

BUDGET SUGGESTIONS

For 2003



Information Bulletin No. 513
August 2002

MUNICIPAL
RESEARCH
& SERVICES
CENTER
OF WASHINGTON

Budget Suggestions For 2003

**Municipal Research & Services Center
of Washington**

2601 Fourth Ave, Suite 800

Seattle, WA 98121-1280

(206) 625-1300

mrsc@mrsc.org ■ www.mrsc.org

The Municipal Research & Services Center of Washington gratefully acknowledges the financial support of the Municipal Research Council, which made the publication of this document possible.

Copyright © 2002 by the Municipal Research & Services Center of Washington. All rights reserved. Except as permitted under the Copyright Act of 1976, no part of this publication may be reproduced or distributed in any form or by any means or stored in a database or retrieval system without the prior written permission of the publisher; however, governmental entities in the state of Washington are granted permission to reproduce and distribute this publication for official use.

Introduction

Here is your copy of *Budget Suggestions for 2003*. As always, we try to provide you with timely budget information, within the constraints that we face in getting information from the state.

In this publication you will find:

- Descriptions and interpretations of 2002 legislation that may affect your budget.
- CPI forecasts and state-shared revenue forecasts, including a look ahead to 2004.
- An update on the tax increment financing legislation by Jeffrey Nave of Foster Pepper & Shefelman.
- An article on the levy lid lift by Stacey Crawshaw-Lewis of Preston Gates & Ellis.
- An article on e-mail meetings and public records by Paul Sullivan, MRSC Legal Consultant.
- A discussion of performance measures from Mike Bailey, Finance Director, City of Lynnwood.
- Some information on property taxes and state utility taxes on water used for irrigation.
- Analyses of Initiative 776, Initiative 790, and Referendum 51.

Judith Cox, our Public Finance Consultant, was the author of much of the material in this publication. We also had contributions from the people noted above and we thank them for their assistance. Holly Martin designed and produced the document. Nicole Stiver, Connie Elliot, and Amy Harper proofed a portion of the document. Bob Meinig, Jim Doherty, and Paul Sullivan, MRSC legal consultants, provided insight on Initiative 776 and some of the legislation. We hope this material will assist you as you proceed through the budget process.



Richard Yukubousky, Executive Director
Municipal Research & Services Center of Washington

Table of Contents

Budget Calendar for Preparation of 2003 Budgets	1
Biennial Budgets	3
Share Your Information Resources Through MRSC	3
Association of Washington Cities Service Fees – 2003	3
 County Budget Calendar for Preparation of 2003 Budgets	 4
 2002 Legislation That May Affect Your Budget	 5
Referendum 51 (ESHB 2969, Ch. 202, Laws of 2002)	5
Changes in City Bid Limits (HB 2527, Ch. 94, Laws of 2002)	5
Tax Increment Financing Again (SHB 2592, Ch. 12, Laws of 2002)	5
Provision of Street Light Services (HB 2902, Ch. 102, Laws of 2002)	5
Sales Tax for Emergency Communications Systems (2SHB 1477, Ch. 176, Laws of 2002)	6
Funding for Wireless E-911 Calls (HB 2595, Ch. 341, Laws of 2002)	6
New Metropolitan Park District Legislation (SHB 2557, Ch. 88, Laws of 2002)	6
Public Facilities District Laws Amended (3SSB 5514, Ch. 363, Laws of 2002)	7
Property Tax Exemption for Multiple-Unit Dwellings Broadened (SHB 2466, Ch.146, Laws of 2002)	7
Revitalizing Downtown and Neighborhood Commercial Districts (SHB 2437, Ch. 79, Laws of 2002)	8
Surcharge on Recording Fees (SHB 2060, Ch. 394, Laws of 2002)	8
Two Jail Bills (HB 2407, Ch.124, Laws of 2002) and (SHB 2541, Ch. 125, Laws of 2002)	8
Protection for LID Guaranty Funds (ESB 6505, Ch. 41, Laws of 2002)	9
Cities May No Longer Levy Utility Taxes on Payphone Services (SHB 2031, Ch. 179, Laws of 2002)	9
Street Vacation Fees (SB 6798, Ch. 55, Laws of 2002)	9
 Inflation Forecast	 10
Consumer Price Index	10
Implicit Price Deflator for Personal Consumption Expenditures	16
 CPI Changes for 2002	 18
 Revenue Forecasts	 20
Franchise Fees and Utility Taxes	20
City State-Shared Revenues	21
Table 2 – State-Collected Revenues – Total Dollar Amount	23
Table 3 – State-Collected Revenues – Per Capita Amount	23
Where Are the County State-Shared Revenue Forecasts?	24
Table 4 – Distribution of Fire Insurance Premium Tax	25
What's Ahead for Cities and Counties in 2004?	27

Table of Contents continued

Tax Increment Financing (Again) 28
by Jeffrey C. Nave, Foster Pepper & Shefelman PLLC

Reintroducing the Levy Lid Lift 34
by Stacey Crawshaw-Leis, Preston Gates & Ellis LLP

E-Mail Meetings and Public Records 36
by Paul Sullivan, MRSC Legal Consultant

Performance Measurement – “Its Time Has Come” 39
by Michael Bailey, Finance Director, City of Lynnwood

New IRS Services 42

Taxing Matters 43

Referendum 51 46

Initiatives 48

Budget Calendar for Preparation of 2003 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 2002 Date
1. Request by city 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. ^{1,2}	September 9
2. Estimates are to be filed with the city clerk.	By fourth Monday in September. ²	September 23
3. Estimates are presented to the chief administrative officer (CAO) for modifications, revisions or additions. City 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 1
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 7
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.	

Budget Suggestions for 2003

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2002 Date
6. CAO prepares preliminary budget and budget message ³ and files with the city legislative body and city clerk.	At least 60 days before the ensuing fiscal year.	November 1
7. Clerk publishes notice of filing of preliminary budget with city clerk 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 1 through November 15
8. Setting property tax levies (RCW 84.52.020 and RCW 84.52.070).	November 15 for first class cities (except Seattle), code cities, and second class cities. November 30 for Seattle 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 1 through 29 (suggested)
10. Copies of proposed (preliminary) budget made available to the public.	No later than six weeks before January 1.	November 20
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 2
12. Adoption of budget for 2003.	Following the public hearing and prior to beginning of the ensuing fiscal year.	Day after last 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
<p>¹RCW 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.</p> <p>²Or 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).</p> <p>³RCW 35.33.031 and RCW 35A.33.055 specify that the budget message must contain the following:</p> <ol style="list-style-type: none"> 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. 		

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. For the 2003-2004 biennium, the last date to pass such an ordinance was June 30, 2002. Cities and town that missed that deadline must wait until 2005-2006 biennium because the first year of a biennial budget must be an odd-numbered year.

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, 2003) nor later than the end of the first year of the biennium (December 31, 2003). 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 & 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.

Association of Washington Cities Service Fees – 2003	
Population Category	Per Capita Rate
Greater than 300,000	0.2301
100,001 to 300,000	0.3578
20,001 to 100,000	0.5585
5,000 to 20,000	0.5079
Less than 5,000	0.4064
Minimum	\$27.50

Maximum fee is \$110,000.

Budget Calendar for Preparation of 2003 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 2002 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	Second Monday in July	July 8
2. Filing of estimates with Auditor or Chief Financial Officer by all officials. RCW 36.40.010	Second Monday in August	August 12
3. Preliminary county budget prepared by Auditor or Chief Financial Officer submitted to board of commissioners. RCW 36.40.050	First Tuesday in September	September 3
4. Preliminary budget hearing by board of commissioners. RCW 36.40.070	First Monday in October	October 7
5. Alternative preliminary budget hearing by board of commissioners. RCW 36.40.071	First Monday in December	December 2
6. Final budget adoption by board of commissioners. RCW 36.40.080	Upon conclusion of budget hearing	Practically, December 31

2002 Legislation That May Affect Your Budget

Referendum 51 (ESHB 2969, Ch. 202, Laws of 2002)

The legislature voted to send this transportation revenue bill to a vote of the people. See the discussion on page 46.

Changes in City Bid Limits (HB 2527, Ch. 94, Laws of 2002)

Chapter 94, Laws of 2002 changes bid (or day labor) limits for Washington cities and towns. The changes took effect on June 13, 2002. The bill raises the day labor limits to:

First Class City over 150,000 population:

- \$70,000 and, after January 1, 2010, \$90,000 for a multi-craft or trade project.
- \$35,000 and, after January 1, 2010, \$45,000 for a single craft or trade project.

First Class City under 150,000 population and Code City 20,000 - 150,000 population:

- \$50,000 and, after January 1, 2010, \$65,000 for a multi-craft or trade project.
- \$30,000 and, after January 1, 2010, \$40,000 for a single craft or trade project.

Second Class City, Code City under 20,000 population, or Town:

- \$45,000 and, after January 1, 2010, \$60,000 for a multi-craft or trade project.
- \$30,000 and, after January 1, 2010, \$40,000 for a single craft or trade project.

These increases reflect inflation since the limits were last adjusted in 1987. The 2010 adjustments assume a three percent annual inflation rate.

Tax Increment Financing Again (SHB 2592, Ch. 12, Laws of 2002)

Several changes were made in last year's community revitalization financing law, including the repeal of the 2010 sunset date. Read more about it in an article beginning on page 28.

Provision of Street Light Services (HB 2902, Ch. 102, Laws of 2002)

In AGO No. 1 2001, the Attorney General concluded that cities could not impose a charge on their utility customers in order to provide street lighting. The analysis addressed both cities with their own electric utilities and those that put a charge for street lights on their water and sewer bills. This legislation amends RCW 35.92.050 to explicitly allow **cities operating their own electric utilities** to pay for street light services as part of their general electric rates instead of their general fund. The conclusion that street light charges may not be added to water and sewer bills remains.

Sales Tax for Emergency Communications Systems (2SHB 1477, Ch. 176, Laws of 2002)

With the approval of a majority of the voters, counties may levy a sales tax of 0.1 percent to provide funds for costs associated with financing, design, acquisition, construction, equipping, operating, maintaining, remodeling, repairing, reequipping, and improvement of emergency communications systems and facilities. As WSAC pointed out in the April 5, 2002, issue of *The Courthouse Journal*, “this very broad purpose could include such things as a seismic retrofit of the dispatch center, purchase of new police radios, equipment upgrades, and salary assistance for 911 call takers.”

In a county with a population of more than 500,000 (King, Snohomish, and Pierce), the county must enter an interlocal agreement with any city over 50,000 that operates its own emergency communications system, before submitting the ballot proposition to the voters. This interlocal will determine the distribution of the tax, if it passes. In addition, in any county that provides these services to another government agency by contract, the contract must be reviewed and renegotiated or affirmed before a vote on this tax.

Funding for Wireless E-911 Calls (HB 2595, Ch. 341, Laws of 2002)

Although 35 percent of 911 calls are made from wireless phones, currently a 911 call from a wireless phone in Washington does not provide location or callback telephone number information.

Before the passage of this law, counties could levy a tax of 50 cents on each switched access telephone line (for those of us unschooled in telecommunications terminology, this means “regular” telephones) and 25 cents on wireless phones. This bill permits a county to levy an enhanced 911 tax of 50 cents for wireless lines whose place of primary use is within the county.

It also puts a state tax on wireless phones of 20 cents per line, matching the tax rate that was already levied on switched access lines. State funds are to be used for, among other things, providing adequate funding to counties to implement wireless E-911 service. The state funds from the tax on switched access lines are not currently shared with any county that has not levied the full 50 cent county tax on switched access lines. In like fashion, the funds from the new state tax on wireless lines will not be shared with any county that has not levied the full 50 cent tax on wireless lines.

A portion of the new tax revenue will be used to offset the wireless companies’ costs of providing the location and telephone number information.

This bill is effective on January 1, 2003.

New Metropolitan Park District Legislation (SHB 2557, Ch. 88, Laws of 2002)

Prior to the passage of this bill, only cities with a population of 5,000 or more had the authority to form metropolitan park districts (MPDs). Now all cities and counties may form metropolitan park districts that include territory in portions of one or more cities or counties. These districts can be created to acquire, manage, maintain, and improve parks, parkways, boulevards, and recreational facilities. Note that “recreational facilities” are a new permitted use of funds.

MRSC has established an extensive Web site at www.mrsc.org/parks/SPD-MPD.htm, giving full details on the new legislation. Among the topics included are formation of an MPD, governance alternatives, and taxing and debt issuance authority.

