

# BUDGET SUGGESTIONS

For 2012



# **Budget Suggestions For 2012**

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# Introduction

Here is your copy of *Budget Suggestions for 2012*. As always, we try to provide you with timely information, within the constraints we face in getting information from the state.

In this publication you will find:

- Descriptions and interpretations of 2011 legislation that may affect your budget.
- Inflation and state-shared revenue forecasts, including a look ahead to 2012.
- An article on the role and responsibility of bond counsel by David O. Thompson of K&L Gates.
- An article on county road levy shifts and diversions.
- An article from the State Auditor's Office on reporting of funds by cash-basis local governments.
- An article on the "public safety" sales and use tax under RCW 82.14.450 and how to estimate potential revenues.
- An article on the taxes that must be paid on league and entry fees.
- An article on Initiative 1183, the passage of which would privatize the state liquor system.

Judy Cox, our Public Finance Consultant, is the author of much of the material in this publication. We also have included contributions from the people noted above, and we thank them for their assistance. Holly Stewart designed and produced the document. Joe Levan, Carol Tobin, Connie Elliot, Peter Breen, Erica Zwick, and Bob Meinig, wrote, proofed, or edited parts of the document. We hope this material will assist you as you go through the budget process and into 2012.

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# Budget Calendar for Preparation of 2012 Budgets

## in First (Under 300,000), Second, and Fourth Class Municipalities and Code Cities

Budget requirements for first (under 300,000) and second class municipalities, and towns are listed in chapter 35.33 RCW, as amended, and for cities under the Optional Municipal Code in chapter 35A.33 RCW, as amended. Chapter 35.32A RCW contains the budget law for cities over 300,000 population (Seattle).

Chapters 35.34 RCW and 35A.34 contain the provisions for a biennial budget. Thus far only a few cities are using the two-year budget process. Please see last page of budget calendar.

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2011 Date
1. Request by clerk to all department heads and those in charge of municipal offices to prepare detailed estimates of revenues and expenditures for next fiscal year (calendar year).	By second Monday in September. <sup>1, 2</sup>	September 12
2. Estimates are to be filed with the clerk.	By fourth Monday in September. <sup>2</sup>	September 26
3. Estimates are presented to the chief administrative officer (CAO) for modifications, revisions or additions. Clerk must submit to CAO proposed preliminary budget setting forth the complete financial program, showing expenditures requested by each department and sources of revenue by which each such program is proposed to be financed.	On or before the first business day in the third month prior to beginning of the fiscal year.	October 3

<sup>1</sup>RCW 35.33.031 actually provides "on **or before** the second Monday of the fourth month," etc. Therefore, pursuant to the state budget law, that step (and certain others) could be taken before the dates listed here. See also, RCW 35A.33.030.

<sup>2</sup>Or at such other time as the city or town may provide by ordinance or charter (RCW 35.33.031 and .051 and 35A.33.030 and .050).

**Budget Suggestions for 2012**

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2011 Date
4. CAO provides the legislative body with current information on estimates of revenues from all sources as adopted in the budget for the current year. CAO also provides the legislative body with the clerk's proposed preliminary budget setting forth the complete financial program, showing expenditures requested by each department and sources of revenue by which each such program is proposed to be financed.	No later than the first Monday in October.	October 3
5. The legislative body must hold a public hearing on revenue sources for the coming year's budget, including consideration of possible increases in property tax revenues. (Chapter 251, Laws of 1995, codified as RCW 84.55.120.)	Before legislative body votes on property tax levy. Deadlines for levy setting are in item 8 below.	
6. CAO prepares preliminary budget and budget message <sup>3</sup> and files with the city legislative body and city clerk.	At least 60 days before the ensuing fiscal year.	November 2
7. Clerk publishes notice that preliminary budget has been filed and publishes notice of public hearing on final budget once a week for two consecutive weeks.	No later than the first two weeks in November.	November 2 through November 15
8. Setting property tax levies	November 30 for <i>all</i> cities and towns.	
9. The legislative body, or a committee thereof, must schedule hearings on the budget or parts of the budget and may require the presence of department heads.	Prior to the final hearing.	November 2 through 30 (suggested)
10. Copies of proposed (preliminary) budget made available to the public.	No later than six weeks before January 1.	November 18

<sup>3</sup>RCW 35.33.031 and RCW 35A.33.055 specify that the budget message must contain the following:

1. An explanation of the budget document;
2. An outline of the recommended financial policies and programs of the city for the ensuing fiscal year;
3. A statement of the relation of the recommended appropriation to such policies and programs;
4. A statement of the reason for salient changes from the previous year in appropriation and revenue items;
5. An explanation for any recommended major changes in financial policy.

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2011 Date
11. Final hearing on proposed budget.	On or before first Monday of December, and may be continued from day-to-day but no later than the 25th day prior to next fiscal year (December 7).	December 5
12. Adoption of budget for 2012.	Following the public hearing and prior to beginning of the ensuing fiscal year.	Day of your public hearing through December 31.
13. Copies of final budget to be transmitted to the State Auditor's Office and to MRSC.		After adoption

## Biennial Budgets

All cities and towns that wish to begin budgeting on a biennial basis must pass an ordinance to that effect six months prior to the beginning of the fiscal year. The first year of a biennial budget must be an odd-numbered year. **The next year in which you can start a biennial budget will be 2013. If you are planning to do a biennial budget for 2013-2014, remember that you must pass your ordinance by June 30, 2012.** Next year's issue of *Budget Suggestions* will not come out until late July, so a reminder will not do much good then.

The calendar for the initial preparation of a biennial budget is almost identical to that of an annual budget with some obvious differences, such as the substitution of "biennium" for "year." RCW 35.34.130 and RCW 35A.34.130 require that an ordinance be passed providing for a mid-biennial review and modification of the biennial budget. This must occur no sooner than eight months after the start (September 1, 2011) nor later than the end of the first year of the biennium (December 31, 2011). Notice and hearings are required as outlined in RCW 35.34.130 or RCW 35A.34.130. A complete copy of the budget modification, as adopted by ordinance, must be sent to MRSC and the State Auditor's Office.

## Share Your Information Resources Through MRSC

In addition to the copies of the final budget you send to the State Auditor, please send copies to MRSC at:

**Municipal Research and Services Center of Washington**  
2601 Fourth Ave, Suite 800 • Seattle, WA 98121-1280

We would also like other documents of general application to share with other cities and towns. The list of things we would like includes: ordinances; forms (tax, business license, job application, etc.); policies and procedures manuals (if you don't have a complete manual, but you do have bits and pieces, send those); job descriptions; interlocal agreements; examples of requests for proposals for anything; contracts; franchise agreements. In short, just about everything that is needed to run a city or town.

# Budget Calendar for Preparation of 2012 Budgets

## for Non-Charter Counties

The annual budget time-line requirements for non-charter counties in Washington are found in Chapter 36.40 RCW. According to RCW 36.40.071, the board of commissioners may set alternative dates for entire process to conform with the alternative preliminary budget hearing date.

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2011 Date
1. Call for Estimates. County Auditor notifies all officials to file budget requests and projected revenues for ensuing fiscal year. RCW 36.40.010.	On or before the second Monday in July	July 11
2. Filing of estimates with auditor or chief financial officer by all officials. RCW 36.40.010 and 36.40.030.	On or before the second Monday in August	August 8
3. Preliminary county budget prepared by auditor or chief financial officer submitted to board of commissioners. RCW 36.40.040 and 36.40.050.	On or before the first Tuesday in September	September 6
4. Preliminary budget hearing by board of commissioners. RCW 36.40.070.	First Monday in October	October 3
5. Alternative preliminary budget hearing by board of commissioners. RCW 36.40.071.	First Monday in December	December 5
6. Final budget adoption by board of commissioners. RCW 36.40.080.	Upon conclusion of budget hearing	Practically, December 31

### Biennial Budgets (RCW 36.40.250)

Counties can start a biennial budget in any year. They are not limited to an odd-numbered year as cities are. And, their biennial budget statute gives no indication of when the ordinance or resolution providing for a biennial budget must be passed. From a practical standpoint, it probably needs to be done during the first half of the year so that departments can prepare the estimates that are due to the auditor in August.

# 2011 Legislation That May Affect Your Budget

## **New Uses for Real Estate Excise Tax Revenues (HB 1953, Ch. 354, Laws of 2011)**

The 2011 legislature expanded, for a limited period of time, the uses of the real estate excise tax, both the first quarter percent (REET 1) under RCW 82.46.010 and the second quarter percent (REET 2) under RCW 82.46.035.<sup>1</sup> Cities and counties may now, with some restrictions, use REET 1 and REET 2 for operations and maintenance (O&M) of existing capital projects. Counties may use REET 2 funds for debt service on existing projects that are listed in RCW 82.46.010. This new authority expires on December 31, 2016.

### **New Uses**

Cities and counties may use REET 1 funds for operations and maintenance of existing capital projects as listed under RCW 82.46.010(6). These projects are:

streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks; recreational facilities; law enforcement facilities; fire protection facilities; trails; libraries; administrative and/or judicial facilities;

Cities and counties may use REET 2 funds for operations and maintenance of existing capital projects as listed in RCW 82.46.035(5). They are:

streets, roads, highways, sidewalks, street and road lighting systems, traffic signals, bridges, municipally owned heavy rail short line railroads, domestic water systems, storm and sanitary sewer systems, and planning, construction, reconstruction, repair, rehabilitation, or improvement of parks; and © “short line railroads” means class III railroads as defined by the United States surface transportation board. [Note that “short line railroads” are eligible for expenditure of funds only until June 30, 2012.]

Counties only may use REET 2 revenues for payment of existing debt service on capital projects listed in RCW 82.46.010(6). See the list above.

### **Limits on Expenditures**

The maximum amount of REET 1 that may be spent on O&M is the greater of \$100,000 or 35 percent of the available funds, not to exceed \$1 million. The maximum amount of REET 2 that may be spent on O&M is also the greater of \$100,000 or 35 percent of the available funds, not to

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<sup>1</sup>For information on other uses of REET funds, see *A Revenue Guide for Washington Cities and Towns* (Municipal Research and Services Center: Seattle, 2009), pp. 26-29, [http://www.mrsc.org/Publications/rg\\_city\\_2009.pdf](http://www.mrsc.org/Publications/rg_city_2009.pdf) and *A Revenue Guide for Washington Counties* (Municipal Research and Services Center: Seattle, 2010) pp. 35-38. <http://www.mrsc.org/Publications/countyrg10.pdf>

exceed \$1 million. For counties that use REET 2 monies for payment of debt service, the total they can spend on debt service and on O&M together is the greater of \$100,000 or 35 percent of the available funds, not to exceed \$1 million.

Here are some examples: 1) If your available funds of REET 1 (and/or REET 2) are \$200,000, 35 percent of that amount is \$70,000. You may, however, choose to use \$100,000 on O&M. In fact, for any amount of funds up to \$285,217, \$100,000 will always be a greater amount than the 35 percent amount.

2) If your available funds of REET 1 (and/or REET 2) are, say, \$700,000, you may choose to spend \$245,000 (.35 times \$700,000) on O&M.

3) With available REET 1 and/or REET 2 funds of \$2,857,143, you may choose to spend \$1,000,000 on O&M. Thirty-five percent of \$2,857,143 is \$1,000,000, so you have hit the upper limit. Even if you have REET 1 and/or REET 2 funds of more than \$2,857,143, you cannot spend more than \$1,000,000.

This legislation takes effect on July 22, 2011 and sunsets on December 31, 2016.

### **Rules on Supplanting for the Mental Health Sales Tax Changed (SSB 5722, Ch. 347, Laws of 2011)**

Under prior law, a portion of the sales tax receipts collected under RCW 82.14.460 was allowed to supplant existing funding in certain amounts that decreased from 50 percent in calendar year 2010 to zero in 2015.

With the passage of ch. 347, Laws of 2011, new, more generous, limits are put into effect. For cities with a population of more than 30,000 and counties with a population of more than 25,000, the new rules are as follows:

- Up to 50 percent of the funds may be used to supplant existing funding in calendar years 2011 and 2012;
- Up to 40 percent for calendar year 2013;
- Up to 30 percent in calendar year 2014;
- Up to 20 percent in calendar year 2015; and
- Up to 10 percent in calendar year 2016.

For counties with a population of less than 25,000, the allowed percentages for supplanting the mental health sales tax are:

- Up to 80 percent for calendar year 2011 and 2012;
- Up to 60 percent for calendar year 2013;
- Up to 40 percent for calendar year 2014;
- Up to 20 percent for calendar year 2015; and
- Up to 10 percent in calendar year 2016.

Spending on the costs of a judicial officer and support staff of a therapeutic court is not subject to any of the supplanting restrictions.

## **Some State Land Use Mandates Deferred; Deadline for Spending Impact Fees Extended (ESHB 1478, Ch. 353, Laws of 2011)**

As AWC has noted in the “Bill At a Glance” section of its May 2011 Fact Sheet, *2011 City/County Fiscal Relief Legislation Summary – ESHB 1478*

(<http://www.awcnet.org/Portals/0/Documents/Legislative/CityCountyFiscalReliefLegSummary0511.pdf>), this bill provides for a number of delays and extensions for certain mandatory requirements.

- Suspends pavement preservation rating reports until 2013-2015 biennium.
- Effective date of new Phase II Municipal Stormwater Permits delayed until August 1, 2013.
- Delays conversion of vehicle fleets to alternative fuels from 2015 to 2018.
- Delays rule-making on reclaimed water use.
- Extends GMA and SMA update cycles from seven years to eight years.
- Allows impact fees to be held for ten years rather than six.

Currently, cities and counties that do not spend or encumber their impact fees on growth-related capital projects within six years of their collection must refund the fees. Section 9 of this bill extends this deadline to 10 years. The new deadline applies to both impact fees collected in the future and those that cities and counties are currently holding from prior collections.

This law becomes effective July 22, 2011.

## **Delegation of Authority for Final Terms of Bond Sales (EHB 1730, Ch. 210, Laws of 2011)**

A bill that might have been missed by many, but one of great importance to municipal bond professionals, is EHB 1730.

In order to get the best borrowing terms (pricing, for example), local governments (cities, counties, and special districts) that are authorized to issue bonds must have the ability to be “nimble” and to act quickly. However, the local government legislative bodies that must approve the terms on which the bonds are issued usually meet once a week at most. The most propitious time to set the terms of the bond sale might turn out to be another day or another time during the same day. Even the ability to call a special meeting is often no help because of the amount of notice that must be given.

This bill allows these local governments to designate certain officials to whom the responsibility of approving the final terms of the bond sale is delegated.

Subsection 2(1) of the bill states that the bond ordinance or resolution must state the parameters within which these officials must work. These parameters are:

The amount, date or dates, denominations, interest rate or rates (or mechanism for determining interest rate or rates), payment dates, final maturity, redemption rights, price, minimum savings for refunding bonds (if the refunding bonds are issued for savings purposes), and any other terms and conditions deemed appropriate by the legislative body of the local government. A county designating a representative in accordance with this

subsection must act in a manner that is consistent with the approved county debt policy adopted in accordance with RCW 36.48.070.

## **Expanded Authority for Joint Utility Operations (ESHB 1332, Ch. 258, Laws of 2011)<sup>2</sup>**

May 5, 2011 – Governor Chris Gregoire recently signed ESHB 1332, a new law that will significantly boost the ability of Washington municipalities to provide water, wastewater, storm and flood water services on a joint basis.

The ESHB 1332 authorizes a new type of intergovernmental municipal corporation known as a “joint municipal utility services authority.” An authority can be created by existing local government utilities to provide either wholesale or retail services on a cooperative basis. The most likely users in the near term will be cities, counties and special purpose districts that desire to provide joint wholesale services to their existing utilities – services such as water supply sources or wastewater services. In the longer term, some local governments likely will form joint authorities to provide more cost-efficient retail services to customers. However, cities may be hesitant to completely transfer retail utility service to joint authorities if it adversely affects their ability to collect utility taxes.

ESHB 1332 allows municipal utilities to execute “formation agreements” that determine the services, the basic governance structure, the framework for capital planning, budgeting, rates, borrowing, asset transfer, and many other features of the entity they create. In other words, the participating governments can write their own “charter” for the new intergovernmental municipal corporation. ESHB 1332 also allows those governments to pick which personnel, public works, eminent domain and surplus property laws will govern the new entity; they are permitted to pick from among the laws that apply to any of the members. However, the new joint authority statute does not add any substantive powers beyond those that may already be exercised by the utility members.

