatives, primarily through the Department of Education and Early Learning (DEEL), the Human Services Department (HSD) and the Office of Sustainability and Environment (OSE).

In sections 3.1 and 3.2 that follow, we provide a comparison of how the 2021 final revenues from these sources compare relative to the November forecast and to their 2019 levels.

3.1 Select Non-General Fund Revenues – Comparison to 2021 Forecasts



Revenue Source	2021			
	Forecast (Nov.)	Year-End Revenues	Forecast Var. in $	Forecast Var. in %
REET	$101,500,000	$112,200,000	$10,700,000	10.5%
Short Term Rental Tax	$7,200,000	$6,000,000	($1,200,000)	(16.7%)
Soda Tax	$18,200,000	$21,200,000	$3,000,000	16.5%

In percentage terms, the forecast discrepancies are generally larger for these three revenues than for the GF sources, but fortunately from budgeting perspective, the differences are either "to the good" or small in absolute terms, in the context of the City's overall revenues.

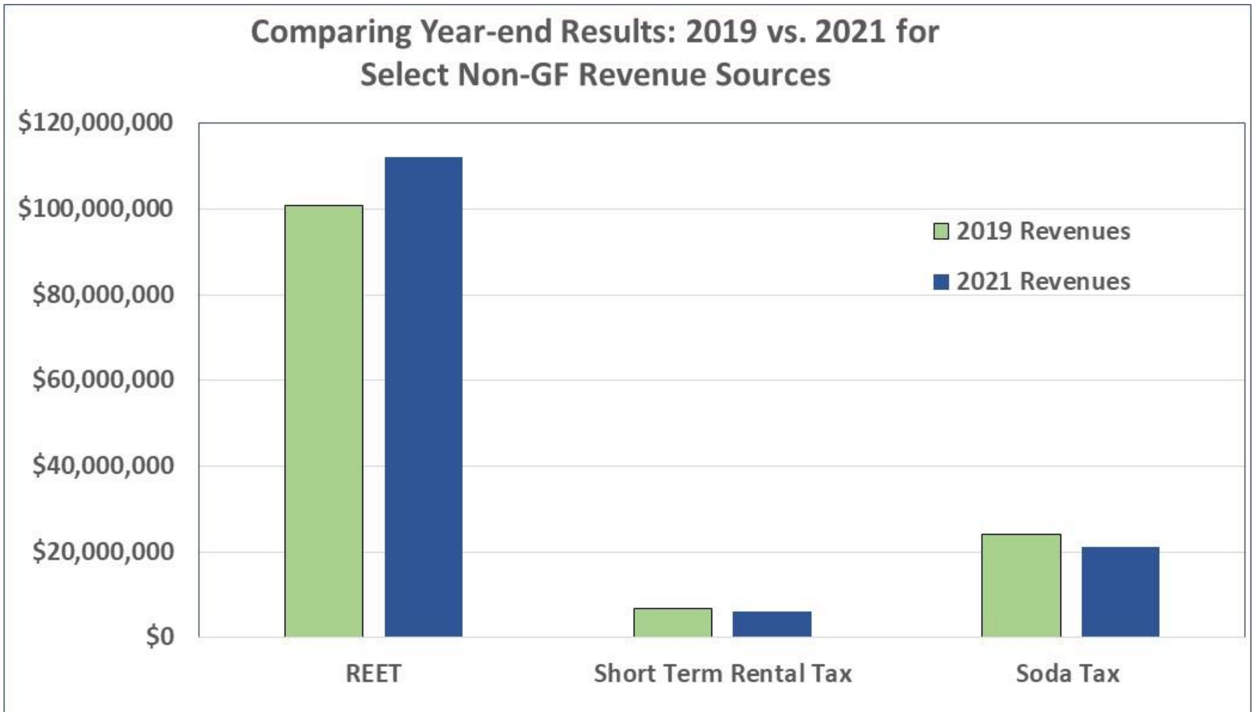
- Real Estate Excise tax totals for 2021 outpaced the November forecast by more than $10.5M, as several large property transactions late in the year added significant unanticipated revenues. The impact of such individual transactions can be large in terms of overall revenues, and obviously the forecast cannot easily anticipate any specific property sale.