From a finance standpoint, the metropolitan park district statutes, in general, provide for greater and more secure funding than park and recreation districts and service areas. Almost completely across the board, metropolitan park districts offer more fiscal capacity and flexibility. This is particularly true for its property tax levy. First, the MPD levy is less subject to prorationing. Although MPDs formed on or after January 1, 2002 are further down the ladder than one formed before that date, anything is better than being absolutely the first districts to have their levy cut if prorationing is necessary. That is the situation for park and recreation districts and service areas. MPDs also have a higher maximum levy – 75 cents per thousand dollars assessed valuation (AV) versus 60 cents. In addition, the MPD levy is voted on by the legislative body and is permanent. Park and recreation districts and service area levies are subject to a vote of the people at least every six years and setting the levy requires a 60 percent majority with a 40 percent voter turnout.

Park and recreation service areas have slightly more generous debt limits than MPDs, having the ability to levy nonvoted debt in an amount equal to 3/8 percent of AV compared to 1/4 percent for MPDs. The total amount – voted and nonvoted – is the same 2 1/2 percent of AV. Park and recreation districts may incur nonvoted debt in an amount equal to 1/4 percent of AV and the total limit is 1 1/4 percent of AV.

Public Facilities District Laws Amended (3SSB 5514, Ch. 363, Laws of 2002)

This 2002 legislation makes some significant changes to the original legislation of 1999 (ch. 165, Laws of 1999). Public facility districts (PFDs) may now include counties in addition cities and contiguous cities in those counties (as long as the county or counties have a population of under one million) in the creation and joint operation of those facilities. Governance provisions are spelled out for such districts. In addition, the term “special events center,” which was considered by some to be ambiguous in the original legislation, is defined as “a facility, available to the public, used for community events, sporting events, trade shows, and artistic, musical, theatrical, or other cultural exhibitions, presentations, or performances.”

The provision in the 1999 legislation that prohibited a city from levying an admission tax on tickets to events in the public facility has been amended to permit such a tax if the revenue is used for construction or maintenance and operation of the facility or for program development and enhancement.

The original 1999 legislation provided for a credit against the state sales tax for a PFD of 0.033 percent. It said that the PFD projects had to commence construction before January 1, 2003, in order to be eligible for this tax break, but did not give a date by which the PFD had to be formed. This legislation states that the PFD must be formed before July 31, 2002, and commence construction by January 1, 2004, in order to qualify for the sales tax credit. The authors of the legislation also sought approval of a sales tax exemption for the cost to construct and equip the PFD projects. This section was vetoed by the governor.

Property Tax Exemption for Multiple-Unit Dwellings Broadened (SHB 2466, Ch.146, Laws of 2002)

In 1995, the legislature passed a law that provided for certain property tax exemptions in urban areas of some cities that were planning under the Growth Management Act. It wanted to provide incentives for the construction and rehabilitation of multifamily housing in areas that cities designated as "residential targeted areas." The legislation gave a 10-year exemption on property taxes on new construction or the increase in

value of a structure because it had been rehabilitated or converted to multiple-unit housing. The exemption does not apply to the value of the land and the housing must meet certain criteria set by the city council. The 1995 bill applied only to cities with a population of at least 150,000. In subsequent years, that limit has been lowered. The current legislation lowers the population requirement to 30,000 or the largest city in a county planning under growth management if no city has a population of at least 30,000.

New language is added providing that, at the end of the exemption period, the new or rehabilitated cost shall be considered “new construction” for property tax purposes in setting the tax levy for the coming year.

Revitalizing Downtown and Neighborhood Commercial Districts (SHB 2437, Ch. 79, Laws of 2002)

This bill does not appear to provide any new authority or opportunities for cities. It lets cities (with a population of over 100,000) designate certain areas as “downtown” or “neighborhood commercial districts,” undertake certain kinds of revitalization activities, measure the increase in its local sales tax revenue in the areas, and spend that increase on revitalization costs, debt service on bonds issued for projects in these districts, etc.

These are all things that we think any city could have done and can do even if this legislation had not been passed. Under existing statutes, cities already could (and some currently do) define areas and neighborhoods that need improvements and spend city funds for various kinds of improvements, planning, promotional activities, historic preservation, and maintenance and security activities. The funds for doing this come from the general fund, of which sales taxes are a part. Apparently no city, so far, has found it to be worth the trouble to keep track of its sales tax from a particular area of the city, but it could have done so if it wished.

Surcharge on Recording Fees (SHB 2060, Ch. 394, Laws of 2002)

Beginning June 13, 2002, county auditors must collect a \$10 surcharge for each document recorded. The auditor may keep five percent of the funds as an administrative fee. Of the remainder, 40 percent will go to the Washington Housing Trust account. The Office of Community Development will develop guidelines for the use of these funds to support housing for very low-income persons. The remainder of the funds will be retained by the county to be used for very low-income housing projects in the county and/or in cities under an interlocal agreement.

Two Jail Bills (HB 2407, Ch.124, Laws of 2002) and (SHB 2541, Ch. 125, Laws of 2002)

Ch. 124 permits regional jails to be created and operated by two or more local governments under the Interlocal Cooperation Act (ch. 39.34 RCW). Ch. 125 lets any city or county contract for jail services with any other city or county. In both bills, there is a provision that any jurisdiction that confines a person in a jail in another county must provide private telephone, video-conferencing, or in-person contact between the defendant and his or her public defense counsel.

Protection for LID Guaranty Funds (ESB 6505, Ch. 41, Laws of 2002)

Cities may now stipulate in an LID bond ordinance that the bonds are not secured by the LID Guaranty Fund. Instead the city may provide a reserve fund. Some smaller cities that have done “developer’s LIDs” have had their guaranty fund drawn down when the development has not been as successful as originally hoped. This legislation provides protection for that fund.

Cities May No Longer Levy Utility Taxes on Payphone Services (SHB 2031, Ch. 179, Laws of 2002)

This bill amends RCW 35.21.710 to create a new category of telephone services called “payphone service.” Along with gross revenues from “competitive telephone service,” those from “payphone service,” from pay phone businesses that do not own their lines or their affiliates, cannot be taxed at utility tax rates. They can be taxed at the retailing business and occupation (B&O) rate. This is small comfort to most cities, however, because the maximum rate in most cities that levy a B&O tax is 0.2 percent compared to the maximum utility tax rate on “telephone business” of six percent and most cities do not even have a B&O tax. The utility tax revenues that cities have received in recent years from taxes on the increasingly widespread use of cell phones almost certainly overwhelms the revenue loss from this bill, but every little bit hurts these days.

One of the attorneys on our staff has read that the number of pay telephones is decreasing because these companies are not getting enough business to cover their costs due to the increasing number of people using cell phones. He hypothesizes that this “tax break” may have been passed for a public policy purpose in the hope that it will slow or halt the decline in the number of such phones. We know it is difficult for some people in urban areas to believe (when they practically get walked over by people talking on cell phones) there are people who do not have cell phones and depend on being able to find a pay phone when they need one.

Street Vacation Fees (SB 6798, Ch. 55, Laws of 2002)

Cities can require purchasers of vacated street property to pay the city an amount up to 50 percent of the appraised value if the street or alley has been part of the public right-of-way for less than 25 years, and up to 100 percent of the appraised value if the property has been in a dedicated public right-of-way for 25 years or more. This bill adds the provision that a city may also require a payment of 100 percent of the appraised value if the property or parts of it were acquired at public expense.

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.

Information on the most recent releases of the CPI can be obtained from the CPI Hotline in Seattle (206) 553-0645 or Portland (503) 231-2045. A link to the most recent releases can be found at www.mrsc.org/finance/cpipage.htm. Questions can be addressed to the Bureau of Labor Statistics, Information and Correspondence, 71 Stevenson Street, PO Box 3766, San Francisco, CA 94119-3766, telephone number, (415) 975-4350.

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 12 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 2002 and 2003.

In May and June, almost all forecasters lowered their inflation forecasts for 2002 compared to their earlier forecasts. We have forecasts for the national inflation rates from the Philadelphia Federal Reserve Bank, which surveys 37 economists; the Research Seminar in Quantitative Economics at the University of Michigan; *The Wall Street Journal*, which surveys 55 economists twice a year (probably some of the same economists that the Philadelphia Federal Reserve surveys); DRI-WEFA, a private consulting firm; and the Office of the Forecast Council for our state. The Forecast Council has used the DRI-WEFA estimate for its forecast of state personal income and we are following their lead. We observe, however, that the inflation forecast for 2002 seems a bit high, based on the data for the first five months.

For the Seattle-Tacoma area we depend on the Office of the Forecast Council and local economists. We are unable to get forecasts for the Portland area.

After growing at a torrid rate of 6.1 percent in the first quarter of 2002, growth in gross domestic product slowed in the second quarter. The consensus of the economists polled by the Wall Street Journal is that growth for the next 12 months will be at a rate of 3.5 percent. This is a relatively low rate of growth for an economy in the early stages of an expansion. The unemployment rate is holding steady as firms are increasing output with productivity gains rather than hiring new workers. However, because of the productivity increases, the average wage is rising for those workers who do have jobs.

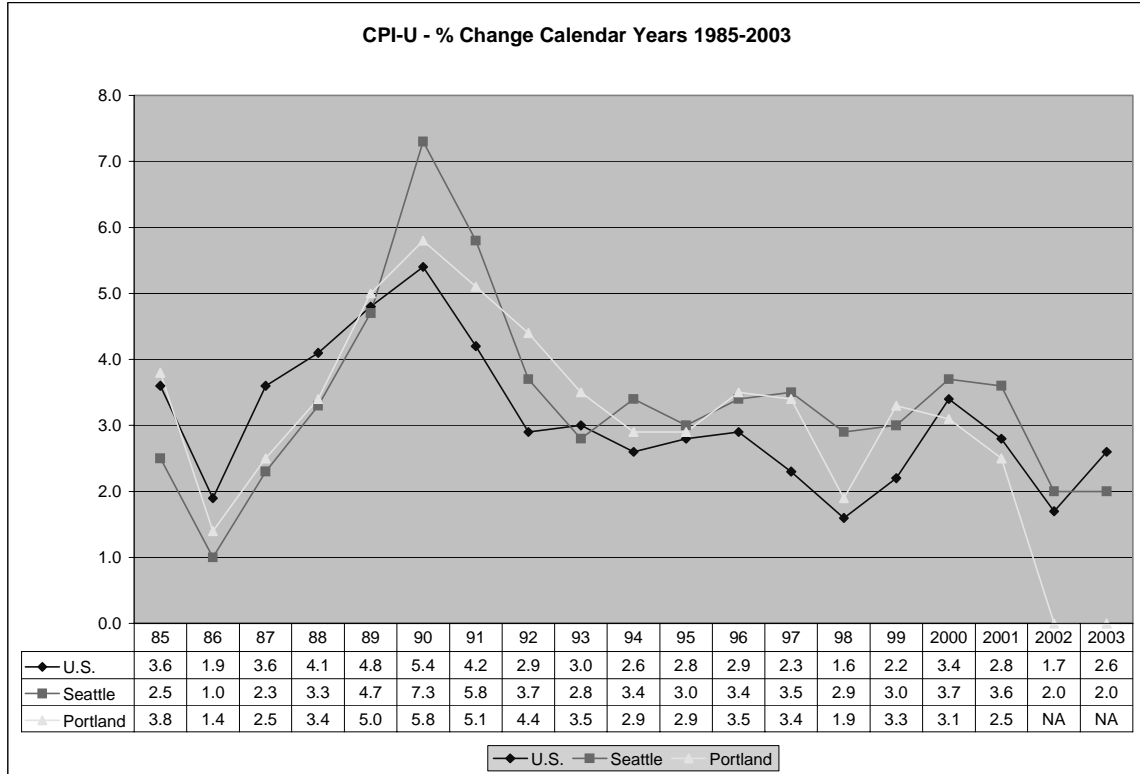
The troubles in the financial markets has had a negative effect on consumer confidence and they have slowed their spending, but not thrown in the towel. Inflation is following its usual pattern of slowing down in the early stages of a recovery. By autumn, we should begin to see an increase in the rate.

It is typical for growth in Washington State to follow the national pattern with a lag. For the remainder of 2002, economists expect a drop in employment in the state and in personal income as aerospace employment continues to fall by more than the increase in jobs at the nuclear waste vitrification plant being built at Hanford. Employment has declined for five straight quarters (through the second quarter of 2002) for the first time since the recession of 1982-1983. An upturn is expected in 2003.