A joint utility authority will have substantial advantages over the joint boards or nonprofit corporations that have been formed in the past under the Interlocal Cooperation Act (Chapter 39.34 RCW). Existing joint boards do not have clear legal authority to own property, to hire employees, or to enter into contracts. Governmentally-created nonprofit corporations frequently encounter uncertainty, among those with whom they contract, as to whether they are “private” or “public.” (They are public instrumentalities, but some are puzzled about how an organization created under the statute for private nonprofit corporations is actually a public entity.) A joint authority created under ESHB 1332 is clearly designated as a municipal corporation, so there should be no confusion that it is a true governmental entity. There should also be no more confusion about whether and which public works, procurement, surplus property and eminent domain laws apply. Finally, the ESHB 1332 specifies that payments and asset transfers among governmental members of a joint authority are exempt from taxation. Property owned by a joint authority will automatically be exempt from property tax because such an authority is clearly designated as a municipal corporation.

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<sup>2</sup>Reprinted, with permission, from the Web site of Foster Pepper PLLC. [www.foster.com](http://www.foster.com)

ESHB 1332 will be a convenient tool and provide a significant opportunity for efficient services and cost savings for local government utilities and their ratepayers.

ESHB 1332 was developed by a committee comprised of representatives of more than 40 state and local entities and several local government associations. ESHB 1332 was drafted primarily by Hugh Spitzer of Foster Pepper PLLC. The process was encouraged by the State Departments of Ecology and Health, which are interested in encouraging efficiencies through interlocal cooperation in the utility field.

### **Allocation of General Fund Revenues to Ambulance Utilities (SHB 1596, Ch. 139, Laws of 2011)**

Legislation was passed in 2005 in response to the Washington State Supreme Court ruling in *Arborwood, Idaho, L.L.C. v. City of Kennewick*, 151 Wn. 2d 359 (2004) that found the charges that cities were using to fund their ambulance utilities were taxes rather than fees. One of the requirements of the legislation was that 70 percent of the total costs of the utility, as of May 5, 2004, had to be funded by general fund money.

This bill repeals that requirement and gives cities more budget flexibility in their general fund. Before cities can reduce their general fund allocation, however, they must hold a public hearing with 30 days notice being given in the ratepayers bills. At that hearing they must present the most recent cost of service study for the utility, a summary of current utility revenue sources, a budget for the utility with the reduced allocation, and any proposed changes in utility rates and/or level of service.

### **State-shared Revenue Allocations Reduced in Operating Budget (2ESHB 1087, Ch. 50, Laws of 2011, 1st sp. sess.)**

Several sections of the state's 2011-2013 operating budget reduce state-shared revenue allocations to cities and counties by 3.4 percent per year for the 2011-2013 biennium. Revenue allocations that are decreased include:

Section 960. Liquor revolving fund (Liquor board profits)

Section 969. Liquor excise tax

Sections 970-972. Criminal justice revenues under RCW 82.14.310, RCW 82.14.320, and RCW 82.14.330

Section 974. Streamlined sales tax mitigation

Section 975. City-county assistance account

In some cases the amendment to the statute explicitly states that the decrease is 3.4 percent. For example, section 970 amends RCW 82.14.310 by adding the following language:

During the 2011-2013 fiscal biennium, the amount that would otherwise be transferred into the county criminal justice assistance account from the general fund under subsection (1) of this section must be reduced by 3.4 percent.

For the decrease in liquor excise taxes, one has to do some math. Section 969 states, in part:

During the 2011-2013 fiscal biennium, 66.19 percent of the sums collected and remitted under RCW 82.08.150 (1) and (2) must be deposited in the state general fund and the remainder collected and remitted under RCW 82.08.150 (1) and (2) must be deposited in the liquor excise tax fund.

Prior to the passage of the legislation, the split was 65 percent to the state general fund and 35 percent to cities and counties from the liquor excise tax fund. To do the math for the change in the city and county allocation: if 66.19 percent is now going to the state, that leaves 33.81 percent for the cities and counties ( $100 - 66.19 = 33.81$ ). The decrease from 35 percent to 33.81 percent is 1.19 percent. Dividing 1.19 by 35, we get 3.4 percent.

All the state-shared revenue calendar year forecasts in this publication include these decreases for half the year in calendar years 2011 and 2013 and for a full year in calendar year 2012.

### **Two Bills Affect Pensions (SHB 2021, Ch. 362, Laws of 2011; HB 2070, Ch. 5, Laws of 2011, 1st sp. sess.)**

SHB 2021 eliminates the Uniform COLA that some retirees receive, which will save money for state and local governments. It also increases certain minimum pensions, which will offset the savings from the elimination of the COLA by a small amount. In addition, the bill lowers the minimum amount that employers must pay for the unfunded liability of PERS 1 from 5.25 percent to 3.5 percent. This also saves money for the state and local governments.

Although there is a table on page 6 of the fiscal note for the bill <https://fortress.wa.gov/binaryDisplay.aspx?package=29529>, showing the percentage decrease in pension rates that the State Actuary estimated for the fiscal note, more recent information on pension contribution rates should be showing up soon on this website. [http://osa.leg.wa.gov/Actuarial\\_Services/Funding/contr\\_rate\\_warning.htm](http://osa.leg.wa.gov/Actuarial_Services/Funding/contr_rate_warning.htm).

AWC, in its *Final Legislative Bulletin* and presentations on the outcome of the legislative session, warns that it expects PERS 1 retirees to bring suit over the elimination of the COLA so do not count on these budget savings quite yet.

HB 2070 is a bill that provides some protections for employees' pensions. Pensions for state and local government workers, that are based on salaries earned during the 2011-2013 biennium, will not be reduced because of reduced work hours, mandatory leave without pay, temporary layoffs, or pay reductions that are part of the governmental unit's expenditure reduction efforts.

### **Public Hospital Districts May Now Solicit and Accept Gifts (SB 5116, Ch. 37, Laws of 2011)**

Public hospital districts (PHDs) will be pleased to know that, with the passage of SB 5116, they have explicit statutory authorization to engage in certain activities related to raising money and charitable contributions. SB 5116, effective July 22, 2011, amended RCW 70.44.060 to expressly

allow PHDs to, among other activities, solicit and accept gifts of personal and/or real property; sell, invest, or expend the proceeds from the gifts; and enter into contracts with for-profit or nonprofit organizations for these purposes, including, but not limited to, contracts for the use of the PHD's facilities, property, personnel, or services. Under RCW 70.44.060 before it was amended, PHDs did not have express authority to engage in such activities. Over the past several years, the State Auditor's Office (SAO) raised the issue with PHDs and urged them to pursue legislation to provide such express authority which, with the passage of SB 5116, has now been granted.

**Leasing the Warehousing and Distribution of Liquor (ESSB 5942, Ch. 45, Laws of 2011, 1st sp. sess.)**

Within 120 days of June 15, 2011, the Office of Financial Management (OFM) must conduct a nonbinding competitive bidding process to select a private sector firm to lease the warehousing and distribution functions of the state's liquor operations. The retailing operation would not be affected. The proposals must demonstrate a "positive financial benefit to the state, local government, and interested stakeholders" and meet a number of other requirements. A one-time, upfront payment during the 2011-2013 biennium is required. If no proposals meet the criteria set out, OFM must inform the Liquor Control Board that none are satisfactory.

# Inflation Forecast

## Consumer Price Index

The Consumer Price Index (CPI) is a measure of the change in prices paid over time for a fixed “market basket” of goods and services. The Consumer Price Index for All Urban Consumers (CPI-U) measures the percentage change in prices faced by urban consumers and covers approximately 87 percent of the population. The Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) is sometimes referred to as the “blue collar measure.” It is a subset of the CPI-U. Its market basket reflects the expenditures of urban households that derive more than half their income from clerical and hourly wage jobs. It covers approximately 32 percent of the population.

Data for each of these indices for the United States as a whole are compiled on a monthly basis. The results are available during the third week of the following month. Each of these indices is published for the Portland-Salem area (formerly called the Portland-Vancouver index) twice a year. The results for the first half of the year are available during the third week of August. The second half figures are published in the third week of February. At the beginning of 1998, the Seattle-Tacoma index was renamed the Seattle-Tacoma-Bremerton index and expanded to include Island, Kitsap, and Thurston counties. It is compiled six times a year, in the even-numbered months. The results are published in the middle of the following month.

The Bureau of Labor Statistics recommends the use of one of the national indices for all contracts. Not only are the Seattle-Tacoma-Bremerton and Portland-Salem versions published less frequently, they also are based on a smaller sample and are, therefore, more volatile and subject to measurement error. None of these indices measures price changes in rural areas. But realizing that towns in rural areas need some indicator to use, we recommend one of the U.S. indices. Always write your contracts so that you will be adjusting on the basis of actual CPI figures. Never use estimates for contract adjustments.

A link to the most recent releases can be found at <http://www.bls.gov/ro9/currentpc.pdf>. Questions may be directed to [BLSinfoSF@BLS.GOV](mailto:BLSinfoSF@BLS.GOV) or (415) 625-2270.

Table 1 on the following pages gives monthly historical information on the U.S. CPI-U and CPI-W, bimonthly data for Seattle, semiannual data for Seattle and Portland, and annual averages. The graphs on page 14 give historical information on the annual average CPI-U and CPI-W for the U.S., Seattle, and Portland, as well as some forecasts for 2011 and 2012.

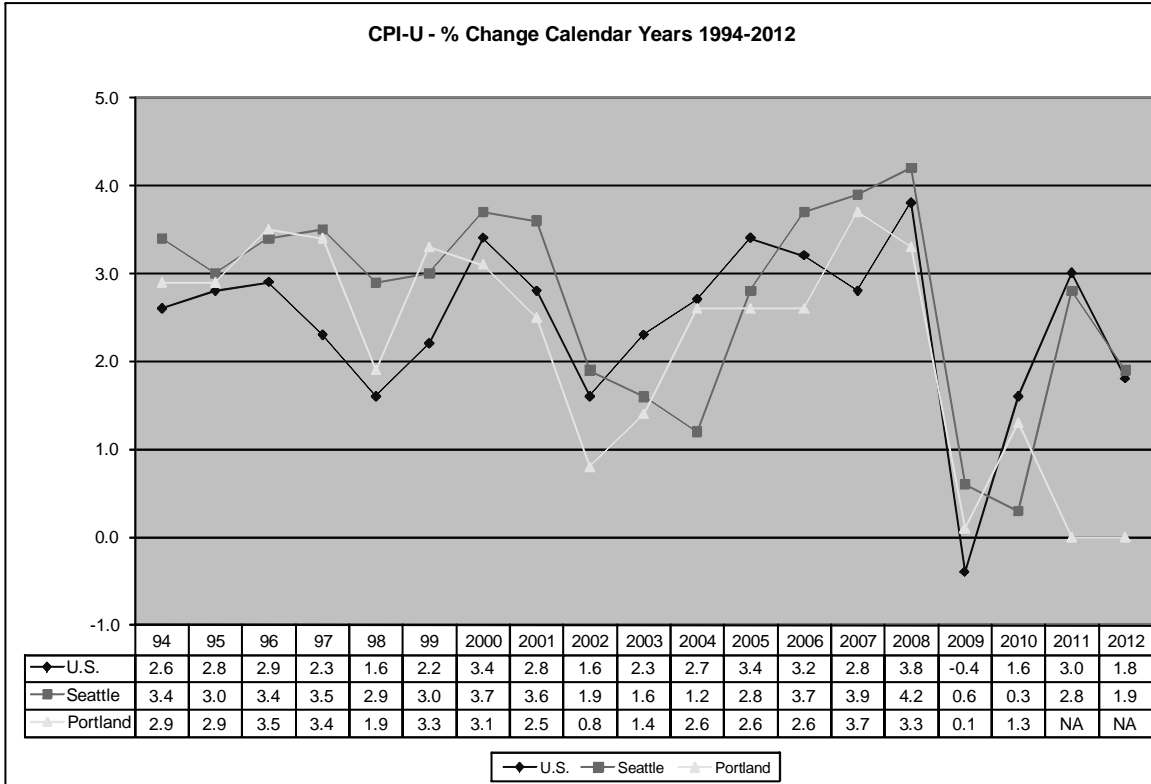
We have forecasts for the national inflation rates from the Research Seminar in Quantitative Economics at the University of Michigan, Global Insight, the Livingston Survey from the Federal Reserve Bank of Philadelphia, and the Washington State Economic and Revenue Forecast Council. The Forecast Council uses the Global Insight estimate and the estimate of the Blue Chip consensus forecast for its forecast of the national CPI and we have used that as a guide. For the Seattle-Tacoma area, we depend on the Forecast Council and local economists. We are unable to get forecasts for the Portland area.

The National Bureau of Economic Research says the recession was officially over in June 2009. However, we seem to be in a “soft patch,” to use a term heard often in economic reporting these days. We are experiencing some economic growth, but it is mainly the result of increased productivity in some sectors of the economy, not increased hiring. National unemployment as of June is 9.2 percent, just 9/10 of a percent down from its peak at 10.1 percent. Based on the experience of past recessions, we would expect more of a drop in the unemployment rate and more of an increase in incomes than we are seeing two years after the recession’s official end.

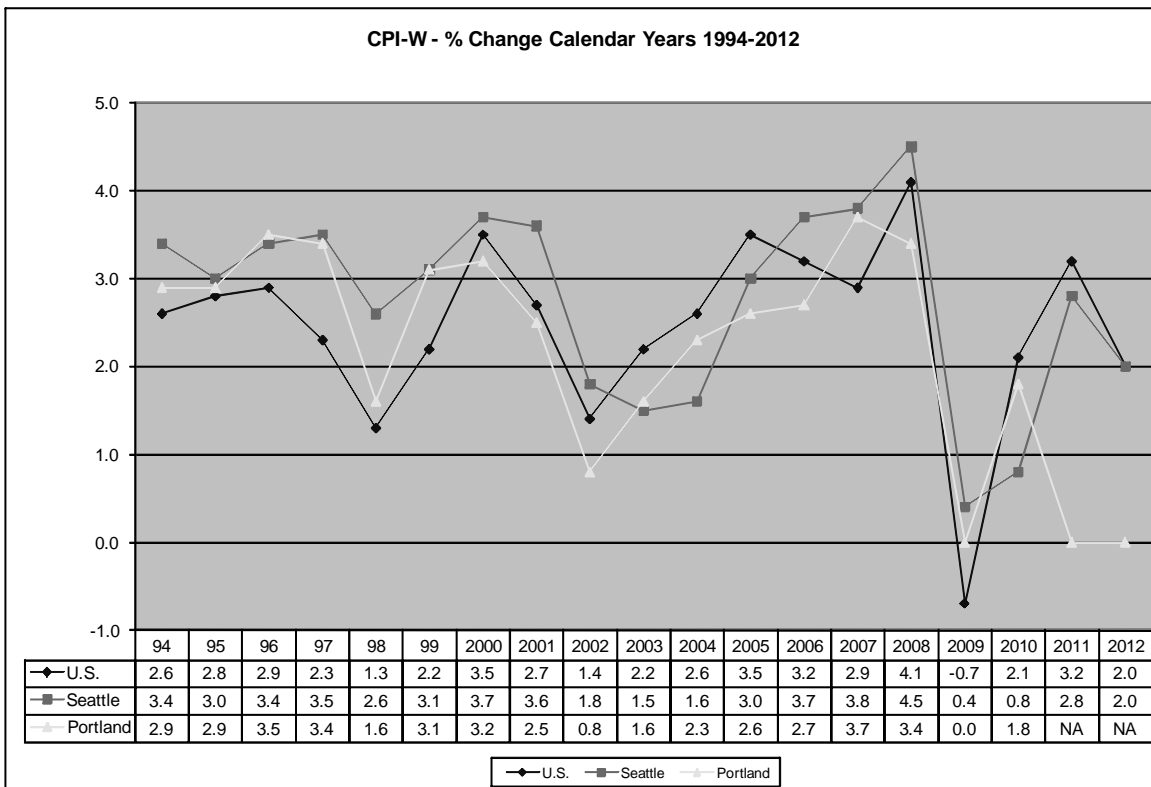
An article by Peter Coy in *Bloomberg Businessweek* describes the situation as an “economic coordination” failure. “Companies won’t hire because customers won’t spend. Customers won’t spend because companies won’t hire.” Those consumers who do have jobs are seeing slow wage and income growth. When adjusted for inflation, personal incomes have been not been growing – they have been essentially flat since the beginning of the year. Add in concerns about debt – both their own personal debt and the U.S. debt – and there is another reason for consumers not spending.