- Revenues from the Sweetened Beverage or "Soda tax" exceeded the November forecast by $3M, which equates to 16.5%. This tax is paid quarterly, so information about its performance relative to forecast is only available a few times year, and a stronger than anticipated 4th quarter drove this result. Looking forward, there may be an opportunity to correlate soda tax revenues with newly available measures of restaurant activity to enhance the accuracy of these forecasts.

- Short-Term Rental tax revenues fell short of forecasts by almost 19% ($1.1M), consistent with overall challenges that the Omicron variant has played in delaying recovery in the hospitality sector. The full impacts of Omicron were difficult to predict in early November when the forecast was developed.

3.2 Select Non-General Fund Revenues – Comparison of 2019 and 2021 Year-end Results

When compared to 2019, the final 2021 revenues for these three sources reinforce the observations made previously about the differential impacts the pandemic has had across economic sectors.



Revenue Source	2019 Revenues	2021 Revenues	Year/Year Difference in $	Year/Year Difference in %
REET	$100,900,000	$112,200,000	$11,300,000	11.2%
Short Term Rental Tax	$6,800,000	$6,000,000	($800,000)	(11.8%)
Soda Tax	$24,100,000	$21,200,000	($2,900,000)	(12.0%)

- The real estate sector, particularly in terms of real estate transactions, has remained strong through the pandemic. Sales slumped somewhat during the first half 2020, when the pandemic first began, but since then both the commercial and residential markets have done well, with demand strong and relatively easy access to the capital and credit needed for such transactions. Increasing interest rates may have some negative impact going forward, but it remains unclear what impacts both inflation and shifting Federal Reserve policies will have on the "cost of credit".

- In contrast, the Hospitality & Leisure sector has been hit hard, and the modest recovery that began last summer was slowed by the rise of Omicron late last year. Consistent with these persistent challenges, Soda tax and Short-Term Rental tax remain about 12% below their pre-pandemic levels

4. REVIEW OF SELECT TRANSPORTATION-SPECIFIC REVENUES

In recent years, the City has taken several steps to significantly increase annual funding for both the maintenance and expansion of the City's transportation system. This includes renewal of a voter-approved transportation levy, the adoption of a commercial parking tax, and the creation of the Seattle Transportation Benefit District. The latter provided a path to new vehicle license fee and sales tax revenue earmarked for transportation purposes. Following the format established in the previous two sections, the discussion below highlights how some of these transportation-focused revenue streams have performed relative to forecast, and relative to their pre-pandemic, 2019 levels. The four specific revenues reported upon here include:

Commercial Parking Tax. The City currently imposes a 12.5% tax on commercial parking transactions, with 100% of the revenues dedicated to transportation purposes.