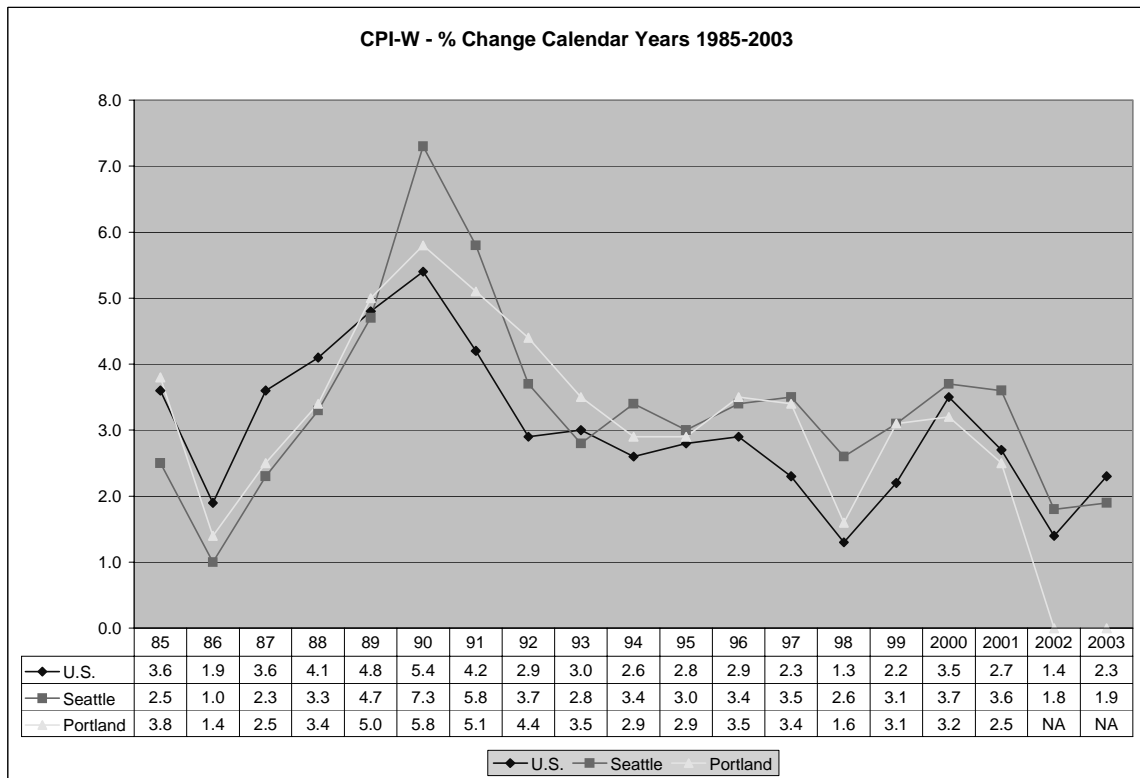
For the last eight years, the inflation rate in the Seattle area has been higher than the national rate for both the CPI-U and CPI-W. The Office of the Forecast Council is predicting that the Seattle rate for CPI-U will be below the national rate for the next few years.

There are always risks to any forecast. For the first time in a number of years, the value of the U.S. dollar is falling against foreign currencies. Foreign firms may hold prices constant in dollar terms to maintain market share. But if they let them rise, that will have an impact on inflation figures. In addition, there are concerns about increases in energy prices if military action is taken to remove Saddam Hussein from power.

Budget Suggestions for 2003



Figures for 2002-2003 are Estimates



Figures for 2002-2003 are Estimates

Table 1
Consumer Price Index
1990 to Present

Year	Month	All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
		Seattle	Portland	U.S.	Seattle	Portland	U.S.
1990	January			127.4 (5.2%)			125.9 (5.2%)
	February			128.0 (5.3)			126.4 (5.2)
	March			128.7 (5.2)			127.1 (5.2)
	April			128.9 (4.7)			127.3 (4.5)
	May			129.2 (4.4)			127.5 (4.1)
	June			129.9 (4.7)			128.3 (4.5)
	First half '90	124.2 (6.4%)	124.9 (4.7%)		122.0 (6.4%)	121.8 (4.6%)	
	July			130.4 (4.8)			128.7 (4.5)
	August			131.6 (5.6)			129.9 (5.4)
	September			132.7 (6.2)			131.1 (6.1)
	October			133.5 (6.3)			131.9 (6.2)
	November			133.8 (6.3)			132.2 (6.3)
	December			133.8 (6.1)			132.2 (6.1)
Second half '90	129.4 (8.2)	129.8 (6.7)		126.9 (7.9)	126.6 (6.7)		
ANNUAL AVE.	126.8 (7.4)	127.4 (5.8)	130.7 (5.4)	124.4 (7.1)	124.2 (5.6)	129.0 (5.2)	
1991	January			134.6 (5.7%)			132.8 (5.5%)
	February			134.8 (5.3)			132.8 (5.1)
	March			135.0 (4.9)			133.0 (4.6)
	April			135.2 (4.9)			133.3 (4.7)
	May			135.6 (5.0)			133.8 (4.9)
	June			136.0 (4.7)			134.1 (4.5)
	First half '91	133.0 (7.1%)	132.8 (6.3%)		130.2 (6.7%)	129.6 (6.4%)	
	July			136.2 (4.4)			134.3 (4.4)
	August			136.6 (3.8)			134.6 (3.6)
	September			137.2 (3.4)			135.2 (3.1)
	October			137.4 (2.9)			135.4 (2.7)
	November			137.8 (3.0)			135.8 (2.7)
	December			137.9 (3.1)			135.9 (2.8)
Second half '91	135.2 (4.5)	135.1 (4.1)		132.4 (4.3)	132.1 (4.3)		
ANNUAL AVE.	134.1 (5.8)	133.9 (5.1)	136.2 (4.2)	131.3 (5.5)	130.8 (5.3)	134.3 (4.1)	
1992	January			138.1 (2.6%)			136.0 (2.4%)
	February			138.6 (2.8)			136.4 (2.7)
	March			139.3 (3.2)			137.0 (3.0)
	April			139.5 (3.2)			137.4 (3.0)
	May			139.7 (3.0)			137.6 (2.8)
	June			140.2 (3.1)			137.6 (3.0)
	First half '92	137.8 (3.6%)	138.8 (4.5%)		134.8 (3.5%)	135.5 (4.6%)	
	July			140.5 (3.2)			138.4 (3.1)
	August			140.9 (3.1)			138.8 (3.1)
	September			141.3 (3.0)			139.1 (2.9)
	October			141.8 (3.2)			139.6 (3.1)
	November			142.0 (3.0)			139.8 (2.9)
	December			141.9 (2.9)			139.8 (2.9)
Second half '92	140.2 (3.7)	140.9 (4.3)		137.2 (3.6)	137.7 (4.2)		
ANNUAL AVE.	139.0 (3.7)	139.8 (4.4)	140.3 (3.0)	136.0 (3.6)	136.6 (4.4)	138.2 (2.9)	
1993	January			142.6 (3.3%)			140.3 (3.2%)
	February			143.1 (3.2)			140.7 (3.2)
	March			143.6 (3.1)			141.1 (3.0)
	April			144.0 (3.2)			141.6 (3.1)
	May			144.2 (3.2)			141.9 (3.1)
	June			144.4 (3.0)			142.0 (2.8)
	First half '93	141.9 (3.0%)	143.6 (3.5%)		138.9 (3.0%)	140.3 (3.5%)	
	July			144.4 (2.8)			142.1 (2.7)
	August			144.8 (2.8)			142.4 (2.6)
	September			145.1 (2.7)			142.6 (2.5)

Budget Suggestions for 2003

Year	Month	All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
		Seattle	Portland	U.S.	Seattle	Portland	U.S.
	October			145.7 (2.8)			143.3 (2.7)
	November			145.8 (2.7)			143.4 (2.6)
	December			145.8 (2.7)			143.3 (2.5)
	Second half '93	143.9 (2.6)	145.8 (3.5)		141.1 (2.8)	142.6 (3.6)	
	ANNUAL AVE.	142.9 (2.8)	144.7 (3.5)	144.5 (3.0)	140.0 (2.9)	141.5 (3.6)	142.1 (2.8)
1994	January			146.2 (2.5%)			143.6 (2.4%)
	February			146.7 (2.5)			144.0 (2.3)
	March			147.2 (2.5)			144.4 (2.3)
	April			147.4 (2.4)			144.7 (2.2)
	May			147.5 (2.3)			144.9 (2.1)
	June			148.0 (2.5)			145.4 (2.4)
	First half '94	146.4 (3.2%)	147.7 (2.9%)		143.7 (3.5%)	144.3 (2.9%)	
	July			148.4 (2.8)			145.8 (2.6%)
	August			149.0 (2.9)			146.5 (2.9)
	September			149.4 (3.0)			146.9 (3.0)
	October			149.5 (2.6)			147.0 (2.6)
	November			149.7 (2.7)			147.3 (2.7)
	December			149.7 (2.7)			147.2 (2.7)
	Second half '94	149.2 (3.7)	150.1 (2.9)		146.5 (3.8)	146.8 (2.8)	
	ANNUAL AVE.	147.8 (3.4)	148.9 (2.9)	148.2 (2.6)	145.1 (3.6)	145.6 (2.9)	145.6 (2.5)
1995	January			150.3 (2.8%)			147.8 (2.9%)
	February			150.9 (2.9)			148.3 (3.0)
	March			151.4 (2.9)			148.7 (3.0)
	April			151.9 (3.1)			149.3 (3.2)
	May			152.2 (3.2)			149.6 (3.2)
	June			152.5 (3.0)			149.9 (3.1)
	First half '95	151.2 (3.3%)	152.5 (3.2%)		148.3 (3.2%)	149.1 (3.3%)	
	July			152.5 (2.8)			149.9 (2.8)
	August			152.9 (2.6)			150.2 (2.5)
	September			153.2 (2.5)			150.6 (2.5)
	October			153.7 (2.8)			151.0 (2.7)
	November			153.6 (2.6)			150.9 (2.4)
	December			153.5 (2.5)			150.9 (2.5)
	Second half '95	153.3 (2.7)	153.9 (2.5)		150.4 (2.7)	150.7 (2.7)	
	ANNUAL AVE.	152.3 (3.0)	153.2 (2.9)	152.4 (2.8)	149.3 (2.9)	149.9 (3.0)	149.8 (2.9)
1996	January			154.4 (2.7%)			151.7 (2.6%)
	February			154.9 (2.7)			152.2 (2.6)
	March			155.7 (2.8)			152.9 (2.8)
	April			156.3 (2.9)			153.6 (2.9)
	May			156.6 (2.9)			154.0 (2.9)
	June			156.7 (2.8)			154.1 (2.8)
	First half '96	155.6 (2.9%)	157.2 (3.1%)		152.6 (2.9%)	153.9 (3.2%)	
	July			157.0 (3.0)			154.3 (2.9)
	August			157.3 (2.9)			154.5 (2.9)
	September			157.8 (3.0)			155.1 (3.0)
	October			158.3 (3.0)			155.5 (3.0)
	November			158.6 (3.3)			155.9 (3.3)
	December			158.6 (3.3)			155.9 (3.3)
	Second half '96	159.4 (4.0)	160.0 (4.0)		155.9 (3.7)	156.5 (3.8)	
	ANNUAL AVE.	157.5 (3.4)	158.6 (3.5)	156.9 (3.0)	154.3 (3.3)	155.2 (3.5)	154.1 (2.9)
1997	January			159.1 (3.0%)			156.3 (3.0%)
	February			159.6 (3.0)			156.8 (3.0)
	March			160.0 (2.8)			157.0 (2.7)
	April			160.2 (2.5)			157.2 (2.3)
	May			160.1 (2.2)			157.2 (2.1)
	June			160.3 (2.3)			157.4 (2.1)
	First half '97	161.9 (4.0%)	162.6 (3.4%)		158.2 (3.7%)	159.0 (3.3%)	
	July			160.5 (2.2)			157.5 (2.1)
	August			160.8 (2.2)			157.8 (2.1)
	September			161.2 (2.2)			158.3 (2.1)