Since wages are holding steady because of high unemployment, there is not much worry about “cost-push” inflation. With consumers holding back on spending, we should not see “demand-pull” inflation. And yet, if you check the last page of Table 1 on page 17, you will see that inflation rates jumped in the last few months. For example, the U.S. CPI-U growth rate was 1.6 percent in January, 2.7 percent in March, and 3.6 percent in May and June. The Seattle CPI-U growth rate went from 1.5 percent in February to 3.2 percent in June. These increases are mainly due to the higher prices for gasoline and other energy products as result of the crisis in the Middle East, particularly in Libya.

With energy prices beginning to fall somewhat, we expect lower inflation rates during the rest of 2011 and in 2012 as shown in graphs and tables on page 14.



Figures for 2011-2012 are estimates.



Figures for 2011-2012 are estimates.

**Table 1**  
**Consumer Price Index**  
2000 to Present

Year	Month	All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
		Seattle	Portland	U.S.	Seattle	Portland	U.S.
2000	January			168.8 (2.7%)			165.6 (2.9%)
	February	176.1 (3.2)		169.8 (3.2)	171.6 (3.4)		166.5 (3.4)
	March			171.2 (3.8)			167.9 (4.0)
	April	177.7 (3.2)		171.3 (3.0)	173.3 (3.2)		168.0 (3.3)
	May			171.5 (3.2)			168.2 (3.3)
	June	179.2 (3.8)		172.4 (3.7)	174.5 (3.9)		169.2 (3.9)
	First half '00	177.3 (3.3)	176.4 (3.3)		172.8 (3.5)	171.8 (3.4)	
	July			172.8 (3.7)			169.4 (3.9)
	August	180.3 (4.0)		172.8 (3.4)	175.4 (3.9)		169.3 (3.4)
	September			173.7 (3.5)			170.4 (3.5)
	October	182.1 (4.2)		174.0 (3.4)	177.5 (4.3)		170.6 (3.4)
	November			174.1 (3.4)			170.9 (3.5)
	December	181.5 (4.1)		174.0 (3.4)	177.0 (4.1)		170.7 (3.4)
	Second half '00	181.1 (4.1)	179.5 (2.9)		176.4 (4.1)	174.6 (2.9)	
ANNUAL AVE.	179.2 (3.7)	178.0 (3.1)	172.2 (3.4)	174.6 (3.7)	173.2 (3.2)	168.9 (3.5)	
2001	January			175.1 (3.7%)			171.7 (3.7%)
	February	184.0 (4.5)		175.8 (3.5)	179.2 (4.4)		172.4 (3.5)
	March			176.2 (2.9)			172.6 (2.8)
	April	184.2 (3.6)		176.9 (3.3)	179.4 (3.5)		173.5 (3.3)
	May			177.7 (3.6)			174.4 (3.7)
	June	186.3 (4.0)		178.0 (3.2)	181.3 (3.9)		174.6 (3.2)
	First half '01	184.4 (4.0)	181.2 (2.7)		179.6 (3.9)	176.4 (2.7)	
	July			177.5 (2.7)			173.8 (2.6)
	August	186.8 (3.6)		177.5 (2.7)	181.5 (3.5)		173.8 (2.7)
	September			178.3 (2.6)			174.8 (2.6)
	October	187.9 (3.2)		177.7 (2.1)	183.1 (3.2)		174.0 (2.0)
	November			177.4 (1.9)			173.7 (1.6)
	December	186.1 (2.5)		176.7 (1.6)	181.1 (2.3)		172.9 (1.3)
	Second half '01	186.9 (3.2)	183.6 (2.3)		181.9 (3.1)	178.5 (2.2)	
ANNUAL AVE.	185.7 (3.6)	182.4 (2.5)	177.1 (2.8)	180.8 (3.6)	177.5 (2.5)	173.5 (2.7)	
2002	January			177.1 (1.1%)			173.2 (0.9%)
	February	187.6 (2.0)		177.8 (1.1)	182.5 (1.8)		173.7 (0.8)
	March			178.8 (1.5)			174.7 (1.2)
	April	188.8 (2.5)		179.8 (1.6)	183.6 (2.3)		175.8 (1.3)
	May			179.8 (1.2)			175.8 (0.8)
	June	189.4 (1.7)		179.9 (1.1)	184.1 (1.5)		175.9 (0.7)
	First half '02	188.3 (2.1)	183.5 (1.3)		183.1 (1.9)	178.7 (1.3)	
	July			180.1 (1.5)			176.1 (1.3)
	August	190.3 (1.9)		180.7 (1.8)	184.8 (1.8)		176.6 (1.6)
	September			181.0 (1.5)			177.0 (1.3)
	October	190.9 (1.6)		181.3 (2.0)	185.5 (1.3)		177.3 (1.9)
	November			181.3 (2.2)			177.4 (2.1)
	December	190.0 (2.1)		180.9 (2.4)	184.6 (1.9)		177.0 (2.4)
	Second half '02	190.3 (1.8)	184.0 (0.2)		184.9 (1.6)	179.3 (0.4)	
ANNUAL AVE.	189.3 (1.9)	183.8 (0.8)	179.9 (1.6)	184.0 (1.8)	179.0 (0.8)	175.9 (1.4)	
2003	January			181.7 (2.6%)			177.7 (2.6%)
	February	191.3 (2.0)		183.1 (3.0)	186.2 (2.0)		179.2 (3.2)
	March			184.2 (3.0)			180.3 (3.2)
	April	192.3 (1.9)		183.8 (2.2)	187.0 (1.9)		179.8 (2.3)
	May			183.5 (2.1)			179.4 (2.0)
	June	191.7 (1.2)		183.7 (2.1)	185.7 (0.9)		179.6 (2.1)
	First half '03	191.6 (1.8)	186.0 (1.4)		186.2 (1.7)	181.7 (1.7)	
	July			183.9 (2.1)			179.6 (2.0)
	August	194.4 (2.2)		184.6 (2.2)	188.2 (1.8)		180.3 (2.1)

## Budget Suggestions for 2012

Year	Month	All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
		Seattle	Portland	U.S.	Seattle	Portland	U.S.
	September			185.2 (2.3)			181.0 (2.3)
	October	193.7 (1.5)		185.0 (2.0)	187.8 (1.2)		180.7 (1.9)
	November			184.5 (1.8)			180.2 (1.6)
	December	191.0 (0.5)		184.3 (1.9)	185.3 (0.4)		179.9 (1.6)
	Second half '03	193.1 (1.5)	186.5 (1.4)		187.1 (1.2)	182.0 (1.5)	
	ANNUAL AVE.	192.3 (1.6)	186.3 (1.4)	184.0 (2.3)	186.7 (1.5)	181.8 (1.6)	179.8 (2.2)
2004	January			185.2 (1.9%)			180.9 (1.8%)
	February	193.5 (1.2)		186.2 (1.7)	187.8 (0.9)		181.9 (1.5)
	March			187.4 (1.7)			182.9 (1.4)
	April	194.3 (1.0)		188.0 (2.3)	189.1 (1.1)		183.5 (2.1)
	May			189.1 (3.1)			184.7 (3.0)
	June	195.3 (1.9)		189.7 (3.3)	190.4 (2.5)		185.3 (3.2)
	First half '04	194.0 (1.3)	189.8 (2.0)		188.7 (1.3)	184.9 (1.8)	
	July			189.4 (3.0)			184.9 (3.0)
	August	194.6 (0.1)		189.5 (2.7)	189.6 (0.7)		185.0 (2.6)
	September			189.9 (2.5)			185.4 (2.4)
	October	196.5 (1.4)		190.9 (3.2)	191.6 (2.0)		186.5 (3.2)
	November			191.0 (3.5)			186.8 (3.7)
	December	195.1 (2.1)		190.3 (3.3)	190.3 (2.7)		186.0 (3.4)
	Second half '04	195.4 (1.2)	192.5 (3.2)		190.5 (1.8)	187.0 (2.7)	
	ANNUAL AVE.	194.7 (1.2)	191.1 (2.6)	188.9 (2.7)	189.6 (1.6)	185.9 (2.3)	184.5 (2.6)
2005	January			190.7 (3.0%)			186.3 (3.0%)
	February	197.6 (2.1)		191.8 (3.0)	192.4 (2.4)		187.3 (3.0)
	March			193.3 (3.1)			188.6 (3.1)
	April	201.3 (3.6)		194.6 (3.5)	196.2 (3.8)		190.2 (3.7)
	May			194.4 (2.8)			190.0 (2.9)
	June	199.8 (2.3)		194.5 (2.5)	194.8 (2.3)		190.1 (2.6)
	First half '05	199.2 (2.7)	194.5 (2.5)		194.1 (2.9)	189.4 (2.4)	
	July			195.4 (3.2)			191.0 (3.3)
	August	199.9 (2.7)		196.4 (3.6)	195.3 (3.0)		192.1 (3.8)
	September			198.8 (4.7)			195.0 (5.2)
	October	203.3 (3.5)		199.2 (4.3)	198.6 (3.7)		195.2 (4.7)
	November			197.6 (3.5)			193.4 (3.5)
	December	200.9 (3.0)		196.8 (3.4)	196.1 (3.0)		192.5 (3.5)
	Second half '05	201.3 (3.0)	197.5 (2.6)		196.5 (3.1)	192.2 (2.8)	
	ANNUAL AVE.	200.2 (2.8)	196.0 (2.6)	195.3 (3.4)	195.3 (3.0)	190.8 (2.6)	191.0 (3.5)
2006	January			198.3 (4.0%)			194.0 (4.1%)
	February	203.6 (3.0)		198.7 (3.6)	198.0 (2.9)		194.2 (3.7)
	March			199.8 (3.4)			195.3 (3.6)
	April	207.4 (3.0)		201.5 (3.5)	202.5 (3.2)		197.2 (3.7)
	May			202.5 (4.2)			198.2 (4.3)
	June	208.2 (4.2)		202.9 (4.3)	203.8 (4.6)		198.6 (4.5)
	First half '06	205.8 (3.3)	199.8 (2.7)		200.8 (3.5)	194.7 (2.8)	
	July			203.5 (4.1)			199.2 (4.3)
	August	209.6 (4.9)		203.9 (3.8)	205.1 (5.0)		199.6 (3.9)
	September			202.9 (2.1)			198.4 (1.7)
	October	209.8 (3.2)		201.8 (1.3)	203.9 (2.7)		197.0 (0.9)
	November			201.5 (2.0)			196.8 (1.8)
	December	209.3 (4.2)		201.8 (2.5)	204.3 (4.2)		197.2 (2.4)
	Second half '06	209.5 (4.1)	202.5 (2.5)		204.4 (4.0)	197.3 (2.7)	
	ANNUAL AVE.	207.6 (3.7)	201.1 (2.6)	201.6 (3.2)	202.6 (3.7)	196.0 (2.7)	197.1 (3.2)
2007	January			202.416 (2.1%)			197.559 (1.8%)
	February	211.704 (4.0)		203.499 (2.4)	205.746 (3.9)		198.544 (2.2)
	March			205.352 (2.8)			200.612 (2.7)
	April	215.767 (4.0)		206.686 (2.6)	210.388 (3.9)		202.130 (2.5)
	May			207.949 (2.7)			203.661 (2.8)
	June	215.510 (3.5)		208.352 (2.7)	210.550 (3.3)		203.906 (2.7)
	First half '07	213.810 (3.9)	206.653 (3.4)		208.373 (3.8)	201.217 (2.8)	
	July			208.299 (2.4)			203.700 (2.3)
	August	215.978 (3.0)		207.917 (2.0)	210.220 (2.5)		203.199 (1.8)

		All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
Year	Month	Seattle	Portland	U.S.	Seattle	Portland	U.S.
	September			208.490 (2.8)			203.889 (2.8)
	October	218.427 (4.1)		208.936 (3.5)	213.107 (4.5)		204.338 (3.7)
	November			210.177 (4.3)			205.891 (4.6)
	December	218.966 (4.6)		210.036 (4.1)	214.024 (4.8)		205.777 (4.3)
	Second half '07	217.502 (3.8)	210.460 (3.9)	208.976 (3.1)	212.160 (3.8)	204.801 (3.8)	204.466 (3.3)
	ANNUAL AVE.	215.656 (3.9)	208.556 (3.7)	207.342 (2.8)	210.266 (3.8)	203.009 (3.6)	202.767 (2.9)
2008	January			211.080 (4.3%)			206.744 (4.6%)
	February	221.728 (4.7)		211.693 (4.0)	216.332 (5.1)		207.254 (4.4)
	March			213.528 (4.0)			209.147 (4.3)
	April	223.196 (3.4)		214.823 (3.9)	218.483 (3.8)		210.698 (4.2)
	May			216.632 (4.2)			212.788 (4.5)
	June	228.068 (5.8)		218.815 (5.0)	223.573 (6.2)		215.223 (5.6)
	First half '08	223.569 (4.6)	214.619 (3.9)	214.429 (4.2)	218.664 (4.9)	209.456 (4.1)	210.309 (4.6)
	July			219.964 (5.6)			216.304 (6.2)
	August	227.745 (5.4)		219.086 (5.4)	223.273 (6.2)		215.247 (5.9)
	September			218.783 (4.9)			214.935 (5.4)
	October	225.915 (3.4)		216.573 (3.7)	220.687 (3.6)		212.182 (3.8)
	November			212.425 (1.1)			207.296 (0.7)
	December	222.580 (1.7)		210.228 (0.1)	216.424 (1.1)		204.813 (-0.5)
	Second half '08	225.869 (3.8)	216.159 (2.7)	216.177 (3.4)	220.721 (4.0)	210.557 (2.8)	211.796 (3.6)
	ANNUAL AVE.	224.719 (4.2)	215.389 (3.3)	215.303 (3.8)	219.692 (4.5)	210.006 (3.4)	211.053 (4.1)
2009	January			211.143 (0.0%)			205.700 (-0.5%)
	February	224.737 (1.4)		212.193 (0.2)	218.752 (1.1)		206.708 (-0.3)
	March			212.709 (-0.4)			207.218 (-0.9)
	April	225.918 (1.2)		213.240 (-0.7)	220.208 (0.8)		207.925 (-1.3)
	May			213.856 (-1.3)			208.774 (-1.9)
	June	227.257 (-0.4)		215.693 (-1.4)	221.993 (-0.7)		210.972 (-2.0)
	First half '09	225.580 (0.9)	214.102 (-0.2)	213.139 (-0.6)	219.853 (0.5)	207.898 (-0.7)	207.883 (-1.2)
	July			215.351 (-2.1)			210.526 (-2.7)
	August	227.138 (-0.3)		215.834 (-1.5)	221.873 (-0.6)		211.156 (-1.9)
	September			215.969 (-1.3)			211.322 (-1.7)
	October	226.277 (0.2)		216.177 (-0.2)	221.339 (0.3)		211.549 (-0.3)
	November			216.330 (1.8)			212.003 (2.3)
	December	225.596 (1.4)		215.949 (2.7)	220.905 (2.1)		211.703 (3.4)
	Second half '09	226.475 (0.3)	217.191 (0.5)	215.935 (-0.1)	221.463 (0.3)	211.950 (0.7)	211.377 (-0.2)
	ANNUAL AVE.	226.028 (0.6)	215.647 (0.1)	214.537 (-0.4)	220.658 (0.4)	209.924 (0.0)	209.630 (-0.7)
2010	January			216.687 (2.6%)			212.568 (3.3%)
	February	226.085 (0.6)		216.741 (2.1)	221.215 (1.1)		212.544 (2.8)
	March			217.631 (2.3)			213.525 (3.0)
	April	226.513 (0.3)		218.009 (2.2)	222.309 (1.0)		213.958 (2.9)
	May			218.178 (2.0)			214.124 (2.6)
	June	226.118 (-0.5)		217.965 (1.1)	221.857 (-0.1)		213.839 (1.4)
	First half '10	226.195 (0.3)	217.508 (1.6)	217.535 (2.1)	221.714 (0.8)	213.036 (2.5)	213.426 (2.7)
	July			218.011 (1.2)			213.898 (1.6)
	August	227.645 (0.2)		218.312 (1.1)	223.444 (0.7)		214.205 (1.4)
	September			218.439 (1.1)			214.306 (1.4)
	October	227.251 (0.4)		218.711 (1.2)	223.112 (0.8)		214.623 (1.5)
	November			218.803 (1.1)			214.750 (1.3)
	December	226.862 (0.6)		219.179 (1.5)	222.853 (0.9)		215.262 (1.7)
	Second half '10	227.190 (0.3)	219.179 (0.9)	218.576 (1.2)	223.053 (0.7)	214.409 (1.2)	214.507 (1.5)
	ANNUAL AVE.	226.693 (0.3)	218.344 (1.3)	218.056 (1.6)	222.384 (0.8)	213.722 (1.8)	213.967 (2.1)
2011	January			220.223 (1.6%)			216.400 (1.8%)
	February	229.482 (1.5)		221.309 (2.1)	225.790 (2.1)		217.535 (2.3)
	March			223.467 (2.7)			220.024 (3.0)
	April	231.314 (2.1)		224.906 (3.2)	228.313 (2.7)		221.743 (3.6)
	May			225.964 (3.6)			222.954 (4.1)
	June	233.250 (3.2)		225.722 (3.6)	230.072 (3.7)		222.522 (4.1)

## Implicit Price Deflator for Personal Consumption Expenditures

Monthly Index and Cumulative Percentage Change from July 2010 - Base Year 2005

	Jul 10	Aug	Sep	Oct	Nov	Dec	Jan 11	Feb	Mar	Apr	May
<b>Orig. Index</b>	110.959	111.135	111.205	111.429	111.507	111.789	112.179	112.633	113.108	113.483	113.677
<b>Cum. % Change</b>		0.159	0.222	0.424	0.494	0.748	1.100	1.509	1.937	2.275	2.450
<b>IPD % Proj.</b>		1.903	1.330	1.694	1.482	1.795	2.199	2.586	2.905	3.033	2.939
<b>Prev. 12 Mo. % Change</b>		1.351	1.276	1.201	1.048	1.135	1.234	1.604	1.872	2.240	2.504

**Source:** Survey of Current Business, Table B.1 - The Disposition of Personal Income, and/or BEA news releases.

The top row represents the preliminary and revised implicit price deflator indices for personal consumption expenditures (IPD) published by the Bureau of Economic Analysis (BEA). (Every month from August to May, the BEA goes back and revises the data for the last three to six months.) The second row represents the cumulative percentage change in the preliminary or revised index from July of 2010. The third row represents the projections of the annual IPD since July of 2010 when using the methodology of dividing the cumulative percentage change since July by the number of months since July and then multiplying the dividend by 12 to obtain an annual estimate. The fourth row represents the actual percentage change over the last 12 months.