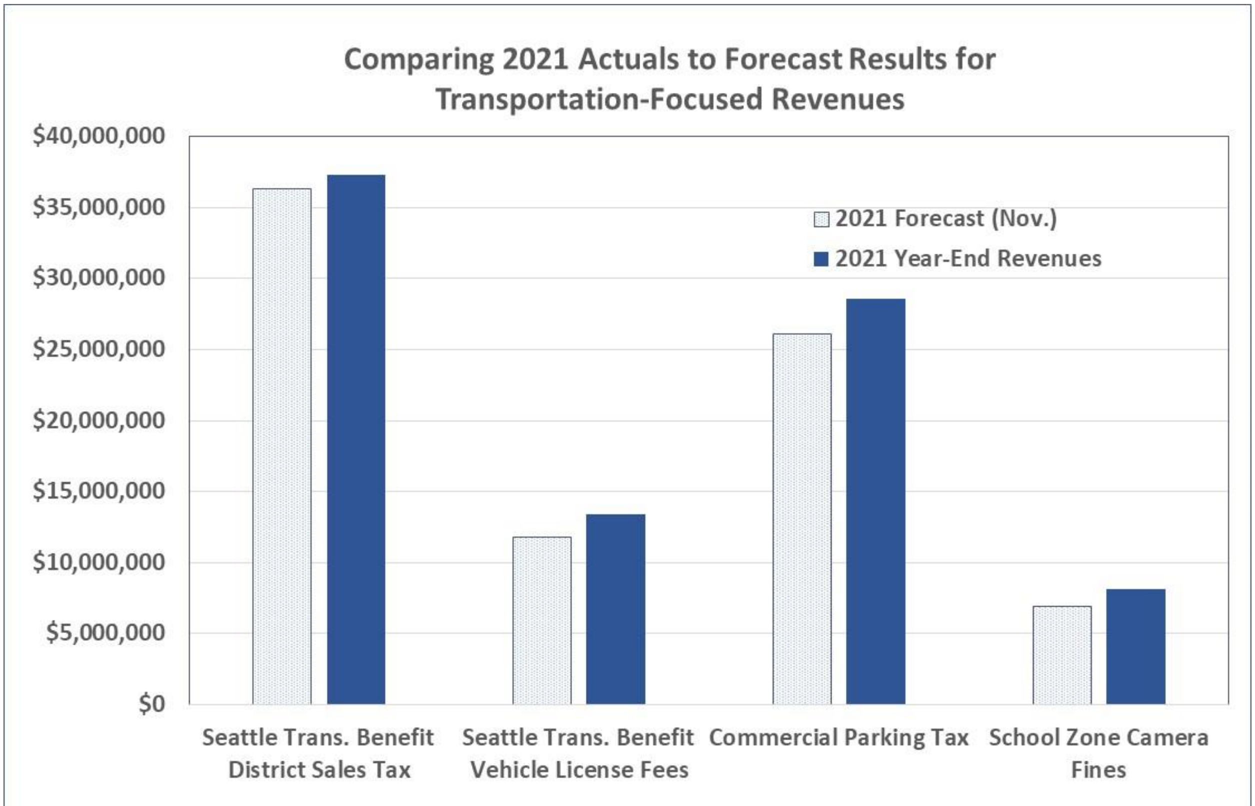
Seattle Transportation Benefit District Sales Tax. In November of 2020, the residents of Seattle approved a ballot measure that imposes a 1.5% tax on retail sales within the City. This represented an increase from the 1% rate that had been previously approved but was set to expire. The revenues generated by this increment in the overall sales tax rate are restricted to transportation purposes.

Seattle Transportation Benefit District Vehicle License Fee (VLF). The City's Transportation Benefit District also raises revenues through a $40 VLF. This fee is assessed each year when owners renew their vehicle's registration. The VLF had been set at $80 per year through 2020, but as part of the proposal to increase the sales tax rates to 1.5% the City reduced the VLF to $40.

School Zone Camera Fines. The City uses automated cameras to enforce speed limits in areas near schools, as is authorized by state law. Under existing City policy, 100% of the (net) revenues generated from the resulting traffic tickets is directed into the School Safety Traffic and Pedestrian Improvement Fund, and is used to pay for school-related traffic safety projects.

4.1 Select Transportation-Specific Revenues – Comparison to 2021 Forecasts

The chart and associated data table below highlight that the final 2021 revenues generated by all four of these transportation-specific sources exceeded the November forecasts produced by the City Budget Office.



Revenue Source	2021			
	Forecast (Nov.)	Year-End Revenues	Forecast Var. in $	Forecast Var. in %
Seattle Trans. Benefit District Sales Tax	$36,300,000	$37,300,000	$1,000,000	2.8%
Seattle Trans. Benefit Vehicle License Fees	$11,800,000	$13,400,000	$1,600,000	13.6%
Commercial Parking Tax	$26,100,000	$28,600,000	$2,500,000	9.6%
School Zone Camera Fines	$6,900,000	$8,100,000	$1,200,000	17.4%

There is not a consistent explanation for the variance from forecast across these revenue streams. The Sales tax and Commercial Parking tax discrepancies reflect a general increase in local economic activity, including increased business activity and the associated demand for parking. The revenue from school zone cameras is influenced by overall traffic volumes, but also the number of cameras in place and operational in school zones. In 2021, Vehicle License Fees were increased mid-year, and COVID supply chain issues disrupted vehicle sales and delivery, both of which made revenue forecasting more challenging than usual.