		All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
Year	Month	Seattle	Portland	U.S.	Seattle	Portland	U.S.
	October			161.6 (2.1)			158.5 (1.9)
	November			161.5 (1.8)			158.5 (1.7)
	December			161.3 (1.7)			158.2 (1.5)
	Second half '97	164.1 (2.9)	165.5 (3.4)		159.9 (2.6)	161.7 (3.3)	
	ANNUAL AVE.	163.0 (3.5)	164.0 (3.4)	160.5 (2.3)	159.0 (3.1)	160.4 (3.3)	157.6 (2.2)
1998	January			161.6 (1.6%)			158.4 (1.3%)
	February	166.5 (N/A)		161.9 (1.4)	162.2 (N/A)		158.5 (1.1)
	March			162.2 (1.4)			158.7 (1.1)
	April	166.4 (N/A)		162.5 (1.4)	161.9 (N/A)		159.1 (1.2)
	May			162.8 (1.7)			159.5 (1.5)
	June	167.5 (N/A)		163.0 (1.7)	168.2 (N/A)		159.7 (1.5)
	First half '98	166.6 (2.9%)	166.1 (2.2%)		162.1 (2.5%)	162.2 (2.0%)	
	July			163.2 (1.7)			159.8 (1.5)
	August	168.5 (N/A)		163.4 (1.6)	168.5 (N/A)		160.0 (1.4)
	September			163.6 (1.5)			160.2 (1.2)
	October	169.3 (N/A)		164.0 (1.5)	164.9 (N/A)		160.6 (1.3)
	November			164.0 (1.5)			160.7 (1.4)
	December	169.4 (2.7)		163.9 (1.6)	164.9 (2.7)		160.7 (1.6)
	Second half '98	168.9 (2.9)	168.1 (1.6)		164.4 (2.8)	163.5 (1.1)	
	ANNUAL AVE.	167.7 (2.9)	167.1 (1.9)	163.0 (1.6)	163.2 (2.6)	162.9 (1.6)	159.7 (1.3)
1999	January			164.3 (1.7%)			161.0 (1.6%)
	February	170.6 (2.5)		164.5 (1.6)	166.0 (2.3)		161.1 (1.6)
	March			165.0 (1.7)			161.4 (1.7)
	April	172.2 (3.5)		166.2 (2.3)	167.8 (3.6)		162.7 (2.3)
	May			166.2 (2.1)			162.8 (2.1)
	June	172.7 (3.1)		166.2 (2.0)	168.0 (3.2)		162.8 (1.9)
	First half '99	171.6 (3.0)	170.8 (2.8)		167.0 (3.0)	166.2 (2.5)	
	July			166.7 (2.1)			163.3 (2.2)
	August	173.4 (2.9)		167.1 (2.3)	168.8 (3.1)		163.8 (2.4)
	September			167.9 (2.6)			164.7 (2.8)
	October	174.7 (3.2)		168.2 (2.6)	170.2 (3.2)		165.0 (2.7)
	November			168.3 (2.6)			165.1 (2.7)
	December	174.4 (3.0)		168.3 (2.7)	170.1 (3.2)		165.1 (2.7)
	Second half '99	174.0 (3.0)	174.4 (3.7)		169.5 (3.1)	169.6 (3.7)	
	ANNUAL AVE.	172.8 (3.0)	172.6 (3.3)	166.6 (2.2)	168.3 (3.1)	167.9 (3.1)	163.2 (2.2)
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)

Budget Suggestions for 2003

Year	Month	All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
		Seattle	Portland	U.S.	Seattle	Portland	U.S.
	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)

Implicit Price Deflator for Personal Consumption Expenditures

Monthly Index and Cumulative Percentage Change from July 2001

	Jul 01	Aug	Sep	Oct	Nov	Dec	Jan 02	Feb	Mar	Apr	May
Orig. Index	109.70	109.70	109.17	109.87	109.77	109.62	109.79	109.99	110.31	110.77	110.67
Cum. % Change		0.00	-0.48	0.16	0.06	-0.07	0.08	0.26	0.56	0.98	0.88
IPD % Proj.		0.00	-2.90	0.62	0.19	-0.18	0.16	0.45	0.83	1.30	1.06
Prev. 12 Mo. % Change		1.86	0.98	1.50	1.29	1.06	0.66	0.61	0.94	1.19	1.00

Source: Survey of Current Business, Table B.2 - 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 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 2001. The third row represents the projections of the annual IPD since July of 2001 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

Each 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 different** from the rate we have been seeing so far this year. It all depends on how much they “tweak” the data.

In past years, the cumulative percentage change (second row) has generally trended upward from month to month. This year, it has gone up and down and even been negative. In January, it was as low as 0.06 percent. Then, after some significant increases in February, March, and April, it got as high as 0.98, almost

1 percent. In May, it dropped again. It is interesting to look at the May figure in the bottom row, which shows the percentage change in the IPD over the past 12 months. If our statutes used the change in the IPD from May to May, we would know right now that the “magic number” for property tax levy increases for next year would be 1 percent.

If the IPD index number (first row) for July 2002 is at least 110.80, the change in the July to July IPD will be 1 percent. What it will actually turn out to be is very dependent on how much they change the numbers in the June revision.

We will publish the "annual inflation factor" in our Focus section of the MRSC Web site as soon as it is available sometime on or after August 30th. Beginning last year, the BEA stopped including the IPD in its news releases. That means we have to reach the “keeper” of this number in Washington, D.C. August 30, the day that information about July becomes available, is the Friday before the Labor Day weekend. So, there is a possibility that we will not have the information until the following week.

Remember, the number is not **official** until it has actually been published in the September issue of the *Survey of Current Business*. The BEA publishes this journal on its Web site sometime after the middle of the month.

CPI Changes for 2002

New Expenditure Weights

Beginning in January 2002, the Bureau of Labor Statistics (BLS) began using expenditure weights from 1999-2000, replacing the 1993-95 weights it had been using. These weights are constructed using household spending patterns as reported in the *Consumer Expenditure Survey*. The expenditure on each item in the “market basket” is some percentage of the whole basket. This percentage or weight for each item is multiplied by the change in its price from a month ago and from a year ago and these numbers are added for all 211 items in the basket to get the total increase in prices from the prior month and from a year ago. The Consumer Price Index – All Urban Consumers (CPI-U) and the Consumer Price Index – Urban Wage Earners and Clerical Workers (CPI-W) have different weights, with the CPI-U weights coming from the entire expenditure survey. The CPI-W is a subset of the CPI-U and includes expenditures only for consumers who derive more than one-half of their income from clerical or hourly wage occupations.

In the past, the BLS only changed the expenditure weights every 10 years or so. Now, it plans to change them every two years, with the next change coming in January 2004. The BLS ran some simulations on historical data to see how using more current weights would affect the CPI. In some years, using the new weights produced a slightly lower rate of inflation; in some years it was higher. For the first six months of 2002, the BLS is producing CPIs based on both the new and old weights. This is called an “overlap” index and gives people an opportunity to see what kind of difference the new weights make. For each of the first five months of 2002, inflation, as measured by the U.S. CPI-U and CPI-W, has been the same or 0.1 percent lower using the new weights. For the Seattle index, the new weights have produced slightly higher percentage changes.

These changes supposedly better reflect consumer behavior and give consumers, businesses, and policy makers information on how social and technological changes affect inflation. Two-income families do more spending on day care and fast food. The shift toward work outside the office means increases in sales of pagers and hand-held computers. Casual Fridays have led to reducing the weight of men’s suits in the index. New items were added, including Viagra.

New Supplemental Index of Consumer Price Change

In August 2002, the BLS will release a new index to supplement the current CPI-U and CPI-W. It is called the “Chained Consumer Price Index” (C-CPI-U) and is termed a “superlative” index. It will use expenditure data in adjacent price periods to reflect any substitution that consumers make **across** item categories in response to changes in relative prices. In 1999, the BLS introduced the concept of something called the “geometric mean” to take into account consumer substitutions **within** categories. For example, if the price of cheddar cheese goes up, that would seem to increase inflation. But if a consumer switches to cheaper Gouda, the BLS records what consumers actually spent, meaning inflation is lower.

Now the BLS will record these substitutions **across** categories. If the price of beef goes up and people substitute cheaper pork, it will include information on that switch and this will result in a lower measure of inflation. For the time being, the BLS will keep track of these substitutions separately and will not include them in the regular CPI-U. This new methodology is not being used for the CPI-W.

The C-CPI-U will be subject to two revisions as additional expenditure data becomes available. In August, the BLS will release “final” values for 2000, “interim” values for 2001, and “initial” values for the first six months of 2002. In 2003, it will issue “final” values for 2001, “interim” values for 2002, “initial values” for 2003, etc.

Revenue Forecasts

Franchise Fees and Utility Taxes

All cities should have received a “Fact Sheet” from AWC on a Federal Communications Commission (FCC) ruling on cable modem service. Check out http://www.awcnet.org/factsheet_060302_modem.htm if you did not receive a copy. The information on franchise fees also applies to counties.

The FCC ruled “that cable modem service as currently provided is an interstate information service, not a cable service, and that there is no separate telecommunications service offering to subscribers or internet service providers.”

In response to this ruling, providers of cable modem service sent letters to cities and counties in which this service is available. In the letters, the companies said that they were immediately stopping payment of franchise fees on revenues from cable modem service. Some are also arguing that the FCC ruling preempts cities from levying utility taxes on these services also. Ron Rosenbloom of AWC and one of our attorneys, Jim Doherty, say that cities’ ability to levy utility taxes probably depends on how broadly they have defined cable services in their tax code.

Various organizations (National Association of Telecommunications Officers and Advisors (NATOA), National League of Cities, U.S. Conference of Mayors, the National Association of Counties, and the International Municipal Lawyers Association) have joined together in a coalition named the Alliance of Local Organizations Against Preemption and filed a petition for review in the Federal Court of Appeals to challenge the ruling. This process could take up to a year.

Jim Doherty says that it is difficult to tell cities what they should be doing now. As more information becomes available, it will be posted on the Focus page of our Web site.

We **will** offer some speculation about how big an impact this ruling has on revenues.

- Cable modem service is not available in much of the state, so many cities and counties need not worry about lost revenues. However, they might have such service some day in the future, so a potential revenue source might be lost.
- Even in areas where the service is available, subscribers have not been signing up at the rates the cable companies hoped for. And, DSL (fast connection by telephone) providers have offered strong competition. It could be that cable modem service is not currently that important in your revenue stream. In saying this, we do not mean to imply that jurisdictions should not participate in efforts to overturn the ruling. Even potential sources of revenue need protecting.
- We suspect that most cities and counties where cable modem service is available do not know how much of their franchise fees or utility taxes come from this source. The cable companies know, of course. If they tell you they are lowering their franchise fee payments and/or utility taxes, because of this ruling, ask them for documentation of the amount. Might you have to audit them to confirm the figures? That is a possibility.

City State-Shared Revenues

City State-Shared Revenues

Population Forecast

The official April 1, 2002 city population, to be used for distributions in 2003, is 3,617,974. That is 1.5 percent more than the population for April 1, 2001 that was released last year. The incorporation of Liberty Lake, near Spokane, added 4,480 to the population. The remainder of the growth came from annexations and people moving into cities from unincorporated areas.

To the April 1 estimate, we have added an amount to account for the fact that Spokane Valley, with an estimated population of 80,700, will incorporate during the first quarter of 2003 and receive state-shared revenues for the remainder of the year. Because the Washington State Supreme Court has recently found petition annexations to be unconstitutional, we do not expect much growth from annexations. The adjusted April 1 population for 2003 distributions is 3,678,500.

Gasoline Taxes

Our gasoline and diesel tax forecasts come from Brian Calkins of the Department of Transportation. Lower vehicle fuel efficiencies are increasing the amount of gasoline purchased and lower economic activity is reducing the amount of diesel fuel purchased. Revenue forecasts for 2003 and future years are up slightly from the ones made last summer in terms of the number of gallons sold and taxes received. Remember that the gasoline and diesel tax is a flat amount per gallon rather than a percentage of the price at the pump.

As noted on page 46, if Referendum 51 passes in November, cities with a population of 10,000 or more, will receive approximately \$1.95 more per capita in 2003 than shown in Table 3.