### BEA Revisions and Our Forecast

Every June, the BEA does an annual revision of the data for the last three years. This means that the 12-month change in the July index – the one that sets the “inflation rate” for property tax increases – may be quite a bit different from the rate we have been seeing so far this year. It all depends on how much they “tweak” the data.

As you can see in the above table, our “forecasts” range from an increase of 2.450 percent to 2.939 percent. The final number will probably be somewhere in that range. ***It will certainly be above one percent.***

We will publish the annual inflation factor in our Focus section of the MRSC Web site as soon as we can get the information from the BEA sometime in mid-September.

In the meantime, you can track the progress of the IPD on our Web site at <http://www.mrsc.org/Subjects/Finance/ipdcht.aspx>

# Revenue Forecasts

## Population Forecast

The official April 1, 2011 **city** population to be used for distributions in 2012 is 4,313,267. This is 2.8 percent more than the population estimate for April 1, 2010. Almost half of this increase was a result of the 2010 census population being higher than the OFM April 1, 2010 estimate. One percentage point of the growth came from annexations, with the rest coming from secular growth and military adjustments. Each year, we adjust the April 1 numbers upward for annexations that we know were completed after the April 1, 2011 estimates were made or that are in the pipeline for later this year. Cities that annex qualify for state-shared revenue distributions on their new population base, starting the first day of the quarter after the effective date of the annexation.

The June 1, 2011 annexation in Kirkland (31,000) is not in the 2011 population number given above. Including it provides an adjusted population number of 4,344,267 for 2011. We also know of some possible annexation votes coming up in late 2011 or early 2012. If successful, they may have effective dates in the latter part of 2012 or early 2013. We will include these in our population forecast for 2013 state-shared revenues on page 31.

The official April 1, 2011 **county** population is 2,454,633. This is a decrease of almost one percent from 2010. We have used this number, unadjusted, in making the county forecasts for liquor board profits and the liquor excise tax.

## Motor Vehicle Fuel Taxes

*Editor's Note: Fanny N. Roberts, the Transportation Economist for the Financial Planning and Economic Analysis Division of the Department of Transportation, provided the forecasts for the tables.*

City and county gasoline and diesel fuel tax receipts for 2010 were almost exactly on the mark with the forecast in *Budget Suggestions for 2011*. The revised forecast for 2011 is also almost identical to the one made a year ago. In calendar year 2012, motor vehicle fuel tax revenue is expected to increase by less than one percent. Gasoline and diesel fuel prices are expected to increase by 4.7 and 4.2 percent, respectively. Countering the negative effect of these higher prices on the growth of fuel sales will be the positive effect of an estimated 2.7 percent growth in personal income. A reminder: fuel taxes in Washington are assessed as cents per gallon, so fuel tax revenue depends on the number of gallons sold, not the dollar value of the sales.

The **county** distribution formula includes annual road costs and "need" in addition to population. The county estimates, based on these factors, are done by the County Road Administration Board (CRAB). The county allocation percentages for 2012 will be released after the board meets in late July. We will provide this information on our Focus page at [www.mrsc.org](http://www.mrsc.org) when it is available. Counties will also be notified directly by CRAB.

The **city** forecasts for total dollars and per capita amounts are in Tables 3 and 4.

## Liquor Revenues

*Editor's Note: Our liquor revenue forecasts come from the Washington State Liquor Control Board.*

The price for liquor in the state of Washington is comprised of several components. The main component is the standard cost of goods sold, which includes the cost from the manufacturers and the delivery price of the alcohol. Taxes are then applied to the cost, as well as a mark-up for Liquor Control Board costs and surcharges imposed by the Liquor Control Board. The taxes are distributed according to RCW 82.08.150, and surcharges are distributed according to Liquor Control Board policy.

Two items in the 2011-2013 state operating budget affect both liquor board profits and liquor excise tax distributions to cities and counties. First, the state has decreased the shares of these revenues being distributed to cities and counties, while increasing the state share. Second, over the course of the biennium, \$645,000 is being deducted from city liquor profits and county liquor excise taxes to fund the Local Government Fiscal Note (LGFN) program.

**Liquor Board Profits.** Liquor board profits are the difference between the revenue from alcohol sales and the expenditures of the Liquor Control Board. The Liquor Control Board forecasts these profits through their Revenue Forecast Model that provides information to the Washington State Legislature and Economic Revenue Forecast Council.

The 2010 actual net distribution of Liquor Board profits to cities and counties increased by 17.4 percent (\$6.6 million) compared to 2009. In the 2009 legislative session, the legislature voted to increase the markup on liquor sales and some of this money was appropriated for cities and counties in the 2009-2011 biennium. This increase was implemented in August of 2009 and is the major factor contributing to the increase in profits.

Cities and counties will share in a projected \$4.5 million decrease in profits in 2011 and a \$3.0 million decrease in 2012. In part this is because the total revenue stream from the increased markup is earmarked for the General Fund beginning in July, 2011 per 2ESHB 1087. The 2011 legislature also changed the percentages of liquor profits distribution to 51.7 percent for the General Fund and 48.3 percent for cities and counties, as opposed to the current 50/50 split. This change will reduce the profit distributions to cities and counties by 1.7 percent of what they otherwise would be in calendar years 2011 and 2013 and by 3.4 percent for calendar year 2012. The deduction from the cities' share of profits for the LGFN program is approximately \$533,000 for the biennium, or one percent of city liquor profit revenues.

**Liquor taxes.** Liquor taxes distributed in 2010 increased 3.6 percent (\$901,000) compared to 2009. Liquor sales are continuing the slight positive trend in 2011 and 2012. The increased markup will continue to be in effect through at least the 2011-13 biennium. The 2011 legislature also changed the split on liquor excise taxes for the 2011-2013 biennium. It was 65 percent to the state and 35 percent to cities and counties. It will now be 66.19 percent and 33.81 percent, respectively. This will reduce city and county revenues from what they otherwise would be by 1.7 percent in calendar year 2011 and 2013 and 3.4 percent in calendar year 2012. The deduction from the counties' share of liquor excise taxes for the LGFN program is approximately \$111,000 for the biennium, or one percent of county liquor tax revenues.

City forecasts are shown in Tables 3 and 4, county forecasts in Tables 5 and 6.

## City-County Assistance

### **Background**

ESSB 6050, ch. 450, Laws of 2005, established the city-county assistance account in RCW 43.08.290, which until July 1, 2011 received 1.6 percent of the state real estate excise tax. For the 2011-2013 biennium, the percentage amount will fall to 1.546 percent (a 3.4 percent drop) because the state operating budget reduced the amounts of state-shared revenues, of which this is one, transferred to cities and counties. This account provides funding for assistance for certain cities and counties according to the formulas set out below. These jurisdictions lost funding when the motor vehicle excise tax (MVET) was repealed in 2000.

**Counties.** Counties with an unincorporated population of more than 100,000, qualify to receive the amount necessary to increase the sum of the revenues received under RCW 82.14.030(1) (the first half-cent of the sales and use tax) and streamlined sales tax mitigation funds received to the greater of: 1) \$250,000 (to be increased each year by the increase in the July implicit price deflator for personal consumption expenditures); or 2) an amount equal to 65 percent of the state-wide per capita average collected from the first half-cent of the sales and use tax with respect to taxable activity in the unincorporated areas of all counties in the previous fiscal year.

Counties with an unincorporated population of less than 100,000 qualify to receive the amount necessary to increase the sum of the revenues received under RCW 82.14.030(1) (the first half-cent of the sales and use tax) and streamlined sales tax mitigation funds received to the greater of: 1) \$250,000 (to be increased each year by the increase in the July implicit price deflator for personal consumption expenditures); or 2) an amount equal to 70 percent of the state-wide per capita average received from the first half-cent of the sales and use tax with respect to taxable activity in the unincorporated areas of all counties in the previous fiscal year.

In counties with an unincorporated population of 15,000 or less, the county will be certified for the greater of: 1) the amount under the terms in the paragraph above for counties with a population under 100,000; or 2) the amount the county received in “backfill” for FY 2005 under section 716, ch. 276, Laws of 2004 (amended state budget).

If there are not enough revenues to fund the distributions above, then they will each be reduced proportionately. If there are more revenues than necessary to fund the above distributions, they shall be distributed proportionately on the basis of the unincorporated population among those counties that have qualified for city-county assistance funding and impose the full second half cent of the sales and use tax under RCW 82.14.030(2).

**Cities.** The formula used to allocate city funding is based on a sales tax and property tax equalization formula, and the 2005 MVET backfill levels. The sales tax and property tax equalization components of the formula are similar to the former sales tax equalization program that was funded with MVET.

Cities with a population of 5,000 or less qualify to receive distributions equal to the greater of: 1) 55 percent sales tax equalization on the sum of the first half-cent of the sales and use tax received under RCW 82.14.030(1) and streamlined sales tax mitigation funds for the previous fiscal year; 2) 55 percent property tax equalization based on per capita assessed values per \$1,000 assessed value; or 3) their 2005 MVET backfill allocation. However, cities with twice the statewide per capita assessed value are not eligible for funding.

Cities with populations over 5,000 qualify to receive distributions equal to the greater of: 1) 50 percent sales tax equalization on the sum of the first half-cent of the sales and use tax received under RCW 82.14.030(1) and streamlined sales tax mitigation funds for the previous fiscal year; or 2) 55 percent property tax equalization based on per capita assessed values per \$1,000 assessed value. These cities do not qualify for funding if their assessed value per capita is above the statewide average (compared to twice the statewide average for smaller cities).

Distributions for all cities are capped at \$100,000, to be increased each year by the increase in the July implicit price deflator for personal consumption expenditures. (The 2011 cap is \$113,925.) And, new cities that incorporate after August 1, 2005 are not eligible for funding.

If there are not enough revenues to fund the distributions above, then they will each be reduced proportionately. If there are more revenues than necessary to fund the above distributions, they are to be distributed proportionately on the basis of population among those cities that have qualified for city-county assistance and impose the full second half cent of the sales and use tax under RCW 82.14.030(2).

**Certification and distribution dates.** Using the factors for cities and counties described above, the Department of Revenue (DOR) must certify the amounts to be distributed each year by October 1, with preliminary estimates available by September 1.

Funds are distributed quarterly on January 1, April 1, July 1, and October 1. In order for the funds to be distributed on those dates, the transfers must be made in the previous month. The cash payments, therefore, come in December of the year in which the certification is made, then in March, June, and September of the coming year. This means that, for budgeting purposes, cities and counties are dealing with two different certification years. Here is how it works.

When you pass your budget for 2012 this coming November or December, you will know the amount for which you are certified for 2012, but the first payment from that certification will arrive this December and is part of the current year's (2011) budget receipts. The amount you budget for 2012 will depend on your estimates of how much you will receive in March, June, and September 2012 based on your October 1, 2011 certification, plus your "guesstimate" of what you will receive in December 2012, which will depend on the certification that is made next year on October 1, 2012. The following table shows the various payments and their timing.

<b>City-County Assistance Distributions</b>			
	<b>Statutory Date for Distribution</b>	<b>Actual Payment Date</b>	<b>Certification Date</b>
<b>2011 Budget</b>			
Payment 1	April 1, 2011	Late March 2011	October 1, 2010
Payment 2	July 1, 2011	Late June 2011	October 1, 2010
Payment 3	October 1, 2011	Late September 2011	October 1, 2010
Payment 4	January 1, 2012	Late December 2011	October 1, 2011
<b>2012 Budget</b>			
Payment 1	April 1, 2012	Late March 2012	October 1, 2011
Payment 2	July 1, 2012	Late June 2012	October 1, 2011
Payment 3	October 1, 2012	Late September 2012	October 1, 2011
Payment 4	January 1, 2013	Late December 2012	October 1, 2012

Table 2

### **Forecasts**

After two good years for city-county assistance receipts in 2006 and 2007, revenues decreased in 2008 as the housing market took a beating. State real estate excise taxes, the funding source, fell and cities and counties each received \$5.06 million compared to \$7.6 million the year before – a decrease of a third. This was enough to fully fund the counties at the amounts for which they were certified, but cities received only 65 percent of their certification amounts.

In 2009, receipts of real estate excise tax receipts fell to \$3.04 million, another big decrease – this time, 40 percent. Luckily, section 805 of the 2009-2011 operating budget contained a transfer from the Public Works Assistance Account of \$2.5 million to both cities and counties on July 1 of 2009 and 2010, to be paid out in the September/October distribution. With the total distributions in 2009 to both cities and counties of \$5.54 million, counties were fully funded while cities received 67 percent of their 2009 certified amounts – just about what we had forecast.

For 2010, the operating transfers of \$2.5 million to both cities and counties from the Public Works Assistance Account bailed cities and counties out again. Receipts from the real estate excise tax were relatively steady at \$3.15 million for both cities and counties and, adding in the \$2.5 million transfers, they each received \$5.65 million. Counties were more than fully funded because their certification amount was \$3.90 million. Cities received 66.3 percent of the amount for which they were certified. We had forecast that they would get 70 percent.

**2011 Update.** The total certification amounts for cities for **2011** is \$ 6.59 million. For counties, the amount is \$4.13 million. Of this amount, both cities and counties have already received \$1.39 million in the first two payments (made at the end of March and June) for 2011. According to the June 2011 forecast of real estate excise tax receipts, cities and counties are each currently

expected to receive \$0.87 million from the real estate excise tax in the October distribution, which is paid out in September. The bad news is that there are no \$2.5 million transfers this year to enhance the city and county pots of money. Hmm. \$1.39 million plus \$0.87 million equals \$2.26 million. Not very close to either the city or county certification amounts. How much can you expect to come in the door in December 2011 from the January 2012 distribution?

For this information, cities and counties need to check out the web page <http://dor.wa.gov/content/doingbusiness/6050distributions.aspx>. Click on “2011 City and County Distributions.” These spreadsheets show the amounts for which each city and county (note the “county” tab at the bottom) is certified in 2011 (look at the column in pale green, titled “ESSB 6050 Amount”). They also show how much each city and county has received so far in the first two distributions for the 2011 budget (the “April 2011 Distribution” received in March and the “July 2011 Distribution” received in June) and the amount they are expected to receive in the October distribution (to be received in September). Pay no attention to the last column titled “Total.” For revising your 2011 revenue estimates, this is a meaningless number, since the cash from the “January 2011 Distribution” has already been counted as part of your actual revenues for 2010.