4.2 Select Transportation-Specific Revenues – Comparison of 2019 and 2021 Year-end Results

A number of factors also make it difficult to assess how these revenues have been affected by the pandemic, and a comparison to 2019 only provides a meaningful pre-and post-pandemic view for the Commercial Parking tax. Specific policy changes implemented during 2020 and 2021 had significant impacts on the other three transportation-specific sources. In November of 2020, a voter-approved ballot measure increased the Benefit District Sales tax rate from 1% to 1.5%, but this change did not take effect until April of 2021. At the same time, the VLF was reduced from $80 to $40 per year, but with effective dates of the that did not correspond to the calendar year. The former explains why Benefit District Sales tax revenues increased sharply, and the latter why VLF revenues declined rather dramatically. With respect to School Zone Cameras, some of the devices were disabled during the early phases of the pandemic when schools were closed, and more recently the City has begun to expand the number of cameras, consistent with goals established before the pandemic. These confounding factors make it difficult to interpret the small revenue decline in this source between 2019 and 2021.

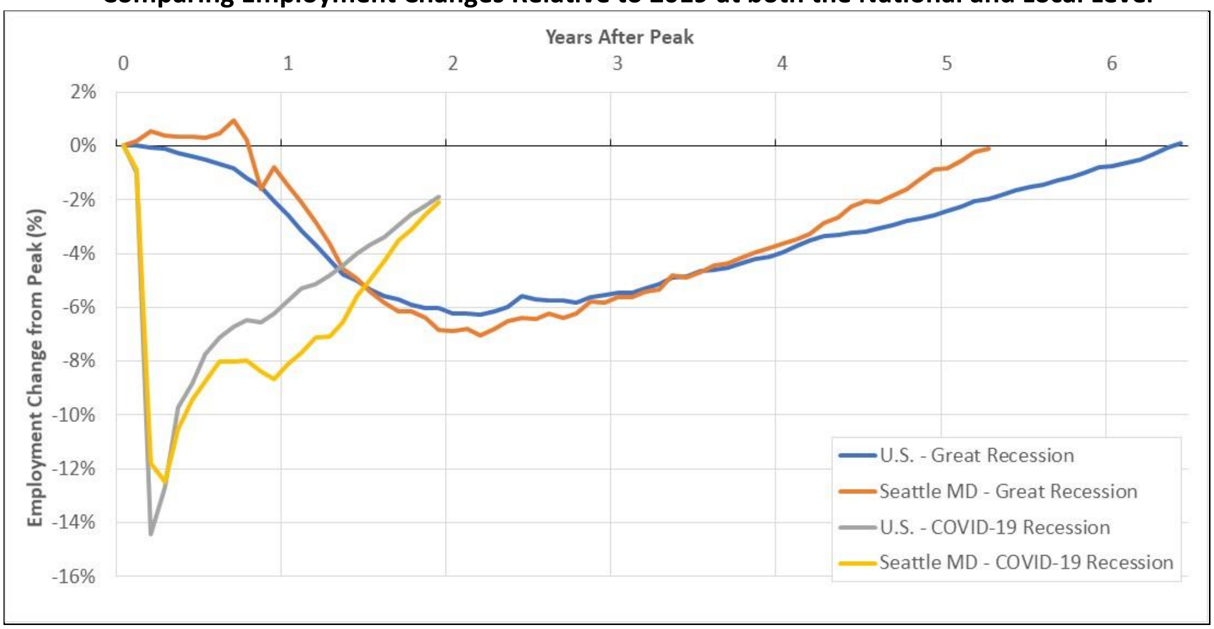
Revenue Source	2019 Revenues	2021 Revenues	Year/Year Difference in $	Year/Year Difference in %
Seattle Trans. Benefit District Sales Tax	$30,400,000	$37,300,000	$6,900,000	22.7%
Seattle Trans. Benefit Vehicle License Fees	$34,400,000	$13,400,000	($21,000,000)	(61.0%)
Commercial Parking Tax	$49,200,000	$28,600,000	($20,600,000)	(41.9%)
School Zone Camera Fines	$9,700,000	$8,100,000	($1,600,000)	(16.5%)

While there were confounding factors that affected the other transportation-specific revenue streams, the impacts of the pandemic on Commercial Parking tax revenues have been both clear and significant. Relative to pre-pandemic levels, these revenues have declined by almost 40%. The fact that final 2021 revenues exceeded forecast can be seen as some evidence of recovery, but clearly there is a long way to go before payments reach their pre-pandemic levels. Moreover, much of the Commercial Parking tax revenues are generated in the City's downtown core, and with significant uncertainty remaining about how "work from home" and hybrid work schedules will affect overall demand for parking in this area, the long-term prospects for this revenue stream remain unclear.