Liquor Revenues

The growth in liquor excise tax revenues last year was much higher than we thought it would be, increasing by 7 percent. This was the third year in a row of growth above 7 percent. In 1999, it was 10 percent! Some of you probably remember the mid-90's when it was zero percent or less. This makes no sense to us. The liquor excise tax is a percentage tax on the price of a bottle. The higher the price, the higher the tax. The total tax generated depends on sales. So, for revenue to increase by, say, 7 percent, the average price of the item sold and the amount of sales need to increase by some combination that adds up to 7 percent.

A few examples. The average price of a bottle sold increases by 5 percent over the previous year and the number of items sold increases by 2 percent. The average price of the item sold increases by 3 percent and the number of items sold increases by 4 percent. We were in a recession last year. One would think people would be buying cheaper liquor. If the average price were to fall by 2 percent, then sales would have to increase by 9 percent to generate a 7 percent increase in revenue.

We are not privy to price and sales data. But, we are still in a recession in Washington, and we are assuming a 4 percent growth rate for next year.

Liquor board profits are primarily composed of the difference between the board's revenues and expenditures. But they also include monies from a tax on beer and a distribution of part of the funds received from Class H licenses (establishments that serve hard liquor). Each of these revenue sources has its own forecasting issues because there is not the data set necessary to do any sophisticated kind of modeling as there is, for example, for the gas tax.

The forecasts we receive are based on those that go to the Office of the Forecast Council, since a good share of these monies are deposited in the state general fund. Because the Liquor Board makes its forecasts for the state on a fiscal year basis and cannot provide us with calendar year forecasts, we simply add the two relevant fiscal year forecasts together and divide by two to get the calendar year forecasts.

We asked Rob Kirkwood of the Liquor Board to provide us with some narrative describing the factors that informed his estimates. He responded, as follows.

Projections for liquor profits continue to increase despite the slowing economy. There are many factors behind the Liquor Control Board's continued success in raising revenues. Not the least of which is our Business Plan that includes the goal to "Maximize revenues to the state's taxpayers". This Business Plan includes a number of strategies to increase net profits. A few of these strategies include the continued implementation of Best Business Practices aimed at reducing operating costs, plus increasing sales revenue through product selection, pricing, and store locations.

The Liquor Control Board is committed to providing reliable revenue estimates to local governments so they can plan their level of service with confidence. We understand the financial pressures that both state and local governments are under. We also realize the crucial role we play in generating and distributing these revenues.

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 \$4,600,000, to be increased each July by "the fiscal growth factor," which is the average, for the last three years, of growth in state population and the growth in the implicit price deflator.

Remember, we can only forecast the part of the revenue under RCW 82.14.330 that is handed out on a purely per capita basis – 16 percent – and that is estimated to be 18 cents in 2002 and 18 cents in 2003. Each city, however, will receive a minimum of \$1,000, no matter how small their population. If a city contracts for law enforcement services, or if it has (or plans to start) innovative law enforcement programs, domestic violence prevention programs, and/or child abuse prevention programs, the finance staff should make certain that the police chief fills out the applications for the funds that the Office of Community Development administers for these programs.

The remaining funds are handed out partially based on crime rates. The cities that may qualify for those programs know who they are and are aware of the problems they have in estimating these revenues.

Summary of Local Share of State-Collected Revenues (Cash Basis)				
Total Dollar Amounts – 2000 to 2003				
<i>(All Cities and Towns)</i>				
	2000	2001	2002 Revised	2003 Estimate
Gas Tax (unrestricted)	\$50,992,834	\$51,804,480	\$51,806,000	\$53,222,000
Gas Tax (restricted)	23,842,516	24,222,054	24,222,000	24,885,000
Profits of Liquor Board	20,451,582	18,952,876	18,522,000	18,551,000
Liquor Tax	11,015,336	11,824,411	12,466,000	12,964,000
Motor Vehicle Excise Tax	8,868,416	0	0	0
Camper Excise Tax	168,009	0	0	0
Criminal Justice – Population-based	909,219	750,024	765,000	774,000
Total	\$116,247,912	\$107,553,845	\$107,781,000	\$110,396,000

Table 2

Per Capita Amounts – 1996 to 2003 (Cash Basis)								
<i>(All Cities and Towns)</i>								
	1996	1997	1998	1999	2000	2001	2002 Rev.	2003 Est.
Gas Tax (unrestricted)	\$15.51	\$15.36	\$15.41	\$15.30	\$15.12	\$14.66	\$14.51	\$14.42
Gas Tax (restricted)	7.08	7.18	7.20	7.15	7.07	6.85	6.78	6.74
Profits of Liquor Board	5.57	5.51	7.18	5.34	6.06	5.36	5.19	5.03
Liquor Tax	2.92	2.93	3.01	3.14	3.27	3.35	3.49	3.51
Motor Vehicle Excise Tax	13.88	11.97	12.62	13.70	2.63	0.00	0.00	0.00
Camper Excise Tax	.28	0.28	0.29	0.30	0.05	0.00	0.00	0.00
Criminal Justice – Population-based	.34	0.38	0.38	0.46	0.27	0.19	0.18	0.18
Total	\$45.64	\$43.61	\$46.09	\$45.39	\$34.47	\$30.41	\$30.15	\$29.88

Table 3

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 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 percentage 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 2002, the amount of premium tax on homeowner's insurance was much higher than we have seen past years. In addition, the percent of losses attributable to fire in the homeowner's category was higher than "normal," so more money than we had forecast was available for distribution to firemen's pension funds. This resulted in the so-called "ratio value" per firefighter increasing to \$531 from the forecasted \$418. Since both the amount of tax and the loss percentage for the 2002 distribution were similar to the actual amounts in 2001, we may have to redefine what "normal" is. We will wait and see for one more year.

For 2003, we are assuming that as a result of Initiative 747, there will be no growth in the number of firefighters and that the factors that determine the size of the pot of money will follow their historical averages, resulting in a per firefighter distribution of approximately \$450. We have read that property and casualty (commercial multi-peril) rates increased dramatically in some parts of the country after 9/11. If Washington was one of those areas, the insurance premiums from those policies (and the taxes) will be higher than those we have used in our forecast.

We want to remind our readers, once again, that these forecasts are completely dependent upon fire loss experience and insurance premiums and we really have no accurate way to forecast either.

Where Are the County State-Shared Revenue Forecasts?

State-shared revenues must meet two criteria for our office to be able to provide forecasts. First, the amounts that will be available to be shared must be subject to forecasting using economic variables or provided by state agencies. (We work with agency economists.) Second, and this is perhaps more important, the funds must be allocated **solely on the basis of population**. Take criminal justice revenues, for example. A small portion of city criminal justice funds are allocated on the basis of population. We provide per capita estimates for that portion. Much of the rest of city criminal justice funds and **all** county funds are distributed based on a formula that includes population as one factor, but relative crime rates as another. We cannot forecast crime rates. Cities and counties will have to wait until the Washington Association of Sheriffs and Police Chiefs determine the crime rates and calculate the actual amounts to be distributed. Forecasts for future years cannot be made.

Or, look at gas taxes. The Department of Transportation forecaster does an excellent job of estimating revenues and, because all the city gas tax money is distributed solely on a per capita basis, we have been able to make good forecasts for cities. The county distribution formula, however, includes annual road costs and "need," in addition to population. We cannot forecast these additional variables. We do know, however, that the estimated distribution for 2003 is \$152 million. As discussed on page 46, if Referendum 51 passes, another \$5.9 million will be added.

Distribution of Fire Insurance Premium Tax – RCW 41.16.050			
<i>May 2002</i>			
City/District	Ratio Value	Number of Paid Firefighters as of January 1, 2002	Amount¹
Aberdeen	\$530.76	38	\$ 20,168.88
Anacortes		18	9,553.68
Auburn		77	40,868.51
Bellevue		175	92,882.98
Bellingham		132	70,060.31
Bothell		50	26,537.99
Bremerton		53	28,130.27
Camas		34	18,045.84
Centralia		15	7,961.40
Chehalis		14	7,430.64
Edmonds		40	21,230.40
Ellensburg		21	11,145.96
Everett		175	92,882.98
Hoquiam		22	11,676.72
Kelso		12	6,369.12
Kennewick		75	39,806.99
Kent		145	76,960.18
Kirkland		64	33,968.63
Longview		36	19,107.36
Lynnwood		44	23,353.44
Mercer Island		29	15,392.04
Moses Lake		29	15,392.04
Mountlake Terrace		25	13,269.00
Mount Vernon		32	16,984.32
Olympia		76	40,337.75
Pasco		41	21,761.16
Port Angeles		22	11,676.72
Port Townsend		10	5,307.60

Distribution of Fire Insurance Premium Tax – RCW 41.16.050 <i>May 2002</i>			
City/District	Ratio Value	Number of Paid Firefighters as of January 1, 2002	Amount¹
Pullman		21	11,145.96
Puyallup		51	27,068.75
Raymond		13	6,899.88
Redmond		97	51,483.71
Renton		105	55,729.79
Richland		55	29,191.79
Seattle		1014	538,190.53
Shelton		7	3,715.32
Spokane		315	167,189.37
Sumner		16	8,492.16
Sunnyside		15	7,961.40
Tacoma		382	202,750.28
Toppenish		6	3,184.56
Tukwila		60	31,845.59
Vancouver		155	82,267.78
Walla Walla		48	25,476.47
Wenatchee		30	15,922.80
Yakima		68	36,091.67
King County #2		32	16,984.32
King County #10		117	62,098.91
Spokane County #1		134	71,121.83
Totals		4245	2,253,075.78
<p>¹The 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.</p>			

Table 4

Despite of the passage of Initiative 695, counties are continuing to receive state-shared criminal justice funding from the state. This is in addition to the small amounts of "backfill" money distributed to some counties for the state fiscal year 2003. Referendum 49 shifted part of this funding from the now-repealed motor vehicle excise tax to the state general fund. The initial appropriation, made for the state fiscal year 2000, was \$23.2 million. It is increased every July by an amount equal to "the fiscal growth factor," which is the average, for the last three years of growth, in state population and the growth in the implicit price deflator.

There are two county state-shared revenues that are distributed on a population-only basis: liquor board profits and liquor excise taxes. Since neither generates much money, these forecasts are probably not too useful, but they were easy to make. **Our revised forecast for 2002 liquor board profits is \$2.25 per capita and, for the liquor excise tax, it is \$1.14 per capita. For 2003, the estimates are \$2.11 and \$1.18.**

What's Ahead for Cities and Counties in 2004?

The incorporation of Gateway (50,000 population), in Pierce County, may be on the ballot in September. If it is and the election is successful, it would incorporate in August 2003 and receive its full complement of state-shared revenues in 2004. Supporters of the incorporation of Frederickson, also in Pierce County, are aiming for an election in early 2003. If this is approved by the voters, they would get state-shared revenues for three quarters in 2004. Their estimated population is 10,500.

City Per Capita State-Shared Revenue Estimates – 2004		
	With No Incorporations	With Incorporations
Gas Tax (restricted)	\$7.04	\$6.83
Gas Tax (unrestricted)	15.06	14.60
Liquor Board Profits	5.39	5.22
Liquor Excise Tax	3.70	3.58

Table 5

County Per Capita State-Shared Revenue Estimates – 2004		
	With No Incorporations	With Incorporations
Liquor Board Profits	\$2.29	\$2.35
Liquor Excise Tax	1.27	1.30

Table 6

Tax Increment Financing (Again)

2010 “Sunset” Provision is Repealed

by Jeffrey C. Nave, Foster Pepper & Shefelman PLLC

(Editor’s Note: This article was reprinted, with permission, from “Municipal & Public Finance News,” Spring 2002)

On March 12, 2002, Governor Locke signed Substitute House Bill 2592 (Chapter 12, Laws of 2002). This bill remedied one of the fatal flaws in the tax increment financing (“TIF”) statutes enacted in 2001 – it repealed the 2010 expiration date applying to such statutes. The bill also made certain “housekeeping” amendments to clarify the existing statutes. The amendments take effect on June 13, 2002.

Those of you following the recent efforts to bring TIF to Washington State understand that the repeal of the “sunset” provision is big news. Many more TIF projects will be financially feasible because the tax allocation scheme established by chapter 39.89 RCW can extend for an indefinite period of time. In light of this significant change, we are providing a revised summary of the TIF laws.

The Law

Chapter 212, Laws of 2001 (generally codified in chapter 39.89 RCW), as amended by Chapter 12, Laws of 2002.

Chapter 39.88 RCW, the prior TIF statutory scheme, was ruled unconstitutional in *Spokane v. Leonard* (1995) on the grounds it diverted tax revenue intended to support the common schools. (The voters rejected attempts in 1973, 1982 and 1985 to amend the Washington Constitution and authorize tax increment financing.)