The last cash payment for calendar year 2011 will come in December and it will be the “January 2012 Distribution” from the new certification for 2012 that will be made by October 1, 2011, with preliminary estimates available sometime in September.<sup>1</sup> It will be posted at this same website, <http://dor.wa.gov/content/doingbusiness/6050distributions.aspx> and will be titled “2012 Recertification and Quarterly Distribution Estimates” or something close to that. (Yes, this information on “timing” is confusing. Maybe it is time to take another look at Table 2 above, which shows the timing of the payments and the statutory distributions.) Right now, the folks at the Economic and Revenue Forecast Council are estimating that the January 2012 distribution (December 2011 payment) will be an estimated \$0.79 million for cities and the same amount for counties. That would make the total for the four payments for the 2011 budget year \$3.05 million. Therefore, we are forecasting that cities will get approximately 46 percent (3.05/6.59) of their certification amounts for 2011 and counties will receive 74 percent (3.05/4.13).

**2012.** When the preliminary certification for 2012 is posted on this website, <http://dor.wa.gov/content/doingbusiness/6050distributions.aspx>, sometime in the latter part of September cities and counties both need to check it. (Note, as mentioned above, this spreadsheet should be titled “2012 Recertification and Quarterly Distribution Estimates,” maybe with the word “preliminary” included.) Neither cities nor counties will get the total amount for which they are certified. Currently the estimate of the real estate excise tax revenue to be distributed next year to both cities and counties is \$4.04 million. You can calculate what your entity’s percentage share will be by taking the amount in the “ESSB 6050 Amount” column for your entity and dividing it by the city or county total at the bottom of the column. Multiply that “share” by \$4.04 million to get

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<sup>1</sup>RCW 43.08.290(6)(d) states, in part:

By September 1, 2010, and September 1 of every year thereafter, the department of revenue must make available a preliminary certification of the amounts to be distributed under this section...

What the drafter of the legislation did not realize is that the July implicit price deflator for personal consumption expenditures is not published in the *Survey of Current Business* from the Bureau of Economic Analysis until the September issue, which is posted on their website sometime during the third week of September. Therefore the “preliminary” certification is not available on September 1.

your estimated dollar amount for 2012. This methodology assumes that your share of the last payment in 2012 (which will come from the October 1, 2012 certification for 2013) will be the same percentage amount as the first three payments and this probably a pretty good assumption for most entities.

If you cannot wait until the release of the preliminary certification in September to make your budget estimate, then take your percentage share of the **2011** certification and multiply it by the estimated pot of city or county revenue for 2011, \$4.04 million. For many entities, that will be a pretty good estimate.

## Criminal Justice Revenues

With the repeal of the motor vehicle excise tax, the only money that **cities** receive by statute comes from language that says that beginning July 1, 1999, a transfer would be made from the general fund to both city accounts under RCW 82.14.320 and RCW 82.14.330. Each transfer was appropriated originally at \$4.6 million, to be increased each July by “the fiscal growth factor” in RCW 43.135.025, which is the average growth in state personal income for the prior ten fiscal years. By 2010, the distributions had grown to over \$6.5 million. For the 2011-2013 fiscal years, this distribution will be reduced by 3.4 percent because this is another of the state-shared revenues for which the transfer to cities and counties was reduced in the state operating budget.

Seventy percent of the revenue distributed under RCW 82.14.330 is handed out on a purely per capita basis. RCW 82.14.330(1)(b) distributes 16 percent of the pot on a per capita basis, with each city receiving a minimum of \$1,000, no matter how small their population. RCW 82.14.330(2) was amended in 2003 to delete the language that allocated certain percentages to innovative law enforcement programs, domestic violence prevention programs, and child abuse prevention programs, with the requirement that the cities send in funding requests for each program to CTED. The funds for these three areas, totaling 54 percent of the pot, are now distributed by the Office of the State Treasurer on a strictly per capita basis. There is a requirement that these funds be spent on some combination of innovative law enforcement programs, domestic violence prevention programs, and child abuse prevention programs, but no requirement of how much must be spent in each area. All the money can be spent in one area if a city wishes. In Tables 3 and 4, we identify the 16 percent distribution as “Criminal Justice -- Population,” which is what the treasurer’s office calls it. The 54 percent distribution is labeled “Criminal Justice Special Programs.”

Ten percent of the revenues go to cities that contract for law enforcement services.

The remaining funds under RCW 82.14.330 and all the revenues under RCW 82.14.320 are handed out partially based on crime rates and we cannot forecast them. The cities that may qualify for these funds know who they are and are aware of the problems they have in estimating these revenues.

In spite of the passage of Initiative 695, **counties** are continuing to receive some state-shared criminal justice funding from the state general fund under the provisions of RCW 82.14.310. The initial appropriation, made for the state fiscal year 2000, was \$23.2 million and grew to \$32.8 million in 2010. It is increased every July by “the fiscal growth factor, which is the average growth in state personal income for the prior ten fiscal years. The county funding formula includes population, the

crime rate of the county, and the annual number of criminal cases filed in superior court. Because revenues are not handed out on a strictly per capita basis, MRSC can provide no forecasts. We do know, however, that for the 2011-2013 fiscal years, this distribution will be reduced by 3.4 percent because this is another of the state-shared revenues for which the transfer to cities and counties was reduced in the state operating budget.

## **Fire Insurance Premium Tax**

The state collects a two percent tax on the premiums of all insurance policies written. Twenty-five percent of the tax collected on fire policies and the **fire component** of homeowner's and commercial multi-peril policies, are distributed to cities and fire districts that have firemen's pension funds. Premiums attributed to losses from such things as burglaries, tornadoes, floods, etc., are not shared with cities. For the homeowner s and commercial multi-peril policies, actual data is collected on the loss experience due to fire as a percent of total losses. These percentages are then applied to the total premium taxes collected from these policies to get the taxes attributed to the fire component.

For the distribution in 2011 as shown in Table 7, the number of paid firefighters was two percent less than we forecast. This was the primary reason why the "ratio value" (the total premium distribution divided by the number of paid firefighters) was \$882 – about two percent higher than the \$860 we forecast.

For 2012 we are assuming cities and fire districts will maintain their firefighting staffing at the current level. We also assume that premiums for homeowners and fire policies will increase by two percent and that the percent of losses due to fire will follow their historical norms. These assumptions produce a ratio value of \$887.

We want to remind our readers, once again, that these forecasts are completely dependent on fire loss experience and insurance premiums and we really have no way to forecast either, although we do know that the latter are currently increasing.

<b>Summary of Local Share of State-Shared Revenues</b> <b>Total Dollar Amounts – 2009 to 2012</b> <b>(All Cities and Towns)</b>				
	2009	2010	2011 Revised	2012 Estimate
Gas Tax	\$88,603,991	\$90,168,854	\$91,279,000	\$91,870,000
Profits of Liquor Board	28,014,708	33,276,498	29,471,000	26,875,000
Liquor Tax	19,902,527	20,622,713	21,341,000	21,764,000
Criminal Justice - Special Programs	3,353,503	3,508,322	3,610,000	3,700,000
Criminal Justice – Population-based	993,630	1,039,503	1,070,000	1,096,000
<b>Total</b>	<b>\$140,868,359</b>	<b>\$148,615,890</b>	<b>\$146,771,000</b>	<b>\$145,305,000</b>

**Table 3**

<b>Per Capita Amounts – 2006 to 2012</b> <b>(All Cities and Towns)</b>							
	2006	2007	2008	2009	2010	2011 Rev.	2012 Est.
Gas Tax	\$23.20	\$24.19	\$22.82	\$21.72	\$21.49	\$21.22	\$21.15
Profits of Liquor Board	6.46	7.33	6.73	6.87	7.93	6.85	6.19
Liquor Tax	4.28	4.55	4.80	4.88	4.91	4.96	5.01
Criminal Justice - Special Programs	0.75	0.77	0.79	0.82	0.84	0.84	0.85
Criminal Justice – Population-based	0.22	0.24	0.23	0.24	0.25	0.25	0.25
<b>Total</b>	<b>\$34.91</b>	<b>\$37.08</b>	<b>\$35.37</b>	<b>\$34.53</b>	<b>\$35.42</b>	<b>\$34.12</b>	<b>\$33.45</b>

**Table 4**

Summary of Local Share of State-Shared Revenues Total Dollar Amounts – 2009 to 2012 (All Counties)				
	2009	2010	2011 Revised	2012 Estimate
Profits of Liquor Board	\$7,564,488	\$8,882,058	\$7,983,000	\$7,390,000
Liquor Excise Tax	4,528,882	4,686,178	4,837,000	4,912,000
<b>Total</b>	<b>\$12,093,370</b>	<b>\$13,568,236</b>	<b>\$12,820,000</b>	<b>\$12,302,000</b>

Table 5

Per Capita Amounts – 2005 to 2012 (All Counties)								
	2005	2006	2007	2008	2009	2010	2011 Rev.	2012 Est.
Profits of Liquor Board	\$2.95	\$2.72	\$3.07	\$2.90	\$2.96	\$3.50	\$3.22	\$3.01
Liquor Excise Tax	1.43	1.50	1.61	1.74	1.77	1.85	1.95	2.00
<b>Total</b>	<b>\$4.38</b>	<b>\$4.22</b>	<b>\$4.68</b>	<b>\$4.64</b>	<b>\$4.73</b>	<b>\$5.35</b>	<b>\$5.10</b>	<b>\$5.01</b>

Table 6

<b>Distribution of Fire Insurance Premium Tax – RCW 41.16.050 May 2011</b>			
<b>City/District</b>	<b>Ratio Value</b>	<b>Number of Paid Firefighters as of January 1, 2011</b>	<b>Amount<sup>1</sup></b>
Aberdeen	\$881.55	35	30,854.31
Anacortes		21	18,512.59
Auburn		75	66,116.39
Bellevue		212	186,888.98
Bellingham		143	126,061.91
Bothell		57	50,248.45
Bremerton		56	49,366.90
Camas		39	34,380.52
Centralia		21	18,512.59
Chehalis		14	12,341.73
Ellensburg		30	26,446.55
Everett		175	154,271.57
Hoquiam		23	20,275.69
Kelso		12	10,578.62
Kennewick		75	66,116.39
Kent		171	150,745.36
Kirkland		88	77,576.56
Longview		44	38,788.28
Lynnwood		52	45,840.69
Mercer Island		29	25,565.00
Moses Lake		28	24,683.45
Mount Vernon		35	30,854.31
Olympia		90	79,339.66
Pasco		51	44,959.14
Port Angeles		23	20,275.69
Pullman		31	27,328.11
Puyallup		57	50,248.45
Raymond		12	10,578.62

Distribution of Fire Insurance Premium Tax – RCW 41.16.050 May 2011			
City/District	Ratio Value	Number of Paid Firefighters as of January 1, 2011	Amount <sup>1</sup>
Redmond		153	134,877.43
Renton		130	114,601.73
Richland		55	48,485.35
Seattle		1,024	902,709.04
Shelton		6	5,289.31
Spokane		272	239,782.09
Sumner		24	21,157.24
Sunnyside		16	14,104.83
Tacoma		378	333,226.58
Toppenish		7	6,170.86
Tukwila		62	54,656.21
Vancouver		181	159,560.88
Walla Walla		48	42,314.49
Wenatchee		30	26,446.55
Yakima		83	73,168.80
King County #10		125	110,193.98
King County #2		41	36,143.62
Spokane County #1		163	143,692.94
<b>Totals</b>		<b>4,497</b>	<b>\$3,964,338.44</b>
<sup>1</sup> The amounts shown in the fourth column are the actual distributions by the state. However, if one multiplies the ratio value shown by the number of firefighters in each row, the results are slightly different from the actual amount shown. We have displayed the ratio value as rounded to two decimal places; the actual ratio value used by the state had nine decimal places.			

**Table 7**

## What's Ahead for Cities and Counties in 2013 (and Beyond)?

This is the section in which we report on the possibilities of incorporations and annexations that might result in significant changes in state-shared revenues for the year after next.

The passage of SSB 5321, ch. 550, Laws of 2009, changed the annexation landscape. This bill amended 2006 legislation dealing with credits against the state sales tax for certain cities doing annexations. It extended the time period for which credits are available from January 1, 2010 to January 1, 2015 and also made Seattle eligible. Because of the extension, cities do not seem to be in quite as much of a hurry to vote on annexation these days. (For evidence of this statement, note that most of the entries on the list below were also on the list in last year's *Budget Suggestions*.) And, if they do vote and the annexation is approved, cities are in less of a hurry than in the past to make the annexation effective.

Here is a list of annexations and one incorporation that we have heard about:

- Bothell - Snohomish County (22,000; November 2011 vote; estimated effective date of annexation, January 1, 2013)
- Seattle or Burien - North Highline - (17,400; Seattle will decide whether to hold an annexation vote by February 2012. Burien might beat them to it. Effective date could be January 1, 2013?)
- Lynnwood - (27,000; November 2012 vote; estimated date of annexation, no information)
- Renton - West Hill (15,560; vote in February 2012 for annexation January 1, 2013)
- Silverdale in Kitsap County incorporation - vote Spring 2012, incorporate Spring 2013.

Below you will find tables that show the forecasts of 2013 per capita revenues.

<b>City Per Capita State-Shared Revenue Estimates – 2013</b>		
	<b>With No Incorporations/ Annexations</b>	<b>With Incorporations/ Annexations</b>
Gas tax	\$21.13	\$20.81
Liquor board profits	6.45	6.36
Liquor excise tax	5.02	4.95
Criminal Justice (special programs)	0.88	0.87
Criminal Justice (population-based)	0.26	0.26
<b>Total</b>	<b>\$33.74</b>	<b>\$33.25</b>

<b>County Per Capita State-Shared Revenue Estimates – 2013</b>	
Liquor board profits	\$3.23
Liquor excise tax	2.08
<b>Total</b>	<b>\$5.31</b>

# The Role and Responsibility of Bond Counsel

by David O. Thompson, K&L Gates LLP

## Introduction

When a governmental entity borrows money – typically by issuing bonds – it is customary for an attorney to serve as “bond counsel.” This attorney is typically outside counsel, an independent law firm or individual attorney, not a staff attorney for the governmental entity. Such an attorney is experienced in municipal law in general and the law of municipal finance in particular. An attorney serving as bond counsel must be familiar with the many types of governmental entities, each with its own particular requirements for and limitations on borrowing money.

Bond counsel provides legal advice, not financial advice. Other consultants to a financing transaction – underwriters and financial advisors – provide the financial advice. The attorney serving as bond counsel reviews the borrowing transaction – and assists in structuring the transaction – so that at the conclusion of the transaction, he or she can provide an “approving legal opinion.” This traditional opinion of bond counsel states that the bonds (or other evidence of indebtedness issued by the governmental entity) are legal, valid and binding obligations of the issuer and enforceable against the issuer. If interest on the bonds is exempt from federal or state income taxes, the opinion of bond counsel will describe that exemption.

## Origin of the Concept of Bond Counsel

The practice of submitting state and municipal bonds to independent counsel for an opinion regarding their validity grew out of the defaults that occurred, largely with railroad aid bonds, in the late 1870s and early 1880s. Some cities and counties, believing that the construction of a railroad through their corporate limits would bring general prosperity and increase property values, issued bonds in aid of the projects, often in amounts that equaled, or even exceeded, their entire assessed valuations.

The result was inevitable. Widespread defaults on paying these bonds occurred. Subsequently, courts determined that some of the bonds had been illegally issued and millions of dollars of the bonds were held invalid. (See *Oliver Wendell Holmes Devise History of the Supreme Court of the United States, Vol. VI, Reconstruction and Reunion (1864-88)*, Chapters 12 and 13, by Professor Charles Fairman (1971)). Particular features of municipal law led to the findings of invalidity: lack of public purpose in the financings, violation of debt limitations, or failure to obtain voter approval. Investors discovered that the limitations on the incurring of governmental debt were substantial and significantly different from those governing private corporations, and investors were deemed to have knowledge of those limitations. Unlike most private corporations, governmental issuers could avoid debt that was *ultra vires*, i.e., outside the scope of their powers. That realization made investors wary, making it “difficult for public bodies, especially small communities and those that

borrowed infrequently, to raise necessary funds on reasonable terms.” (See National Association of Bond Lawyers, *The Function and Professional Responsibilities of Bond Counsel*, Second Edition, (1995).)

To assure investors that municipal bonds were legally issued and enforceable, dealers in municipal bonds began the practice of employing attorneys independent of the governmental issuers with experience in municipal law to examine the proceedings under which the bonds were authorized to be issued, and to render an opinion as to the validity of the bonds. The experiment succeeded. It was found that the investing public had confidence in the ability and integrity of these lawyers, and would purchase bonds, the validity of which they had approved. By 1900, selling municipal bonds with an accompanying opinion of bond counsel had become the industry standard. (See David M. Wood, *Fundamentals of Investment Banking*, Prentice-Hall, 1946).