5. Overview of Economic Climate

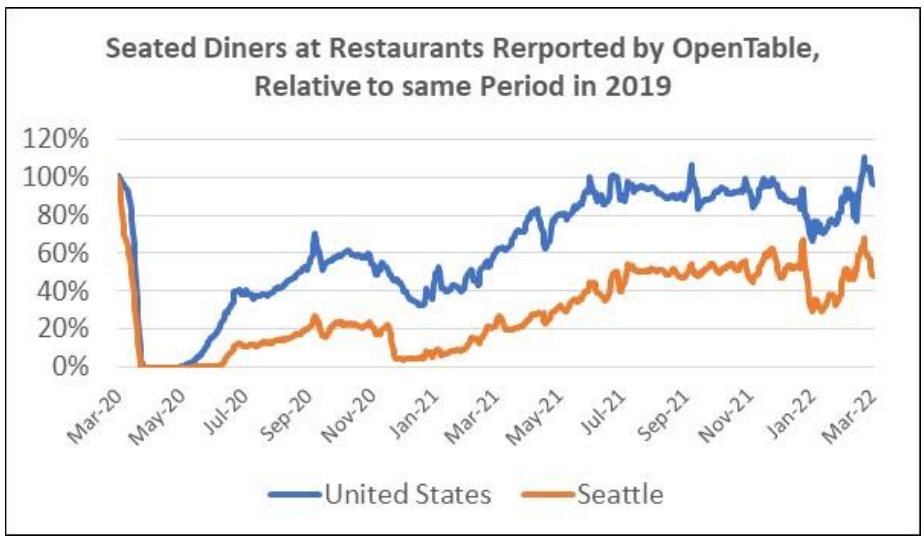
To provide some additional context for the revenue results presented in this report, this final section provides an overview of recent economic developments, with a specific focus on how conditions have evolved since October and November, when the most recent forecast was developed. At high level, the economic news since last fall has been consistent with the trends we saw emerging early in the third quarter of 2021. The overall recovery has been strong in both the national and local economies, with employment, income, and spending growth slightly outpacing forecasts at both levels. This is reflected in the data that show economically dependent revenue streams, such as Retail Sales and Business and Occupation tax performing somewhat above our November forecast. As highlighted in the graph below, while initially lagging behind the nation in terms of recovering the jobs lost during the initial stages of COVID, Seattle has now almost "caught up" the rest of the nation. Overall employment is still below the levels seen before the pandemic began, but the local are now matches the nation with overall employment reaching roughly 98% of pre-pandemic levels. This graphic also provides an opportunity to see how the current jobs recovery compares to the period after the Great Recession that began with 2007 financial crisis. To date, the recovery from the pandemic has been much more rapid, although the initial job losses were also much steeper.

Comparing Employment Changes Relative to 2019 at both the National and Local Level