Who Can Initiate TIF Projects?

Cities; counties; and port districts.

Which Local Governments Are Authorized to Participate in TIF Projects?

Rural county library districts; intercounty rural library districts; metropolitan park districts; counties; park and recreation service areas; park and recreation districts; road districts; fire protection districts; port districts; public utility districts; cultural arts, stadium and convention center districts; cemetery districts; public hospital districts; and flood control zone districts.

What Is TIF?

Designated “community revitalization financing” in the Washington statutes – but commonly known as “tax increment financing” – TIF generally refers to a financing mechanism that allows a local government to “trap” increased property tax revenue resulting from the growth of assessed value within an increment area. This tax revenue services debt issued to finance public improvements that spur private development within the increment area.

Unlike other tax increment laws around the Country, Washington’s TIF laws do not authorize the issuance of special revenue bonds. Rather, such laws merely provide an additional source of revenue (*i.e.* a portion of the regular taxes levied by other taxing districts) to apply toward debt service on the issuer’s general indebtedness.

What Is an “Increment Area”?

An “increment area” is a geographic area within the city, county or port district that creates the increment area. In this sense, increment areas are similar to local improvement districts.

How Are Increment Areas Created?

By the adoption of an ordinance (in the case of cities) or a resolution (in the case of counties and port districts) after a public hearing is held regarding the proposed financing of the public improvement. Unlike laws relating to local improvement districts, the TIF laws do not: (i) require that notice be mailed to property owners within the proposed increment area; (ii) establish protest procedures; or (iii) limit the authority to create an increment area if protests are made at the hearing.

Do Cities, Counties and Port Districts Have Free Reign to Create Increment Areas?

No. Various factors must be present before an increment area can be created—(i) the entity creating the increment area must expect that the proposed public improvements will encourage private development and increase the fair market value of real property within the increment area, (ii) the anticipated private development must be consistent with countywide planning policies adopted under the Growth Management Act, and (iii) the anticipated private development must be consistent with the entity’s comprehensive plan and development regulations adopted under the Growth Management Act. The ordinance/resolution creating the increment area must contain findings in this regard.

What Are the Purposes for Which TIF Is Authorized?

Tax allocation revenues can be spent only “to finance public improvement costs associated with the public improvements financed in whole or in part by community revitalization financing.”

How Are “Public Improvement Costs” Defined for Purposes of the TIF Laws?

“Public improvement costs” are defined broadly. They include costs of design, planning, acquisition, construction, rehabilitation, improvement and installation of “public improvements;” relocation costs; and financing costs.

Which “Public Improvements” Are Authorized by the TIF Laws?

The phrase “public improvements” includes more than bricks and mortar (and its use throughout the statutes is awkward as a result). “Public improvements” are defined to mean (i) “infrastructure improvements” and (ii) “expenditures” for environmental analysis, professional management, planning, promotion within the increment area, management and promotion of retail trade activities in the increment area, maintenance and security for common or public areas in the increment area, and historic preservation activities.

While maintenance, security and promotion expenditures are defined to be “public improvements,” such expenditures are not included within the definition of “public improvement costs.” If read literally, the only way tax allocation revenue can be used to pay for maintenance, security and promotion within the increment area is if bonds are issued to finance such expenditures.

What Are “Tax Allocation Revenues”?

Those tax revenues derived from the imposition of “regular property taxes” on 75% of any increase in the true and fair value of real property in an increment area that is placed on the tax rolls after the increment area is created. The entity creating an increment area can agree to take less tax revenue than the maximum allowed by the TIF laws, so long as bond debt service, bond reserve, and other bond covenant requirements are satisfied. Under such circumstances, the “tax allocation revenues” would be the tax revenues actually distributed to finance the public improvements.

What Taxes Are Subject to TIF Allocation?

“Regular property taxes,” which are defined for TIF purposes to mean property tax levies that (i) are subject to the aggregate limitation set forth in RCW 84.52.043 (*i.e.* the “\$5.90 per \$1,000 assessed value” limitation) and 84.52.050 (*i.e.* the “one percent” limitation), or (ii) are levied by a port district or a public utility district.

What Taxes Are Excluded from TIF Allocation?

- Regular property taxes levied by the State for the support of the common schools;
- Regular property taxes levied by a port district or a public utility district, to the extent the port district or public utility district specifies (*e.g.* in the resolution submitting the levy request to the county assessor) that the tax receipts will be used to make required debt service payments on general indebtedness;
- Voter-approved regular property tax levies to fund emergency medical services;

- Regular property taxes levied by counties under RCW 84.34.230 to fund the acquisition of open space and conservation futures;
- Voter-approved regular property tax levies by counties, cities and towns to fund affordable housing for low-income households; and
- Certain voter-approved regular property taxes levied by metropolitan park districts.

What Is the Maximum Levy Rate Subject to TIF Allocation?

The maximum levy rate subject to allocation under chapter 39.98 RCW is \$7.70 per \$1,000 of assessed value of taxable property. However, it is *highly* unlikely that regular property taxes within an increment area would be levied at such an aggregate rate. Under existing laws, this can only occur if: (i) the aggregate levy rate within the increment area for all taxing districts subject to RCW 84.52.043 is \$5.90 per \$1,000 of assessed value; (ii) a port district is levying regular property taxes within the increment area for general purposes, dredging purposes and industrial development purposes (*e.g.* for an aggregate levy rate of \$1.35 per \$1,000 of assessed value); (iii) a public utility district is levying regular property taxes within the increment area (*e.g.* for an aggregate levy rate of \$0.45 per \$1,000 of assessed value); *and* (iv) neither the port district nor the public utility district has specified that the receipts from such tax levies will be used to pay debt service on general indebtedness.

When Are Tax Allocation Revenues First Distributed?

During the year after the increment area is created.

Who Allocates the Assessed Values for TIF Purposes?

The county assessor. The TIF laws do not authorize a county assessor to revalue property within the increment area unless the revaluation is pursuant to the assessor's revaluation plan. In other words, assessors are not authorized to make special revaluations solely to accommodate TIF financing.

Who Distributes Tax Revenues for TIF Purposes?

The county treasurer.

Is TIF Financially Feasible?

Yes, under certain circumstances. Assessed value within an increment area must increase by approximately \$18 million to support each \$1 million of TIF bonds. Stated conversely, approximately \$55,000 of TIF bonds can be supported by each \$1 million increase of assessed value within the increment area. These estimates assume various factors, including (i) a 20-year bond amortization period; (ii) an interest rate of 5% per annum; (iii) the tax allocation revenues will be based on an aggregate regular property tax rate of \$5.90 per \$1,000 of assessed value; and (iv) the entity creating an increment area is entitled to 75% of the increase regular property tax revenues resulting from the growth of assessed values within the increment area.

When Does the Tax Allocation Process Terminate?

The TIF tax distribution scheme terminates when tax allocation revenues are no longer necessary or obligated to pay the costs of the public improvements. Because the “sunset” provision was removed from the TIF laws in 2002, a tax allocation program can be extended for an indefinite period of time. Other taxing districts may require a specific terminate date in the written agreements required by the TIF laws.

Can Members of the Public Halt the TIF Creation Process?

Yes, but in a very limited way. A member of the public can challenge the validity of the TIF statutes or the formation process. However, any such challenge must be commenced within 30 days after notice is published regarding the creation of the increment area.

Can Other Local Governments Halt the TIF Creation Process?

Yes. Fire protection districts have ultimate “veto” power over the creation of the increment areas. A fire protection district must agree to participate in the TIF project for the project to proceed.

In addition, taxing districts that levy at least 75% of the regular property tax within the increment area must approve the TIF project by means of a written agreement. A TIF project cannot proceed without this agreement.

What Risks Are Unique to Local Governments Issuing TIF Bonds?

The entity creating an increment area will receive *no* tax allocation revenues if the assessed value of the increment area declines below its original amount, or if a court determines the TIF is unconstitutional.

Washington’s newest TIF laws have not been tested in court. While they appear to address many of the shortcomings of the prior laws, there can be no guarantee the new laws are constitutional.

TIF bonds are payable from tax revenues. As a result, such bonds are treated as “general indebtedness” under the TIF laws. This is consistent with court decisions construing the Washington Constitution. Although “nonpublic participants” in TIF financings may be required to provide “adequate security to protect the public investment” in the increment area, the issuer’s general fund ultimately may be at risk to the extent tax allocation revenues are insufficient to pay debt service on TIF bonds.

Because TIF bonds will be a “general indebtedness,” such bonds will count against an issuer’s constitutional and statutory debt limits.

Observations and Suggestions

Municipalities that are considering whether to create an increment area should prepare a detailed analysis of the historical and anticipated tax levy rates within the proposed increment area, as well as the purpose of each such tax. This analysis should consider the potential impacts of future limitations on the amount by which regular property taxes can increase—such as the limitations imposed by Initiative 747. Only after such

an analysis is prepared can one estimate the aggregate tax rate that should be used in projecting future tax allocation revenues for a specific increment area.

Because significant increases in assessed value of property must occur in the increment area before tax allocation revenues will be sufficient to finance meaningful improvements, community revitalization financing favors projects involving undeveloped and under-developed property (*i.e.* where the potential for growth in assessed value is the greatest).

TIF bonds will be most useful if they are issued in conjunction with other types of bonds, such as revenue bonds or special assessment bonds, or if additional sources of revenue are pledged to the payment of TIF bonds.

For political reasons, a city, county or port may be required to distribute a portion of their tax allocation revenues to other taxing districts (*e.g.* if necessary to secure the consent of those taxing districts.)

Until a court passes upon the constitutionality of the TIF laws, it is unlikely that any bond counsel firm will be willing to render an unqualified approving opinion regarding bonds that are solely secured by tax allocation revenues. Such opinions likely will be rendered for general obligation bonds that are secured by a pledge of the issuer's full faith and credit (even if tax allocation revenues are expected to be the primary source of repayment).

We look forward to working with our clients as they consider this new economic development tool.

Reintroducing the Levy Lid Lift

by Stacey Crawshaw-Lewis, Preston Gates & Ellis LLP

Financing Within the Former 106% Limitation

After passage of Initiative 747, cities and other taxing districts are rediscovering an important tax tool: the **levy lid lift (RCW 84.55.050)**. Previously, taxing districts set their annual levy amount within the constraints of the “106% levy lid.” Under the 106% levy lid, taxing districts over 10,000¹ could increase the total dollar amount of their regular property taxes annually by the lesser of inflation or 106% of their highest levy in the three previous years (plus an adjustment to reflect the value of new construction, improvements, and State-assessed property). With supermajority council or board approval and a finding of substantial need, these taxing districts could increase their levy by an amount up to the full 106%.

The 106% levy lid gave most taxing districts sufficient leeway to raise taxes without having to ask voters for extra taxing authority. In fact, political realities operated as a more stringent cap than did the levy lid – most taxing districts routinely increased their regular levy amount less than the full 106%. Many “banked” their excess capacity under RCW 84.55.092.

101% Levy Limitation

I-747 reduced the 106% levy lid to a “101% levy lid.” Now, taxing districts with a population over 10,000 can increase the amount of their regular property taxes annually by the lesser of inflation or 101% of the highest levy in the three previous years (again, adjusted to account for new construction, improvements, and State-assessed property). Inflation can be expected to exceed one percent; consequently, the levy lid will likely be a flat 101%. Taxing districts with a population less than 10,000 are subject to a flat 101% limitation.

Drawing on “Banked” Levy Capacity

Because the cost of providing public services may rise more than one percent per year, the new 101% levy lid places significant constraints on city and other jurisdictions’ budgets. To keep pace with rising costs, some jurisdictions can draw on amounts that they “banked” under RCW 84.55.092. Whether a jurisdiction with a population over 10,000 has banked capacity on which to draw depends, in the view of the State Department of Revenue, on whether the jurisdiction previously adopted resolutions or ordinances formally banking capacity. Although Referendum 47 did not explicitly amend the levy banking statute, in 1998 the Department of Revenue interpreted the referendum to require taxing districts of 10,000 or more population to adopt a resolution or ordinance in order to bank capacity above inflation up to 106%, with supermajority council or board approval and a finding of substantial need.