As noted above, the role of bond counsel is a matter of custom. The marketplace, not the law, requires the participation of bond counsel in most municipal borrowing transactions. Concerns about the validity of municipal bonds are more than a historical footnote. The default on some of the bonds issued by the Washington Public Power Supply System led to considerable litigation and a significant case holding that the key municipal obligations securing the WPPSS bonds were ultra vires. See *Chemical Bank v. Washington Power Supply System*, 99 Wn.2d 772 (Wash. 1983).

## **Professional Responsibility and Standard of Care**

In any municipal financing transaction, it is the responsibility of bond counsel to see that the transaction proceeds smoothly and that, to the extent possible, legal problems are avoided, whether they affect the validity of the bonds or not. In so doing, the attorney serving as bond counsel must be aware of and consider applicable statutory, constitutional and local charter or code provisions governing the issuer’s powers and procedures, relevant case law, federal and state tax laws, federal and state securities laws, and the customs and practices of the municipal securities industry. In this role, bond counsel often acts more as a supervisor for the transaction than as an advocate. Nonetheless, as in any transactional practice, it is important for the attorney serving as bond counsel to remember – and to remind other participants to the transaction – that he or she is not serving as “attorney to the deal.” Most commonly, the attorney serving as bond counsel is hired by and represents the issuer, but occasionally bond counsel will be hired by and represent another participant in the transaction.

The traditional “opinion of bond counsel” is typically an “unqualified” opinion as to the validity and enforceability of the governmental debt obligation. This is a high standard. The municipal securities marketplace expects that an attorney serving as bond counsel will not provide such a legal opinion if he or she believes that any reasonable argument can be made against the validity of the bonds. In making legal judgments that form the basis for the bond counsel opinion, an attorney serving as bond counsel must assume that all legal questions will be litigated and that any reasonably foreseeable adverse outcome may occur.

It is important to remember that the bond lawyer’s opinion addresses legal issues, not financial ones. The bond lawyer is not providing financial advice either to the issuer or to the purchaser of the bonds, and the bond opinion is not a guarantee of repayment. Questions about the feasibility of a particular project or the ability of a municipality to repay its debts must be addressed to the appropriate municipal staff or consultants.

## Selecting Bond Counsel

The relationship between an issuer and bond counsel may take many forms, especially depending on the size of the issuer and the frequency of its borrowing transactions. Some issuers have a long-standing relationship with a law firm providing bond counsel services for all of the issuer's borrowing transactions. Other issuers may hire bond counsel on an issue-by-issue basis, or may use different firms for different types of bonds, e.g., one firm to handle general obligation bonds and another firm to handle revenue bonds. As with other professional services, some Washington issuers select bond counsel through a "request for proposals" or "request for qualifications" process; others do not. For further information on engaging bond counsel, see *The Selection and Evaluation of Bond Counsel*, 1998 Edition, National Association of Bond Lawyers.

Most law firms and municipal issuers expect to have a written engagement letter or contract to memorialize their mutual expectations about bond counsel services. Such an engagement letter or contract may be open-ended and cover many transactions or it may cover only a single transaction. Depending on the nature of the transaction, bond counsel may be paid on an hourly basis or, more often, on a fixed fee basis. For further information on engagement letters, see *Model Engagement Letters, Second Edition*, (1998), National Association of Bond Lawyers.

## Services Provided by Bond Counsel

*Preliminary Analysis.* The traditional role of bond counsel was to review the completed proceedings for a borrowing transaction and provide an approving opinion. It is more typical now for bond counsel to play a role from the outset of a transaction. The governmental entity itself or one or more of the consultants working on the financing plan may ask bond counsel for advice on alternative legal structures for the transaction, on the authority of the governmental entity to undertake the proposed transaction and on its ability to issue tax-exempt obligations for the transaction. Occasionally a change in law is required to make the transaction possible. Attorneys providing bond counsel services typically have considerable experience with drafting legislation or reviewing legislation drafted by others to spot opportunities or pitfalls relating to finance matters.

Attorneys serving as bond counsel generally like to be asked about transactions well before their structure is "locked in" and difficult to change. If an election is required to authorize the borrowing, bond counsel would like the opportunity to draft or review the election proceedings to ensure that they comply with all legal requirements.

*Preparation of Initial Documents.* Bond counsel usually prepares all necessary authorizing proceedings, including election proceedings, ordinances, resolutions, petitions, lease financing documents and contracts.

*Supervision.* To the extent agreed to by the issuer and its general counsel, bond counsel may supervise or conduct procedures taken by the governmental entity in connection with the transaction, including consideration of ordinances and resolutions, public hearings, formation of improvements districts, or preparation and confirmation of assessment rolls. Bond counsel may also be asked to participate with other consultants in obtaining a rating for the governmental obligations being issued from one or more of the nationally recognized rating agencies.

*Compliance with Federal Tax Law.* If the transaction involves the issuance of tax-exempt obligations, bond counsel assures compliance with all applicable federal tax law. Since the 1986 changes in the Internal Revenue Code, restrictions on tax-exempt financing have increased and the arbitrage regulations are more complex. Bond counsel prepares all necessary tax documents or works with a special tax counsel.

*Compliance with Federal Securities Laws.* Bond counsel advises the governmental issuer to assure compliance with federal (and where applicable state) securities laws. Increased regulation by the Securities and Exchange Commission (“SEC”) of disclosure in the municipal marketplace makes this a more complex task than in the past. Bond counsel typically reviews any disclosure document prepared to sell bonds to investors to ensure that disclosure about the bonds and the security for the bonds is accurate. Bond counsel also advises the issuer on its obligations, if any, to provide ongoing disclosure after the bonds are issued.

*Sale and Closing Documents.* Bond counsel prepares or obtains all necessary certificates and documents – including the bonds or other debt obligations themselves – that the issuer is required to provide at the closing for the transaction. Bond counsel supervises the closing, i.e. the delivery of the bonds to the purchaser in exchange for the borrowed funds, and ensures that all closing conditions have been met so that he or she can deliver the approving opinion of bond counsel.

*What’s Not Within Bond Counsel’s Scope of Work?* Aspects of a transaction that are unrelated to the traditional bond opinion are typically outside bond counsel’s scope of work. These matters include preparing the official statement or other disclosure document, “blue sky” memoranda, or bond purchase agreement. Bond counsel may perform these tasks, but only if expressly provided for.

After a transaction closes, most bond counsel are happy to answer questions about the bond issue and the issuer’s compliance with post-issuance requirements under federal tax and securities laws. However, the typical scope of work for bond counsel would not cover more extensive activities such as responding to IRS audits or SEC investigations, performing rebate calculations, or preparing continuing disclosure documents.

## **Other Participants in a Bond Sale**

Who is involved in a bond sale depends in part on the type of sale. A small loan from a bank may raise some of the same legal basic issues as the sale of millions of dollars of bonds to investors, but the players and the structure of the transactions will differ considerably.

*Public Offering.* Bonds, notes and other municipal obligations can be sold to investors by an investment banking firm acting as “underwriter.” Such a sale may be negotiated, or the obligations may be sold by a competitive bid process. In either case, the municipality, in cooperation with the underwriter or a financial advisor, prepares an official statement or prospectus to inform potential investors about the nature of the municipal obligation being sold and the credit of the municipality. It may be advantageous for the issuing municipality to obtain a rating of its bonds from one of the national rating agencies. That is a marketing decision that can be made with the advice of the underwriter or financial advisor.

Potential participants in a public offering of municipal bonds, in addition to bond counsel, include the following:

- **Underwriter:** An investment banking firm that agrees to purchase all bonds in a public offering. The underwriter sells the bonds to investors. In a negotiated sale, the underwriter often assists the municipality in preparing the official statement. The underwriter is often represented by counsel.
- **Financial Advisor:** A party providing financial advice to the issuer independent of the underwriter. A financial advisor may assist the municipality in structuring the bond issue and, in a competitive sale, will typically assist the municipality in drafting the official statement and coordinate the bond sale and review and verification of bids.
- **Issuer's general counsel:** The city attorney, county prosecutor or other local counsel may hire bond counsel and may be involved in drafting some of the proceedings of the issuer authorizing the bonds. Local counsel is often asked to give a legal opinion at closing that there is no litigation challenging the issuance of the bonds or the sources of revenue or taxes pledged to pay the bonds.
- **Paying Agent/Trustee:** The corporate trust department of a bank typically handles payments to bondholders, either directly or by making payments to The Depository Trust Company through its book-entry only system for disbursement to the beneficial owners of bonds issued in book-entry form. In Washington, the State Treasurer's office contracts with a bank to provide this "fiscal agency" service to any Washington municipality. Currently The Bank of New York serves as the state's fiscal agency. If the relevant statutes allow the issuer to appoint a bond trustee (instead of using the state fiscal agency), the trustee may also hold bond proceeds to ensure that they are spent for the authorized purpose.
- **Bond Insurers:** Municipal bonds can be issued with a bond insurance policy that guarantees payment of debt service on the bonds. This protects bondholders from a payment default by the issuer. If obliged to make any such payment, the bond insurer will step into the shoes of the bondholders and assert against the issuer whatever claims and remedies are available to the bondholders. Bond insurance is used far less now than before the financial crisis of the past few years. Insured bonds carry the rating of the bond insurer – which was an advantage when most of the major bond insurance companies had AAA ratings – but most of the bond insurers that were active several years ago have experienced significant rating downgrades.
- **Rating Agencies:** Moody's, S&P and Fitch are currently the recognized entities that evaluate the credit of municipal issuers. It is not cost efficient for many small issuers to request ratings on their bonds, so such bonds are either sold without ratings or the issuers obtain bond insurance to obtain a high rating.

*Private Placement.* Instead of selling bonds to investors, a municipal borrowing may be handled as a loan, usually from a bank, in which the bank purchases the bond or note issued by the municipality. In such a private placement, no official statement is prepared and the bank (or other purchaser) instead gives the municipality a certificate stating that it is a "sophisticated investor" and has received all the credit information that it desires. The bank may require an approving

opinion of bond counsel, including an opinion relating to the tax-exempt status of the bond, if applicable.

It is important for both the lending bank and the borrowing municipality to recognize that a bank loan to a municipality cannot be structured or documented like a private commercial loan. The security that a municipality is authorized to provide is different, so the authorizing documentation must be different. Complying with federal tax rules is crucial if the lending bank expects the interest that it earns on the loan to be tax-exempt.

*Governmental Loan Programs.* There are state and federal programs that lend money to municipalities, typically for water and sewer improvements. The Public Works Trust Fund program administered by Washington's Department of Ecology, and the Rural Development and Rural Utilities loan programs administered the U.S. Department of Agriculture are the most significant sources of such loans to Washington municipalities. These lenders require issuers to provide a bond to secure the loan and require an approving opinion of bond counsel.

### **Additional Information**

Publications of the National Association of Bond Lawyers ("NABL") are probably the best sources of information about how bond counsel themselves define their role and the standards by which they practice. See in particular the following, many of which are cited in this paper:

*Model Opinion Report*, (4th edition, 2003), National Association of Bond Lawyers.

*The Selection and Evaluation of Bond Counsel, 1998 Edition*, National Association of Bond Lawyers.

*Model Engagement Letters, Second Edition*, (1998), National Association of Bond Lawyers.

*The Function and Professional Responsibilities of Bond Counsel, Second Edition*, (1995), National Association of Bond Lawyers.

*Standards of Practice: Three Reports by a Special Committee*, (1989) National Association of Bond Lawyers.

The Government Finance Officers Association publishes materials on debt management, hiring finance professionals, and other matters related to borrowing. See [www.gfoa.org](http://www.gfoa.org).

The website of the Municipal Securities Rulemaking Board provides lots of information about types of municipal securities and an extensive glossary of terms used in the municipal bond industry. See [www.msrb.org/msrb1/glossary](http://www.msrb.org/msrb1/glossary).

## Road Levy Shifts and Diversions

Road levy shifts and diversions are ways that counties can turn road levy funds into money for the general or current expense fund.<sup>1</sup> In the discussion below, we will explain how each option works. Cities will be interested in the road levy shift because a county that is contemplating doing one may ask cities for a property tax “buy down.”

### Road Levy Shift

If certain requirements are met, levy authority may be shifted from the road fund to the county general fund. Counties find the shift to be a helpful budget tool because the general fund levy has so many more uses than the road levy. Although the total dollars levied for the general fund and road fund combined do not change with a levy shift, the dollars are collected from different taxpayer groups. All the dollars for the road fund levy come from taxpayers in the unincorporated area. The general fund levy is paid by all county residents – both in incorporated and unincorporated areas.

The maximum regular property tax levy rate (the statutory rate limit) a county may impose on real and personal property is \$1.80 per thousand dollars assessed valuation (AV) for its current expense or general fund and \$2.25 per thousand dollars AV for its road fund. However, a county may raise its general fund levy rate through a levy shift up to \$2.475 per thousand dollars AV, provided the total of the levy rates for the general fund and road fund do not exceed \$4.05 per thousand dollars AV **and** the increase in the general fund levy does **not** require in a reduction in the levy of any other taxing district through prorationing.<sup>2</sup> The aggregate regular levy rates of senior taxing districts (counties and cities) and junior taxing districts (fire districts, cemetery districts, library districts, etc.) may not exceed \$5.90 per thousand dollars assessed valuation. If this limit is exceeded, the levy of at least one junior taxing district must be reduced or prorationed.<sup>3</sup>

**An example.**<sup>4</sup> Say that a county wants to shift \$250,000 of levy authority from the road fund to the general fund. It first calculates its maximum allowable levy and levy rate for each fund without a shift. Then, it calculates the rates with the shift. For the general fund to be able to levy \$250,000 more from the same assessed valuation, the tax rate must be increased. So, the first check is whether the new rate is \$2.475 or less. If not, either the shift must be abandoned or the amount of the shift to the general fund must be lowered below \$250,000 until the required tax rate falls to

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<sup>1</sup>We use these terms interchangeably.

<sup>2</sup>RCW 84.52.043(1).

<sup>3</sup>RCW 84.52.043(2).

<sup>4</sup>This example comes from *Property Tax Levies*, Department of Revenue (Olympia, Washington: August 2010). [http://dor.wa.gov/Docs/Pubs/Prop\\_Tax/LevyManual.doc](http://dor.wa.gov/Docs/Pubs/Prop_Tax/LevyManual.doc)

This publication includes an excellent and **more thorough discussion** of road levy shifts on pages 106 - 109. It provides numerical examples of all the calculations necessary to determine whether the various requirements for a road levy shift are met.

\$2.475. The road fund tax rate will fall because \$250,000 less must be raised. The second check is whether the new combined rate is \$4.05 or less. If not, the shift must be abandoned or the amount of the shift must be decreased. The third check is whether the shift may be done without requiring the reduction of another taxing district's levy. Assume, for example, that after shifting \$250,000, a county finds that the general fund/current expense fund tax rates in one of its cities are those shown in column A.

	<b>Column A</b> (Before Buy Down)	<b>Column B</b> (After Buy Down)
General/Current Expense Fund	\$1.90	\$1.90
<b>City</b>	<b>3.10</b>	<b>3.06</b>
Hospital	.48	.48
Library	.46	.46
<b>Total</b>	<b>\$5.94</b>	<b>\$5.90</b>

Because the total is more than \$5.90, the library and hospital district levies would have to be reduced, and, as stated above, this is not allowed by RCW 84.52.043(1). The county can: 1) decide not to do the shift; 2) do the shift for a smaller amount that would only require the county rate to be increased to \$1.86; or 3) do a "buy down" of the city levy of four cents as shown in Column B. RCW 39.67.010 and RCW 39.67.020 allow such a "buy-down."<sup>5</sup> In this case, the county would pay the city an amount equal to \$0.04 times its assessed valuation divided by 1000 to lower its levy to \$3.06 from \$3.10. If the city's assessed valuation is \$102,000,000, this would cost the county \$4,080 ( \$0.04 x \$102,000,000/1000). If the county assessed valuation is \$930,800,000, lowering its general fund tax rate by four cents would cost \$0.04 x \$930,800,000/1000 = \$37,232. The county comes out \$33,152 ahead (\$37,232 – 4,080) by doing the buy-down.

<sup>5</sup>RCW 39.67.010 states:

Any agreement or contract between two taxing districts other than the state which is otherwise authorized by law may be made contingent upon a particular property tax levy rate of an identified taxing district other than the state where such rate affects the regular property tax rate of one of the parties to the contract and therefore affects the party's resources with which to perform under the contract. The governing body of every taxing district that could have its tax levy adversely affected by such a contract shall be notified about the contract.