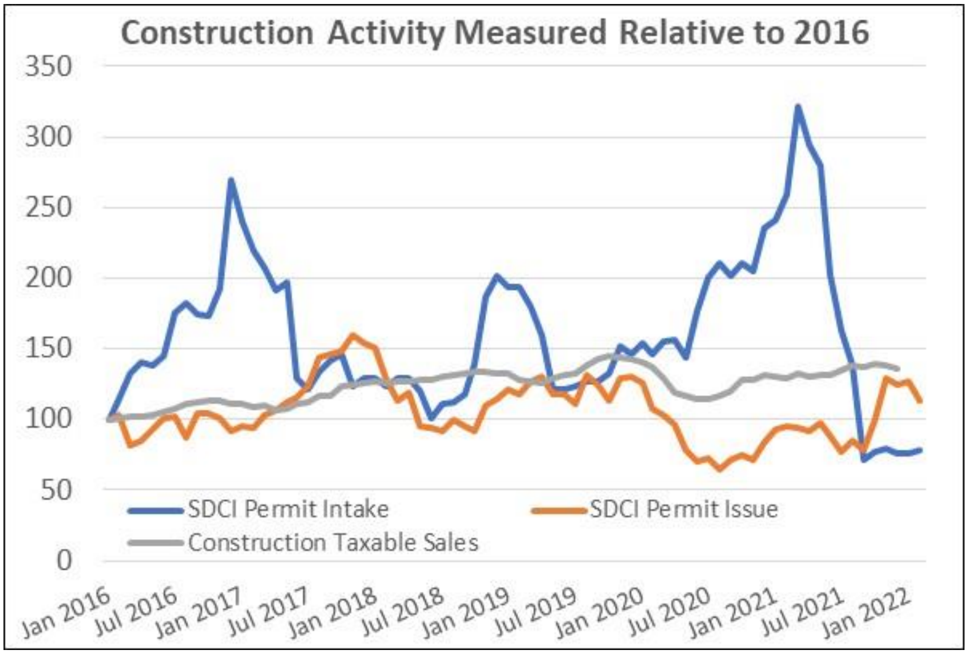


That said, the pandemic continues to have a disproportionate impact on some sectors, and those differential impacts persisted in late 2021 as the Omicron variant created further pain in the Leisure & Hospitality sector. As shown here, data tracking both restaurant and hotel activity reveal that the recovery which had continued through the middle of the year fell back as first Delta and then Omicron led to increased social-distancing measures. This is entirely consistent with the 2021 revenue data from these sectors, which showed that both the Sales and B&O tax revenues generated in this sector lag behind the levels seen in 2019.

Employment recovery in this sector also lags the broader local economy, although at this stage that appears to reflect both reduced demand for employees, and a shortage of workers interested in joining or rejoining the Leisure & Hospitality sector. With masking and social-distancing regulations now being eased or ended, further recovery in the sector is anticipated, but may be constrained in the near-term by worker shortages.



Locally, construction is another sector that has seen some negative impacts from COVID, and for which the future remains notably uncertain. In recent years, Seattle has experienced a high rate of development, with significant investment in both commercial office space and residential construction. Much of this construction had occurred in or near the city center. The shift to "work from home" and hybrid work arrangements has the potential to reduce the demand for office space and shift some share of the demand for housing toward less central locations. Such changes could have significant impacts on City revenues because construction activity has become an important component for both Retail Sales and B&O tax revenues. As shown in the chart below, data from the second half of 2021 foreshadow the changes that may be in the offing. This chart overlays permit data from the Seattle Department of Construction and Inspections (SDCI) and taxable sales from the construction sector. January 2016 levels are taken as a base, and we have measured changes relative to that point.



We can see that during the initial phases of the pandemic there was decline in both the permits issued by SDCI and the associated taxable activity. Both have recovered somewhat since then, and several large multifamily residential projects just recently had their permits issued by SDCI. This explains the upturn in the value of issued permits that occurred in late 2021. However, after holding steady initially, permit *intake* has seen a precipitous decline since September of last year. Permit intake is generally a leading indicator of future construction activity, so obviously this relatively new information raises questions about whether recent levels of construction activity will be maintained into the future.

Beyond the sectoral issues in hospitality and construction, growing inflation represents the other most significant economic development since last fall. When social distancing restrictions were first imposed, lower consumer demand initially put significant downward pressure on prices. Since then, supply chain disruptions in combination with the re-opening economy and the demand induced by fiscal stimulus has caused inflation to spike sharply, reaching levels last seen four decades ago. Last fall, the early consensus among forecasters was that the inflation spike would be short-lived. However, inflation pressures have persisted, with the rate of increase continuing to grow. Last fall, IHIS Markit, the national forecast that we use an input for our modeling, had predicted in the baseline forecast that 2022 inflation, as measured by the CPI-U, would be 3%. Their most recent forecast anticipates that prices will increase at more than twice that rate (6.2%) for 2022.

Inflation has thus emerged as one of the main risks to near-term economic growth. While IHS Markets project that inflation will remain elevated in 2022, their modeling does anticipate that as supply-chain issues are addressed, labor force participation continues to recover, and the Fed increases interest rate more aggressively, inflation will gradually moderate and not be sustained at the currently elevated rates into 2023. That said, Russia's war against Ukraine has now put strong upward pressure on energy prices and threatens to further disrupt supply chains. These developments and other factors will be incorporated into the upcoming economic and revenue forecasts that will be delivered to the Forecast Council on April 8th of this year.