Likewise, I-747 did not repeal the levy banking statute and, therefore, jurisdictions can draw on banked amounts and can continue to bank excess capacity (although the amount that can be banked in the future will

¹For taxing districts with a population of less than 10,000, the limit factor was 106%. RCW 84.55.005(2)(a).

be very limited – no more than one percent per year). Jurisdictions that previously used their capacity, or jurisdictions over 10,000 or more population that did not adopt banking resolutions or ordinances, may need to seek voter approval.

Effect of a Levy Lid Lift

I-747 did not eliminate a taxing district's ability to ask the voters to approve increases in excess of the levy lid. Pursuant to RCW 84.55.050, a simple majority of voters can approve a "levy lid lift", allowing the taxing district to levy an amount approved by its voters up to the applicable statutory rate limitations. The effect of a levy lid lift is to increase the jurisdiction's tax levy "base" for the purposes of the 101% levy lid in future years. That is, in the years following the year of the levy lid lift, the jurisdiction can levy 101% of this new base.

The levy lid lift can only approve a boost in the jurisdiction's base for the next levy year. Further increases in this base (beyond the permitted one percent increase) will again require voter approval. This restriction on multi-year levy lid lifts is a consequence of the following statutory restriction: "Any election held pursuant to this section shall be held not more than twelve months prior to the date on which the proposed levy is to be made." RCW 84.55.050(1).

The new base, however, can apply for a limited or unlimited period (except that if the levy lid lift was approved for the purpose of paying debt service on bonds, the new base cannot apply for longer than nine years). Voters can be asked to approve the increase in the levy for a specified or unspecified purpose.

If the levy lid lift was approved for a limited period or a specified purpose, upon expiration of applicable period or use, the new base will be computed as if the jurisdiction had levied the maximum under the 101% levy lid in the interim period.

Passage of I-747 brings new financial challenges to most Washington taxing districts. Facing these challenges, taxing districts may require a draw on banked capacity or may require voter approval in the form of a levy lid lift. If you have any questions regarding these options, or the form of an ordinance authorizing a levy lid lift vote, please call any of our municipal finance attorneys at (206) 623-7580.

E-Mail Meetings and Public Records

by Paul Sullivan, MRSC Legal Consultant

Ten years ago, few people had even heard about e-mail. Now everyone, it seems, knows about and uses e-mail to communicate with others. Regulations that previously applied only to slower, more face-to-face forms of communication must now be analyzed to determine their applicability to e-mails. This article explores the problems e-mail may pose to open meeting and public record requirements.

Meetings by E-mail

1. **Is it possible to hold a meeting by e-mail?** Yes. Under the open public meetings act, a “meeting” takes place when action occurs, and the term “action” is very broadly defined. Action occurs when business is transacted by a governing body, including when the body engages in discussions, considerations, reviews, evaluations, and the taking of final actions. Given e-mail’s ability to link people together and allow them to share and respond to ideas almost instantaneously, it is possible for members of a governing body to join one another in a meeting, even though the members of the body are in different locations. These inadvertent meetings would *not* be in compliance with the open public meetings act.

Until recently there was only conjecture whether a meeting could be held by e-mail; that speculation, however, has now been confirmed. In *Wood v. Battle Ground School District*, 107 Wn. App. 550, 564, 27 P.3d 1208 (2001), the court of appeals held:

[I]n light of the OPMA's [Open Public Meetings Act] broad definition of "meeting" and its broad purpose, and considering the mandate to liberally construe this statute in favor of coverage, *we conclude that the exchange of e-mails can constitute a "meeting."* In doing so, we also recognize the need for balance between the right of the public to have its business conducted in the open and the need for members of governing bodies to obtain information and communicate in order to function effectively. Thus, we emphasize that the mere use or passive receipt of e-mail does not automatically constitute a "meeting."

The OPMA is not violated if less than a majority of the governing body meet. And the participants must collectively intend to meet to transact the governing body's official business. See 1971 Op. Atty. Gen. No. 33, at 19 (social function can be a meeting if it is scheduled or designed to discuss official business); *Roberts v. City of Palmdale*, 5 Cal. 4th 363, 853 P.2d 496, 503, 20 Cal. Rptr. 2d 330 (1993) (Brown Act applies to collective action, not the passive receipt of e-mail by members absent a concerted plan to engage in collective deliberation). Finally, the governing body members must communicate about issues that may or will come before the Board for a vote; in other words, the members must take "action" as the OPMA defines it. . (Footnotes and some authority omitted; emphasis supplied.)

2. **Does this mean that an elected official cannot receive or share information by e-mail?** No, but it does mean that officials may not use e-mail to “meet” and take action with other officials. Receiving or sending out information would not violate the open public meetings act, but replies and comments shared with a majority of the governing body, or decisions made and shared on-line as result of an e-mail

(e.g., “Yes, I can (or will) support . . .”) would be a violation. Of course, if *less than a quorum* were involved in the e-mail discussion, there would be no violation.

3. **May an unlawful meeting by e-mail be cured by making the meeting public?** No. The problem with an inadvertent and therefore unlawful meeting, one that has been triggered by the exchange of e-mails by a majority of a governing body, is that it is inherently unlawful. It is not scheduled, written notice has not been given, and the public is excluded. There is no way the “unlawfulness” can be cured. (In any case, it is doubtful that an e-mail meeting, even one that has been publicly noted, could be held, as it would be difficult, if not impossible, for the public to be able to attend, listen, and observe as is allowed under the open public meetings act.)
4. **Is there a problem if a member of the public or a staff member e-mails information to all of the elected officials?** No. Passive receipt of information is not a violation. However, if the information is then shared with the other officials, along with comments and conclusions of the official first receiving the information, there may be a violation.
5. **Can the mayor and his or her staff make decisions by e-mail?** Yes. The open public meetings act only affects meetings by governing bodies such as city and town councils and boards of county commissioners. Communications to or from a mayor, although the mayor is an elected official, are not constrained by the act.

E-mails and Public Records

The term “public record” for purposes of the Public Disclosure Act, chapter 42.17 RCW, is very broadly defined; it is

any writing containing information relating to the conduct of government or the performance of any governmental or proprietary function prepared, owned, used, or retained by any . . . local agency regardless of physical form or characteristics.

RCW 42.17.020(36). This definition, along with the equally-broad definition of a “writing” (handwriting, typewriting, printing and every other means of recording any form of communication, including but not limited to letters, words, pictures, sounds, or symbols, and magnetic or paper tapes) supports the conclusion that most official e-mail is a public record, potentially subject to disclosure.

1. **If an e-mail is a public record, does that mean a county or city needs to retain it for possible public review and copying?** Yes. The public has the right to inspect and copy public records, unless inspection is prohibited or the records are otherwise exempt from inspection or copying. E-mails should not be “trashed” or deleted; they must be retained like any other public record.
2. **How should e-mails be retained?** Obviously, e-mails could be retained in each computer. However, since memory space may be scarce and computers are sometimes replaced, it is a good idea to transfer e-mails to a disk, or copy them to a central computer, or print out and retain the messages in paper form.
3. **Does this mean a commissioner or a councilmember should retain e-mails from a home computer?** Yes, if the e-mails relate to county or city business. The same rules that apply to letters sent from or received at home apply: if they contain information regarding the conduct of government, they are public records which should be retained and made available, upon request, for inspection and copying. Obviously, if the e-mail sent or received contains personal, non-governmental information, those portions

may be removed or redacted. Based upon the content of the e-mail, it is also possible that an exemption or prohibition against inspection and copying may exist.

4. **What should an official do if he or she has a public record e-mail on a personal computer?** While the official could probably entertain public record requests at his or her home or business, it is preferable to have the public records functions handled by county or city personnel who are more familiar with the public disclosure procedures. The necessary “transfer” could occur on a piecemeal basis, with each receipt of a governmental e-mail forwarded to the government offices or each e-mail initiated by the official “cc’ed” there. Alternatively, the official could regularly provide disk or paper copies of all e-mails to appropriate city or county officials for retention purposes.

Persons with questions about the interplay between e-mails and public disclosure or open meetings laws are encouraged to discuss their questions with their city, town, or prosecuting attorney or with the legal consultants at Municipal Research.

Performance Measurement – “Its Time Has Come”

by Michael Bailey, Finance Director, City of Lynnwood

“Performance Measurement,” “Service Efforts and Accomplishments,” “Outcome Based Budgeting” – whatever you call it, it is catching on. This is not without good reason. The public sector has always been challenged by how to illustrate its effectiveness to the electorate. The recent flurry of voter initiatives is one example of a sense of frustration of a segment of the public with its government. I am of the opinion that most of the frustration is a result of a lack of our ability to communicate effectively about our services and programs. I believe that this need to have a community dialog about what we do for the public is very important in our governmental structure. Performance measurement gives us a basis for that conversation.

While not new, performance measurement has recently become a much more prominent topic of workshops, conferences, and effort on the part of local government. The origins of performance measurement date back to the Hoover Commission in the 40’s, which assessed the need for the bureaucracy that resulted from the “New Deal.” After a series of management “fads” (I know some of you will be offended by that and I’m sorry) such as planned program budgets in the 60’s, zero-based budgeting in the 70’s, and management by objectives in the 80’s, performance measurement has arrived and appears to be here to stay, in one form or another.

There are some pretty relevant articles on the topic which date back to the 1980’s (most of which are from the International City/County Management Association - ICMA). The ICMA has been a leader in providing a forum for the discussion. The Governmental Accounting Standards Board (GASB) created the forum as well and has done a lot of research on the topic also. In its report, “Service Efforts and Accomplishments Reporting: Its Time Has Come (1989-1993),” the GASB laid the foundation for its Concepts Statement 2. This statement indicates that the GASB believes that SEA (its term for performance measurement) is an appropriate and necessary element of governmental reporting. The board has indicated that requirements for SEA reporting would be developed in time.

The federal government has already created a mandate for performance measurement within federal agencies. The “Government Performance and Results Act” (GPRA) was adopted by Congress and requires performance standards and reports of federal agencies to be developed over a period of years. While the response by the agencies has varied from enthusiasm to passive resistance, it is clear that performance measurement is here to stay. The Australian and New Zealand governments have been even more progressive, and with some impressive results I might add.

So now that we have an idea where it came from, let’s talk about context.

It is my belief that performance measurement is only effective in the context of a plan. They are called different things, but I will use the term “strategic plan.” You need to know what it is you are trying to do and why. If you don’t have this on a piece of paper somewhere, you need to do this right away. I know you are thinking that it is obvious that cities and counties have to exist for a variety of reasons including...(put your own pet programs and services in this thought here). But what are the community’s needs and how are you intending to meet them? I’m talking about a general description of the role of your governmental organization in the community at this point, not detailed tactical plans. The advantage of having this discussion and documenting the results is that you now have something to measure against. Otherwise how

will you know if the measures we will describe below have any relevance? Strategic plans take many forms (and I think that the form is less important than simply having a plan). The key is that the plan serves the role of informing the organization about what it should be doing and why. Let's go on.

So now that we have an idea where it came from and context, let's talk about what performance measurement is.

Performance measurement is an attempt to provide understandable, objective information about programmatic and service performance. It also includes qualitative (or, some would say, subjective) indicators of performance as well. We will illustrate it with some examples later.

Inputs are resources used to provide programs and services. Output is the product that is produced. Efficiency is the output divided by the input, or a measure of our ability to produce output in comparison to the amount of resource used. Effectiveness is whether the output actually made the difference we were hoping for in the community.

Inputs are measured by the very nature of the budgeting process. We have been very good at tracking what things cost. For example, for years we have shown salaries, office supplies, telephone costs, equipment repair, etc., all broken down by department and division. Some budgets have also shown inputs in the context of programs rather than departments. This begins to associate the costs with the services.

Local governments are increasingly including output measures in their budgets. Governments are good at counting things, and this is an extension of that. Examples of this include the number of patrons at a recreation center or the number of traffic tickets issued. This has helped our citizens understand what all those inputs have generated. It has also provided the beginning of an ability to compare results from one jurisdiction to another.

The public wants government to be more efficient and we want to illustrate just how efficient we really are. This creates the obvious need for efficiency measures. These are quite simple really. Using the examples above, if we relate our inputs to programs, we can compare the number of recreation center patrons to the cost of operating the center. We would probably want to break it down a little finer so that it has more meaning. For instance, in Lynnwood, we want to know what it costs us to provide swim lessons at the Recreation Center for instance. To get to an efficiency measure, we take the cost of that program and divide it by the number of persons taking lessons. The result is so many dollars per participant. For traffic tickets you divide the cost of the traffic division by the number of tickets written (if that is a meaningful measure). You can see that the definition of programs begins to become very important in your ability to track costs and products.