And RCW 39.67.020 reads:

Any taxing district other than the state may transfer funds to another taxing district other than the state where the regular property tax levy rate of the second district may affect the regular property tax levy rate of the first district and where such transfer is part of an agreement whereby proration or reduction of property taxes is lessened or avoided. The governing body of every taxing district that could have its tax levy adversely affected by such an agreement shall be notified about the agreement.

## Diverting Road Funds<sup>6</sup>

Although RCW 36.82.020 requires all road levy funds to be spent for “proper county road purposes,” RCW 36.82.040, which establishes the road fund levy, provides an exception. It states, in part:

All funds accruing from such levy shall be credited to and deposited in the county road fund except that revenue diverted under RCW 36.33.220 shall be placed in a separate and identifiable account within the county current expense fund . . . . (Emphasis added.)

RCW 36.33.220 allows the county legislative authority to spend these diverted revenues<sup>7</sup> for any service provided to the unincorporated area:

The legislative authority of any county may budget, in accordance with the provisions of chapter 36.40 RCW, and expend any portion of the county road property tax revenues **for any service** to be provided in the unincorporated area of the county notwithstanding any other provision of law, including chapter 36.82 RCW and RCW 84.52.050 and 84.52.043. (Emphasis added.)

However, if funds diverted under RCW 36.33.220 are not used for traffic law enforcement,<sup>8</sup> the county will be ineligible for rural arterial trust account (RATA) funding unless one of two exemptions applies: 1) the population of the county is less than 8,000; or 2) the county expended revenues collected for road purposes on other governmental services only after the voters authorized a levy lid lift for the road fund under RCW 84.55.050 for such purposes.<sup>9</sup>

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<sup>6</sup>The Washington State County Road Administration Board (CRAB) has an informative PowerPoint presentation on road fund diversion. “Overview of Road Levy Diversion,” October 2003. <http://www.mrsc.org/govdocs/W3CRABDivisions.pdf>

<sup>7</sup>See the *BARS Manual*, Vol. 1, Pt. 3, Ch. 12, Interpretation 3 for information on how to account for diverted road taxes.

<sup>8</sup>In its “Overview of Road Levy Diversion” PowerPoint presentation <http://www.mrsc.org/govdocs/W3CRABDivisions.pdf>, the County Road Administration Board provides a list of allowable “traffic law enforcement” items:

1. Investigation and enforcement of laws on oversize or overweight vehicles on county roads;
2. Investigation and enforcement of other traffic laws and regulations, especially enforcement of speed limits in work zones; and
3. Investigation of all accident scenes and subsequent preparation and testimony in court.

<sup>9</sup>RCW 36.79.140 states, in part:

Only those counties that during the preceding twelve months have spent all revenues collected for road purposes only for such purposes, including removal of barriers to fish passage and accompanying streambed and stream bank repair as specified in RCW 36.82.070, and including traffic law enforcement, as are allowed to the state by Article II, section 40 of the state Constitution are eligible to receive funds from the rural arterial trust account, except that: (1) Counties with a population of less than eight thousand are exempt from this eligibility restriction; (2) counties expending revenues collected for road purposes only on other governmental services after authorization from the voters of that county under RCW 84.55.050 are also exempt from this eligibility restriction;..

See also WAC 136-150-030.

Counties that make a budgetary transfer of funds from the road fund to the general fund, as opposed to a diversion under RCW 36.33.220, must meet the same spending criteria to be eligible for rural arterial trust account funding.<sup>10</sup> Unless their population is less than 8,000, actual expenditures on traffic law enforcement must be at least as great as the amount of funds transferred to the general fund for traffic law enforcement.<sup>11</sup>

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<sup>10</sup>WAC 136-150-022. Ch. 136-150 WAC sets out the conditions under which counties are eligible to receive rural arterial trust account funds.

<sup>11</sup>WAC 136-150-030.

# Funds for Cash-Basis Local Governments

by State Auditor's Office Staff

Three major changes will affect the way cash-basis entities report their funds. The Washington Finance Officers Association and the State Auditor's Office have addressed the changes in training classes; however, due to the nature and timing of the changes, there continues to be confusion. Two of these changes need to be implemented for 2010 annual reports and the third in 2011. The changes are:

- 1) Fund roll-ups on annual reports for 2010.
- 2) Reserved and unreserved fund balances for all funds for 2010 annual reports.
- 3) Analysis of special revenue funds for 2011 annual reports (i.e. implementation of GASB 54).

Fund roll-ups are required when multiple funds are presented for one activity or when funds are incorrectly numbered and presented in annual reports. Some local governments report multiple general funds, instead of reporting **one** general fund. Also, they incorrectly account for debt service and capital projects related to utilities in governmental funds (200-series and 300-series funds). While the **accounting** for these utilities is acceptable in separate funds, the fund number should be permanently corrected to a utility (400 series) fund number.

In the 2011 BARS update, cash-basis local governments were instructed to report reserved and unreserved fund balance for all funds. Reserved fund balance must be externally restricted (i.e., state statute, grantors) or internally committed (i.e., ordinance, resolution). Reserved and unreserved fund balance must be implemented in 2010 annual reports. Since this is a new requirement, is it acceptable to report reserved and unreserved fund balances only in ending fund balances for 2010.

The last change affects all local governments for 2011 annual reports. Each local government will need to evaluate each special revenue fund to determine if it may continue to be reported as a special revenue fund. There is very specific criteria (mathematical test) for this included in the BARS manual part 3, chapter 1. Special revenue funds not meeting "the test" will most likely have to be rolled into their general fund on their annual reports. It is possible the same fund (street fund) could be reported as a special revenue fund for a city, while another city may have to report it in its general fund. Local governments will likely report fewer special revenue funds in their annual reports.

Three common questions the State Auditor's Office receives are:

- 1) When rolling up funds on my C-4s and C-5s, do I also roll-up on my individual schedules?
  - Yes, you report all funds on all schedules the same as you do on your C-4s and C-5s. Your fund structure in your schedules 04 and 05 must match your fund structure in your schedules C-4 and C-5.

- 2) How do I report budget information if I budget the funds differently than I report on my annual report?
  - Report budget information in your notes to financial statements as you budget them. You should include in your notes which funds you have rolled together.
- 3) Since my council wants to see reports that match my budget, what should I do?
  - The requirements we've outlined here are only for external reporting . You may keep your fund structure for accounting and internal reporting in any format for managerial purposes.
- 4) How do I present funds that are legally required to be maintained, but do not meet the required reporting requirements?
  - If there is a conflict between legal, managerial and BARS reporting fund structure, the BARS fund structure prevails for external reporting (annual reports).

If you have any questions about reporting requirements, please use the State Auditor's Client HelpDesk at [www.sao.wa.gov](http://www.sao.wa.gov).

# Calculating Estimated Revenue from Levying the “Public Safety” Sales Tax under RCW 82.14.450

We have had inquiries from a number of cities and counties about the “public safety” sales<sup>1</sup> tax that is allowed under RCW 82.14.450. Below we will discuss the statute and give some guidelines for calculating potential revenue. Note that this is a voter-approved tax and it may be voted on only in the primary and general elections. To put a ballot measure on the November 8, 2011 ballot, the county auditor must receive the resolution by August 16.

## A Summary of the Law

A county legislative body may submit a ballot proposal to a countywide vote for a sales tax increase of up to 0.3 percent. Sales of motor vehicles or leases of motor vehicles for up to the first 36 months are exempt from the tax. The proposal must be approved by a majority of the voters at a primary or general election.

The text of the ballot measure must state the purposes for which the funds will be used. At least one-third of the money must be spent for “criminal justice purposes, fire protection purposes, or both” with no restrictions on type of use for the remaining two-thirds.<sup>2</sup> “Criminal justice purposes” is defined as:

activities that substantially assist the criminal justice system, which may include circumstances where ancillary benefit to the civil justice system occurs, and which includes domestic violence services such as those provided by domestic violence programs, community advocates, and legal advocates.

Sixty percent of the funds are distributed to the county, with the cities in the county getting the remaining 40 percent on a per capita basis. The cities must spend the portions they receive in accordance with the uses stated in the ballot measure.

Legislation passed in 2010<sup>3</sup> amended this statute. It removed language that prohibited supplanting of existing funding. It also extended, in some circumstances, the authority of cities to levy this tax at a rate not to exceed 0.1 percent, effective January 1, 2011.

The total rate of this tax may not exceed 0.3 percent. Therefore, if a county is levying this tax at a rate of 0.3 percent, then no city in that county may levy this tax. However, if a county is levying this tax at a rate of less than 0.3 percent, a city in that county may submit a ballot measure to the

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<sup>1</sup>In this article, when we will use the term “sales tax” to also mean “sales and use tax.”

<sup>2</sup>RCW 82.14.450(4), as amended by ch. 551, Laws of 2009.

<sup>3</sup>Ch. 127, Laws of 2010, §1.

voters at the primary or general election to impose this tax at a rate not exceeding 0.1 percent, to be effective no sooner than January 1, 2011.<sup>4</sup> The ballot measure must state the uses: at least one-third of the revenue must be used for criminal justice purposes, fire protection purposes, or both. Sales of motor vehicles or leases of motor vehicles for up to the first 36 months are exempt from the tax, just as they are from a county tax.

If a county adopts a resolution or ordinance to levy this tax after a city in the county has done so, then the county must give a credit against the county tax for sales within the city to the extent that the sum the city and county tax rates would exceed 0.3 percent. For example, if a city is levying the tax at a rate of 0.1 percent and the county passes a 0.3 percent tax, then the total tax paid in the city will be 0.3 percent, with 0.1 percent being the city tax and 0.2 percent being the county tax, since there is a credit against the county for the city tax. If the city is levying a 0.1 percent tax and the county levies a 0.2 percent tax, then the total in the city is 0.3 percent, while it is only 0.2 percent in the unincorporated area of the county.

Fifteen percent of the proceeds of any tax levied by the city must be given to the county.

### Calculating Revenues

Below you will find a table of some sales and use tax revenue data for Evergreen County and its cities. This table is similar to the one you will find for your county and/or city in Table S1, “2010 Annual Summary of Distributions of Local Sales/Use Tax To Cities and Counties” <http://www.dor.wa.gov/docs/reports/2010/ltd2010/TableS1-2010.PDF> in the Washington State Department of Revenue publication, *2010 Local Sales and Use Tax Distributions*. It differs from that table in that it includes a column (column 3) that sums the revenue from the “basic” (first half cent, first 0.5 percent) and “optional” (second half cent, second 0.5 percent) sales taxes so that we have the totals for entire 1.0 percent sales tax for the county and all the cities. And, it leaves out columns for other sales tax revenues which we are not interested in for this discussion.

**Table A**

<b>Summary of Some Local Sales and Use Tax Distributions for Evergreen County for 2010</b>				
	<b>Column 1</b>	<b>Column 2</b>	<b>Column 3</b>	<b>Column 4</b>
<b>Location</b>	<b>Basic (0.5%)</b>	<b>Optional (0.5%)</b>	<b>Basic plus Optional (1.0%)</b>	<b>Criminal Justice (0.1%)</b>
Evergreen County	\$2,109,142	\$2,082,162	\$4,191,304	Not relevant for this discussion.
City A	1,169,278	1,153,661	2,322,938	
City B	1,398,612	1,380,823	2,779,435	
City C	217,845	215,042	432,887	
<b>Total</b>	<b>\$4,894,877</b>	<b>\$4,831,688</b>	<b>\$9,726,564</b>	

<sup>4</sup>The rules that apply when a county levies the public safety sales and use tax before a city in the county levies it apply when a county and city in the county adopt resolutions/ordinances to submit, on the same date, ballot propositions to the voters to levy the tax. RCW 82.14.450(2)(b), as amended by ch. 127, Laws of 2010, §1.

## A City Tax

Assume that City A is thinking about levying a 0.1 percent tax under RCW 82.14.450(2)(a). We know from the data in column 3 in Table A that the revenue the city received during 2010 from its 1.0 percent tax sales and use tax was \$2,322,938. Let's think about what this number represents. It is the **net** amount<sup>5</sup> the city received. The one percent administrative fee that the state charges and the 15 percent that the county receives from a city's sales tax were taken out before the city got its distribution. Now, what number are we looking for? We want the amount of revenue City A would have received in 2010 from a 0.1 percent tax, **net** of the state's administrative fee and the 15 percent that goes to the county.

This is an easy calculation. 0.1 is one-tenth of 1.0, so we divide the city's revenue from the 1.0 percent tax by 10.  $\$2,322,938/10 = \$232,294$ .<sup>6</sup> For an estimate of what such a tax would bring in for 2012, just increase \$232,294 by the expected growth rate between the two years. Note that you could also have taken the amount you are forecasting for City A's 2012 sales and use tax revenue and divided by 10. You really did not need to use this table at all. However, you will need the table to estimate the revenue for a county tax.

Do not forget that Evergreen County has some interest in this tax because it gets 15 percent of the revenue. We are going to solve for X, the dollar amount the county would receive. There are a couple different ways of doing it. For those people whose algebra is rusty, here is one. Form a ratio of the city tax share in decimal terms, .85,<sup>7</sup> and the amount of tax revenue the city received.  $0.85/232,294$ . Form a similar ratio for the county, with X being the amount the county will receive from its share of the city tax.  $0.15/X$ . Now equate these amounts:

$$\frac{.85}{232,294} = \frac{.15}{X}$$

Cross-multiplying, one gets

$$.85X = .15 \times 232,294$$

Simplifying,  $.85X = 34,844$  Divide 34,844 by .85 and we get  $X = \$40,993$ .

## A County Tax

Now we are going to calculate how much the county and its cities would have received if the county had levied a 0.1 percent tax under RCW 82.14.450(1) in 2010. As it turns out, we already know the total amount because the county was levying a county-wide 0.1 percent tax for criminal justice purposes under RCW 82.14.340 in 2010. If you look at column 4 in Table A, you will find

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<sup>5</sup>RCW 82.14.030(1) and (2).

<sup>6</sup>Note that it is fine to be displaying these numbers to the last digit in the "1's" column when doing the calculations. When presenting your forecast, however, use zeros on the end of the numbers – \$232,000, for example.

<sup>7</sup>If the county is getting 15 percent of the tax, the city ends up with 85 percent.

the total of \$972,619. How this revenue was split between the county and the cities is of no consequence because the allocation factors are different for this public safety tax under RCW 82.14.450.

The \$972,619 is split between the county and the cities on a 60/40 basis. Then the city portion is allocated among the cities, based on their population. In Table B below, you will see the results.

Table B

Revenue from a 0.1 Tax Levied by Evergreen County			
<i>Revenue to be distributed</i>			\$972,619
		<b>Shares</b>	<b>Revenue</b>
County		60%	583,571
Cities		40%	389,048
<i>Revenue distributed to individual cities</i>			
	<b>April 1, 2010 Population</b>	<b>Population Shares</b>	<b>Revenue</b>
City A	6,606	22.6%	\$88,088
City B	19,038	65.3%	253,862
City C	3,532	12.1%	47,098
Total	29,176	100%	\$389,048

First, the \$972,619 is split between the county and the city, with the county receiving \$583,571 and the cities getting \$389,048. In the lower half of the table, the revenue is allocated to the individual cities, based on their relative population.

If the county levies a 0.2 percent tax, the revenues that everyone would have received are simply twice the amount in the table above. And, if the county levies a 0.3 percent tax **and no city has levied a 0.1 percent tax under RCW 82.14.450(2)(a)**, just multiply everything by three.

However, if a city, let's say City A, has levied a 0.1 percent tax before the county levies its tax at a rate of 0.3 percent, the county may not levy the tax on sales in City A. How does this change the revenues everyone receives from the third 0.1 percent portion of the county tax?

To find out one now has to go back to Table A and look at column 3, which lists the distributions when everyone levied a 1.0 percent tax in 2010. We will first remove the row for City A. Then we divide the numbers for Evergreen County and cities B and C by 10 because we want the revenues from a 0.1 percent tax, not a 1.0 percent tax. Look at the result in Table C.

**Table C**

<b>Calculating Total Revenue from a 0.1 Percent Tax Levied by Evergreen County Excluding City A</b>	
<b>Location</b>	<b>Basic Plus Optional (0.1%)</b>
Evergreen County	\$419,130
less 15%	(40,993)
Evergreen County (adj.)	\$378,137
City B	277,944
City C	43,289
<b>Total</b>	<b>\$699,370</b>

Now we have to adjust the distribution for the county. The \$419,130 figure includes the funds the county got from City A, the 15 percent distribution. As we calculated above, that 15 percent distribution was \$40,993. If the tax for City A is being removed from the table, then the county share in that tax has to be removed also. **The amount to be shared from the third 0.1 percent county tax is \$699,370** when the tax cannot be levied in City A because the county must give a credit against the county tax for sales in the city. Note that the only number in this table that “counts” is the total of \$699,370.

Finally, we distribute the \$699,370 tax revenue to the cities and the county as shown in Table D.

**Table D**

<b>Revenue from a 0.1 Tax Levied by Evergreen County When City A Has Already Levied a 0.1 Percent Tax</b>			
<i>Revenue to be distributed</i>			\$699,370
		<b>Shares</b>	<b>Revenue</b>
County		60%	419,622
Cities		40%	279,748
<i>Revenue distributed to individual cities</i>			
	<b>April 1, 2010 Population</b>	<b>Population Shares</b>	<b>Revenue</b>
City A	6,606	22.6%	\$63,340
City B	19,038	65.3%	182,542
City C	3,532	12.1%	33,866
<b>Total</b>	<b>29,176</b>	<b>100%</b>	<b>\$279,748</b>

In Table E, we have summarized the revenue from the various options.

**Table E**

<b>Summary Table</b>				
	<b>0.1% County Tax</b>	<b>0.2% County Tax</b>	<b>0.3% County Tax No City Tax</b>	<b>0.3% County Tax City Levies 0.1% Tax</b>
County	\$583,571	\$1,167,142	\$1,750,713	\$1,627,757
City A	88,088	176,176	264,264	471,810
City B	253,862	507,724	761,586	690,266
City C	47,098	94,196	141,294	128,062
<b>Total</b>	<b>\$972,619</b>	<b>\$1,945,238</b>	<b>\$2,917,857</b>	<b>\$2,917,895</b>
<p>Notes:</p> <p>1. The numbers in the last column were formed by adding:  <math>1,167,142 + 40,993 + 419,622 = 1,627,757</math>  <math>176,176 + 232,294 + 63,340 = 471,810</math>  <math>507,724 + 182,542 = 690,266</math>  <math>94,196 + 33,866 = 128,062</math></p> <p>2. Yes, the totals in the last two columns should be equal. However, they are not because we used column 3 in Table A to form some of the numbers and column 4 for others. If you divide the total of column 3 in Table A by 10, you get \$972,656, which does not equal the \$972,619 in column 4. The Department of Revenue says it has something to do with the fact that the starting date of the criminal justice tax was not the same as the starting dates of the basic and optional taxes. Anyway, here is a good example of why we call them <b>estimates!</b></p>				

## What Taxes Must Be Paid on Amusement and Recreation Services Fees?

**Background.** Last year the Department of Revenue (DOR) auditors found that a city was not following the requirements of WAC 458-20-183 (Amusement, recreation and fitness services), also known as “Rule 183.” It was not collecting and paying the required taxes on “league fees” and “entry fees” that entitle a person or team to participate in an amusement or recreational activity. And, it turned out, there were other cities in the same situation. These cities sought a legislative solution in the 2011 legislature (HB 1452/SB 5422), which would have exempted governmental entities and non-profits from these taxes, but it did not pass.

Since the legislation did not pass, DOR has announced that it is going to begin to enforce the collection of the sales tax and, in some cases, a retailing business and occupation tax, as has long been required by Rule 183.

Because there was confusion over how the terms “league fees” and “entry fees” are defined, DOR wrote and circulated a draft excise tax advisory, which was discussed at a meeting on June 16. Since the meeting was publicized by the Washington Parks and Recreation Association, most of the attendees (in person and by phone) appear to have been parks and recreation people, rather than finance staff. If your parks and recreation people have not checked in with you on this matter, you might follow up with them.

Below, we are reprinting two documents. The first is a response to some of the issues raised at the meeting. It obviously makes more sense if you were at the meeting, but reading it still gives the flavor of what went on, even if you were not. The second document is the Excise Tax Advisory on the issue.

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### **Taxability of Fees Charged for Amusement and Recreation Services<sup>8</sup>**

Over June 16 and 17, the Department hosted three meetings for interested parties to comment on the **draft Excise Tax Advisory–“Taxability of Fees Charged for Amusement and Recreation Services.”** (Draft Excise Tax Advisory 3167.2011) More than 100 people attended the meetings.

A primary concern of those in attendance was the issue date of the Advisory. After due consideration, the Department offers this response:

The Department of Revenue appreciates the participation and discussion at the June 16 and 17 stakeholder meetings regarding the collection of retail sales tax on fees charged for participating in a sports activity or event,

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<sup>8</sup>Reprinted from Department of Revenue Web page  
<http://www.dor.wa.gov/Content/GetAFormOrPublication/PublicationBySubject/TaxTopics/LeagueFees.aspx>

As was discussed at these meetings, the Department published Excise Tax Advisory (ETA) 3167.2011 on July 1. The Advisory provides tax collection and reporting guidance on this issue. A number of organizations were concerned they would not be able to make the system changes necessary to implement the new requirements by July 1. Many also expressed concerns that the July 1 date does not provide enough lead time to explain the change to participants. The Department was asked to reconsider the July 1 deadline.

The Department continues to believe all parties must move forward on this issue, and still intends to issue the ETA on July 1. The Department does, however, recognize the challenges this transition has for stakeholders. For that reason, full compliance with the ETA is expected no later than October 1, 2011.

The Department will work with taxpayers that make a good faith effort to comply during the July 1 – September 31 interim period; finding a fair resolution of the taxes they were not able to collect. To receive such consideration, the taxpayer must document that efforts were made to make necessary changes.

After reading the ETA, if you need clarification about your particular business/organization, you may request a private letter ruling.

<https://fortress.wa.gov/dor/efile/SecureForms/content/contactus/email/rulings.aspx> These responses, written for a specific taxpayer, are binding on both the Department and the taxpayer based on the facts presented.

This page will be updated periodically.

Questions or comments can be directed to Kristine Rompa, Tax Information Specialist, at (360) 705-6656 or KristineR@dor.wa.gov

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## **Excise Tax Advisory Number 3167.2011: Taxability of Fees Charged for Amusement and Recreation Services, July 1, 2011**

by Washington State Department of Revenue

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<b>Purpose</b>	The Department has become aware that there has been much confusion and misunderstanding regarding “entry fees” and “league fees,” as those terms are used in WAC 458-20-183 (Rule 183) <b>Amusement, recreation, and physical fitness services</b> . This Excise Tax Advisory (ETA) clarifies the distinction between nontaxable charges and taxable charges often associated with sport activities and sporting events.
<b>Background</b>	Charges for amusement and recreation services provided to a consumer are taxable as a retail sale under RCW 82.04.050. The gross proceeds of sale are subject to retailing Business & Occupation (B&O) and retail sales taxes, unless a specific exemption applies.

Charges that entitle persons, or groups of persons (teams), to participate in a sports activity or sports event, are charges for amusement and recreation services. Examples of sports activities and events include:

- Basketball, football, hockey, and soccer leagues;
- Cycling, running, swimming, and triathlon events; and
- Baseball, golf, softball, and tennis tournaments

Rule 183 recognizes that there may be fees associated with a sports activity or sports event that do not themselves entitle the person or team to participate in the underlying amusement and recreation activity. Rule 183 defines these fees as follows:

- “Entry fees” means those amounts paid **solely** to allow a person the privilege of entering a tournament or other type of competition. **This term does not include any amounts charged for the underlying activity.** Rule 183(2)(f). [Emphasis added.]
- “League fees” means those amounts paid **solely** for the privilege of allowing a person or person’s team to join an association of sports teams or clubs that compete chiefly amongst themselves. **The term also does not include any amounts charged for the underlying activity.** Rule 183(2)(j). [Emphasis added.]

Rule 183, in defining these terms, contemplates a situation in which a “league fee” or “entry fee” is imposed as well as separate charges that entitle the person or team to participate in the underlying activity. The Department has found that this is generally not the case. The “entry fees” and “league fees” charged by sports teams, leagues, tournaments, and events generally entitle the person or team to participate in the underlying activity.

**Note:** For tax purposes, a fee is classified according to the rights the consumer receives, not the title of the fee. Regardless of how a fee is titled, or what it is commonly called or referred to, if the fee is paid for the right to engage in the amusement and recreation activity, the fee is not an entry or league fee as those terms are defined in Rule 183. Thus, whether referred to as an entry fee, league fee, participation fee, or player fee, or some other name, if the fee entitles the person or team to engage in an amusement and recreation activity it is subject to retail sales tax.

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**Reporting  
income**

**Entry fees and league fees as defined in Rule 183:**

Entry fees and league fees as defined in Rule 183 are not charges for amusement and recreation services and are not retail sales. Thus, entry fees and league fees are not subject to retail sales tax.

- **For-profit and non-profit entities** – these fees are subject to the service and other B&O tax, unless specifically exempt by statute.
- **Counties, cities, and towns** – these fees are subject to the service and other B&O tax classification, if the activity is an “enterprise activity.” See, WAC 458-20-189 (Rule 189) **Sales to and by the state of Washington, counties, cities, towns, school districts, and fire districts** for additional information regarding enterprise activities.

**Fees that entitle a person or team to participate in the underlying amusement and recreation activity:**

These fees, regardless of how they are titled, are charges for amusement and recreation services and are retail sales when charged to consumers.

- **For-profit and non-profit entities** – these fees are subject to retailing B&O and retail sales taxes, unless exempt by statute.
- **Counties, cities, and towns** – these fees are subject to retailing B&O and retail sales taxes, unless specifically exempt by statute. If the activity is an “enterprise activity,” retailing B&O tax will apply. Otherwise, retailing B&O will apply. Regardless of the enterprise status, retail sales tax will be due.

**Non-profit  
Youth  
Organizations**

If a sports league or club qualifies as a non-profit youth organization engaged in character building of youth and is exempt from property tax under RCW 84.36.030; charges imposed for the underlying activity are exempt from both the B&O and retail sales taxes. RCW 82.04.4271 and 82.08.0291.

- The non-profit youth organization is not required to actually own real property that is exempt from property tax under RCW 84.36.030; it is enough that if the non-profit youth organization did own property, it would qualify under the statute.

**Examples**

1. The **City of Olympia** charges each player a \$150 “league fee,” which entitles the player to participate in Olympia’s summer softball league.
  - Although, the fee is called a “league fee,” the charge is a retail sale because it allows players to play softball. Therefore, the fee is subject to retail sales tax.
  - If the activity is an enterprise activity, the fees collected are also subject to the retailing B&O tax classification.
2. **Basketball for All (BFA)** is a for-profit basketball club comprised of six 10-player teams. Players wanting to join and play for a team must pay BFA a \$250 fee. Each player must also separately pay a \$25 fee to Washington Basketball Inc. (WBI), a state association that provides administrative guidance and technical support to registered clubs, an insurance policy covering players, and general promotion of the game of basketball.
  - The \$250 fee charged by BFA is a retail sale because it allows players to play basketball. Retailing B&O and retail sales taxes apply.
  - The \$25 fee charged by WBI is subject to service and other activities B&O tax and is not subject to retail sales tax WBI is not providing the player with an opportunity to play basketball (the underlying amusement or recreational activity).
3. **Same scenario as in Example 2**, except BFA is also paying a \$100 “league fee” to the Hoops Basketball League (HBL) for each team wishing to play in that league. HBL schedules games and maintains the rankings of individual teams. Participating teams/clubs are responsible for finding and paying for facilities and referees for home games.

- The \$100 fee charged by HBL is not a retail sale because it is paid solely to allow teams to join an association of sports teams or clubs that compete with each other.
  - It is the \$250 fee charged players by BFA, as noted in Example 2, that reflects the retail sale of amusement and recreation services.
4. **Same scenario as in Example 2**, except BFA is also paying a \$750 “league fee” to The National Basketball League (NBL) for each team wishing to play in that league. NBL not only schedules games and maintains individual team rankings, but also provides the facilities and referees for the games.
    - The \$750 “league fee” charge reflects a charge for amusement and recreation services because it entitles team players to participate in the underlying activity and is subject to retail sales tax.
    - The \$250 BFA charge to the players is also a retail sale of amusement and recreation services.
  5. **The Senior Soccers** holds an annual tournament. Each player must pay a \$200 fee in order to play in the tournament.
    - The tournament fee is subject to retail sales tax because it is paid in order to participate in the underlying amusement and recreational activity (playing soccer)
    - The tournament fees are subject to retailing B&O tax.
  6. **Running Club** hosts an annual 10k race, charging each runner a \$25 “entry fee” to participate in the run.
    - The \$25 “entry fee” is a retail sale because it is paid by the runner for the right to run in the race and is subject to retailing B&O and retail sales taxes.
  7. **Spike the Ball**, a non-profit youth volleyball league charges each youth player \$350 to play in the winter league.
    - If Spike the Ball is a non-profit youth organization engaged in character building of youth and would be exempt from property tax under RCW 84.63.030, the \$350 is not subject to retail sales tax.
    - The charges are not subject to B&O tax pursuant to RCW 82.04.4271.

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*Note: To view this Excise Tax Advisory in its original format with the Department of Revenue logo, go to <http://www.dor.wa.gov/docs/rules/eta3000/eta31672011.pdf>.*

# Initiative 1183

After the failure of Initiatives 1100 and 1105 to pass in 2010, supporters of the privatization of the state liquor monopoly are back for another try. Initiative 1183 would privatize both the distribution system and the retail sale of liquor in Washington. To be placed on the November 8, 2011 ballot, an initiative needs 241,153 valid signatures. Because over 350,000 signatures were handed in for this initiative, it will almost certainly be on the ballot.

Some features of the new initiative are in response to criticisms made last year. For example, people were concerned that every convenience store and gas station in Washington would be selling liquor. This initiative specifies that a store must have 10,000 square feet under one roof. Supporters estimate that there are 1,300 to 1,500 stores<sup>1</sup> that meet that size requirement compared to the 300 plus stores being operated by the state now. Last year, there was also criticism that having many additional stores selling liquor would present public safety problems. This initiative sets aside \$10 million per year from the Liquor Revolving Fund to enhance public safety programs in cities and counties.

## Effect on City and County Liquor Revenue Distributions

How would the initiative affect the distributions that cities and counties currently get from the Liquor Revolving Fund and liquor excise taxes? The initiative does not affect liquor excise taxes. Those funds would continue to be received by cities and counties just as they are now. Regarding liquor profits, section 302 of the initiative states, in part:

The distribution of spirits license fees under sections 103 and 105 of this act through the liquor revolving fund to border areas, counties, cities, towns, and the municipal research center<sup>2</sup> must be made in a manner that provides that each category of recipients receive, in the aggregate, no less than it received from the liquor revolving fund during comparable periods prior to the effective date of this section.

Because the state would no longer be selling liquor if the initiative passes, there would be no state markup (profits). Instead, the initiative proposes license fees. For retailers, the fees would be 17 percent of gross revenues from liquor sales. Distributors would pay license fees of 10 percent on sales during the first two years and five percent from then on. However, if the total of all fees collected from distributors during the period March 1, 2012 through March 31, 2013 is less than \$150 million, the Liquor Control Board (LCB) would collect additional fees from the distributors by May 31, 2013 to bring the total up to \$150 million. If the total fees collected from distributors are

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<sup>1</sup>Interview of Bruce Beckett by TVW on July 15, 2011. There are exceptions. Someone buying an existing state store at auction may sell liquor (with a license) even if the store does not meet the minimum size requirement.

<sup>2</sup>Distributions are not made to the "municipal research [and services] center." They are made to the Department of Commerce for the county research services account and the city and town research services account. Those accounts are used to fund the contract between the department and MRSC, under which MRSC provides its services to cities and counties.

more than \$150 million, the distributors would get a credit against future fees under rules developed by the LCB. For the years after March 31, 2013, there are no payment guarantees.

If the initiative qualifies for the ballot, the Office of Financial Management will publish a fiscal note on the financial impact of the initiative in early August. This note would provide information as to whether this licensing system would produce enough revenue after the first year to fund the amounts that cities, counties, border areas, and MRSC (via contract with the Department of Commerce) received during a comparable period.

**Timing.** If the initiative is on the November ballot and passes, implementation will move along quickly. By January 1, 2012, the LCB must issue distributor licenses. Distributors with licenses will be able to sell liquor starting March 1, 2012. The first date that retailers with licenses can sell liquor will be June 1, 2012. June 1, 2012 is also the date by which all state liquor stores must be closed.

**Issue with ESSB 5942.** The initiative repeals any law, such as ESSB 5942, that would lease the warehousing and distribution of liquor in the state. See page 11 for a short discussion of ESSB 5942.