Lastly, effectiveness measures are essential to answer the question of whether the public programs are serving their intended purposes as identified in your strategic plan. Assuming your organization has taken the step to define what effect it is hoping to have in your community by the operation of your programs, you will want to test that and see if you are on target. For instance, our examples of swimming and traffic patrol will help us illustrate this.

A community may decide that it needs to operate a recreation center with a swimming pool to enhance the safety and quality of life for the general public (not just those who can afford the private club). For instance, if you have a youth swim program with low entry barriers (inexpensive and accessible) you expect to be able to give the public better life safety skills in water. In addition, if they know how to swim, that will most often translate into a recreational activity, which will enhance their quality of life.

With our traffic ticket example, your community goal may be to improve the safety and efficiency of the roadways. The safety argument is obvious – less traffic law violations should result in fewer accidents. Accidents and road rage incidents will also decrease the efficiency of the roadways and possibly lead to a perceived need for more capacity.

Now, how do you measure effectiveness? As you can tell, these are very “soft” sorts of results. Did your swim program actually result in a safer community and enhance the quality of life of your citizens? Did your efficiency at writing traffic tickets actually decrease the number of accidents? Often, you have to resort to “indicators” of effectiveness knowing that the complete answer is really a combination of things. If the parents do not get the children to the swim lessons, your outcomes won’t be realized. If motor vehicle operators continue to act frivolously, or the roadways are in very poor repair, your traffic program won’t improve the safety of the roadways.

Outcome indicators used to illustrate effectiveness vary. There is no one right way or indicator to use. In my experience, it is important to use those that you really have some influence over and that you believe should have helped with the situation. For instance, a perception of community quality of life and safety is often best determined in a survey. Survey answers are often a good source for a measurement of effectiveness.

So where is all this heading? It is my belief that we are seeing a fundamental change in the types of information that are being provided (and soon will be expected) to meet governmental accountability needs. Many jurisdictions are including these types of information in their budget process. The Government Finance Officers Association (www.gfoa.org) has begun to include these elements in its best practices work and its budget peer review program. The ICMA (www.icma.org/performance) continues to facilitate the topic through its publications and its Performance Measurement Center. The GASB (www.gasb.org) is still conducting research and has an excellent web site. The National Advisory Council on State and Local Budgeting (the blueprint for the current state of the art in governmental budgeting) has included these concepts in its guidance. A copy of these changes can be found at http://www.co.larimer.co.us/budget/budget_practices.pdf. It is just a matter of time before these types of information become common and expected of us in providing the public with assurance that we are doing the right things; that we are doing them well; and that we are efficient at providing them.

If you are interested in getting started, you may want to either start with a pilot project or two. Trying to identify and report on performance data can be a challenging task. The success from a few pilot projects can illustrate that it is “doable” and that there can be rewards. The conversation about the risks and rewards for a performance measurement effort needs a “leader” within your city hall (or county courthouse).

There is a great deal of information becoming available on this subject. I would refer you to the organizations I’ve mentioned above, each of which have numerous resources and additional bibliographies. I would mention one resource which I have used with the skeptics that I’ve come across in my own organization. The editors and writers of *Governing* magazine have written “Measuring Up – Governing’s Guide to Performance Measurement for Geniuses (and other Public Managers).” It is a very down-to-earth discussion of the topic which is very readable. Really – I’ve heard this from all that I’ve recommended it to.

So if you believe we need to find ways to improve our communication with the public, maybe performance measurement is for you. If you want to discuss ideas for getting a successful performance measurement program started, feel free to give me a call.

(Note from MRSC: We have a performance measurement Web site at <http://www.mrsc.org/cityorg/performancemeasurement.htm>.)

New IRS Services

During this past year, the Internal Revenue Service formed the Tax Exempt and Government Entities Division. It specializes in providing information on employment law. The specialist for Washington is:

Clark Fletcher
520 - 112th Ave NE, Suite 300
Bellevue, WA 98004
Telephone No: 425.821.3296
Fax No: 425.820.7955
www.clark.m.fletcher@irs.gov

According to their "fact sheet," topics in which their offices can provide education and clarification include:

- Section 218 coverage issues: voluntary agreements for social security coverage between Department of Health and Human Services (including the Social Security Administration) and state and local governments.
- Worker classification and independent contractor issues: how to determine when an individual is to be classified as an employee of the governmental entity and when an individual is properly identified as an independent contractor.
- Form 1099 compliance and backup withholding issues when dealing with an independent contractor.
- Fringe benefits for your employees (which fringe benefits are taxable, which fringe benefits are nontaxable, what type of taxes are due on various fringe benefits).
- Cafeteria plans and flexible spending accounts.
- Resident alien or nonresident alien employment tax issues
- Treatment of elected officials and board members as employees or independent contractors.
- Special rules concerning firefighters and emergency services with respect to FICA and Medicare coverage.
- Medical residents and how treated for social security purposes.
- Form 5500 issues regarding annual return/report of employee benefit plan
- Form 945 issues, annual return of withheld federal tax used to report income tax withholding from non-payroll distributions.
- Compliance issues regarding W-2, W-3, and W-4s (wage and tax statements, transmittal of wage and tax statements, and employer's withholding allowance certificates)
- Miscellaneous compliance issues (based on the specialized needs of our customers)

Mr. Fletcher prefers that local government officials contact him first by e-mail or letter with their questions. If he needs clarification, he will follow up by telephone.

Taxing Matters

Cities, Be Sure You Know Your Maximum Regular Property Tax Levy Rate If You Are in a Fire and/or Library District!

Many cities are not in a library or fire district. Their maximum levy rate is \$3.375 per thousand dollars assessed valuation (AV). This discussion is **not** directed at them.

For cities that belong to a fire district and/or a library district, the rules are a little more complicated. Nominally they have a maximum rate of \$3.60 per thousand dollars AV. But, they can never collect that much because the levy of the special districts must be subtracted from that amount. The library district levy has a maximum rate of \$0.50 per thousand dollars AV and the fire district rate can be as high as \$1.50. Therefore, if a city belongs to both a fire district and a library district, and if these districts are currently levying at their maximum rate, then the city rate can be no higher than \$1.60 ($\$3.60 - 0.50 - 1.50 = \1.60). If a city is only in a library district, its maximum rate is \$3.10 ($\$3.60 - 0.50 = \3.10). If it is only in a fire district, its maximum rate is \$2.10 ($\$3.60 - 1.50 = \2.10).

If, for some reason, one (or both) of the special districts is not currently levying the maximum rates, the city's **current** levy rate could be higher. Assume the city is in both a fire and library district and that the library district is levying the full \$0.50, but the fire district is only levying \$1.20 per thousand dollars AV. The maximum city levy rate would be $\$3.60 - 1.20 - 0.50 = \1.90 .

Let's assume (sorry for all the "assumes," but the author is an economist) that the current city rate is \$1.80. The fire district decides this year to put a levy lid lift to a vote after the passage of Initiative 747 and raise its rate to \$1.50 and the ballot measure is successful. The assessor will lower the city rate to \$1.60.

"How can that be? Cities are senior taxing districts and fire districts (and library districts) are junior taxing districts." True, but they have a right to levy at their maximum statutory rate. The total rate in a city of the city rate and any library district and/or fire district rate can be no more than \$3.60. After the levy lid lift, the total rate is \$1.80 for the city, \$0.50 for the library, and \$1.50 for the fire district. This totals \$3.80, so the city rate must be lowered by \$0.20 to \$1.60. Of course, this means property tax revenue losses. In this case, it would be in an amount of \$0.20 per thousand dollars AV.

A city rate can never be lowered to less than \$1.60. That's the rate guaranteed it by the statutes as a senior taxing district. But if it has been levying at a rate higher than that, it has been "borrowing" rate capacity from a fire and/or library district. That higher rate is not guaranteed.

We have warned cities not to use any property tax revenue it is receiving by levying at a rate higher than \$1.60 for ongoing expenditures. A forced reduction in the rate could cause fiscal problems if not anticipated. Prudently, it should be used for one-time expenditures or put into reserve funds. We also know it is difficult to do that in these times when the economy has slowed down, cities have lost motor vehicle excise tax and sales tax equalization revenues, and the Initiative 695 "backfill" has not been fully funded. Just be aware it can happen and calculate what the potential revenue loss would be. You can find out from your county assessor what the tax rates currently are for your fire and/or library district so you can make the calculations.

Can We Do a Levy Lid Lift if Our Property Tax Rate Is at Its Statutory Maximum?

One of our guest writers, Stacey Crawshaw-Lewis, gives an overview of levy lid lifts on pages 34-35. However, this is a technical question she does not address and one that we did not think of until it was posed to us. Here is the answer. We checked this out with Kathy Beith in the Property Tax Section of the Department of Revenue.

If you are not in a fire and/or library district, the answer is absolutely not. Your statutory maximum is \$3.375 per thousand dollars assessed valuation (AV). Or, if you are one of the few cities with a Fire Pension Fund, it is \$3.60 per thousand dollars AV. However, if you are in a fire and/or library district, the answer is “maybe.”

Take the following example and it plays off the discussion in the preceding section, so be certain to read that first. Assume that you are annexed to a fire district. The maximum levy rate guaranteed to you is \$2.10. (\$3.60 minus the maximum fire district levy of \$1.50 equals \$2.10.) Let’s say your current rate is \$2.00 and that the fire district’s current rate is \$1.20. Together they equal \$3.20 and that is less than the \$3.60 you are allowed to levy together.

You can go to the voters and ask for a levy rate increase of \$0.40 (\$3.60 – 3.20). However, \$0.30 of that \$0.40 increase is in the fire district’s “territory.” If, next year, the fire district has no increase in AV and wants to increase its levy by one percent (the maximum allowed under Initiative 747, ignoring new construction), the assessor will raise its tax rate by one percent to \$1.212 and your lid lift increase will fall to \$0.388 from \$0.40. And, the fire district could decide it wanted to do a levy lid lift. If it proposed going from \$1.20 to \$1.50 and succeeded, your lid lift would fall to \$0.10 per thousand dollars AV – the difference between your levy rate when you imposed the lid lift (\$2.00) and your guaranteed rate of \$2.10.

Obviously, care must be taken if proposing a lid lift above your statutory maximum rate and you need to understand the risks.

State Utility Tax Deduction for Water Used for Irrigation Purposes

Maybe everyone else already knows this, but MRSC staff just recently became aware of two Department of Revenue rulings, published in 2000, that broadened the definition of “irrigation” in RCW 82.16.050(7). That statute provides for a deduction from gross income of a water utility for “amounts derived from the distribution of water through an irrigation system, for irrigation purposes...” Such a deduction results in a lower state utility tax bill for the utility. On at least three previous occasions, water districts had taken deductions for water used for golf courses and landscaping. The Department of Revenue disallowed them ((Det. No. 91-2294R, 11 WTD 487 (1991), Det. 95-002, 15 WTD 106 (1996), and Det. No. 95-201, 15 WTD 166 (1996)), saying that “irrigation purpose” meant “the artificial watering of agricultural lands in regions where rainfall is insufficient for crops.”

The petitioners argued that “irrigation” also covered non-agricultural purposes and that they should be able to deduct from gross revenues charges for any water used to nourish plant life (in parks and on golf courses, for example), as long as that use of water was segregated (presumably by a separate meter) from other uses of water.

DOR’s ruling was reversed by the courts in two cases: *Alderwood Water Dist. v. Washington*, Thurston County Sup. Ct. No. 91-2-02772-3 (1993) and *Woodinville Water Dist. v. Department of Rev.*, Thurston

County Sup. Ct. No.95- 2-03654-3 (1996). Still it continued to disallow the deduction. Finally, in 1998, it threw in the towel. In Det. No. 98-187, 19 WTD 328 (2000) and Det. No. 98-208, 19 WTD 332 (2000), DOR's Appeals Division overruled all previous determinations and concluded that revenues from non-agricultural uses of water for nourishing plant life was deductible for the purposes of calculating state utility taxes, as long as those uses were segregated.

Municipal utilities may claim refunds from the Department of Revenue for taxes paid on these revenues for the four years prior to the year in which the refund application is made. You can find instructions for filing an amended return at <http://www.dor.wa.gov/Docs/Forms/ExcsTx/ComExcsTxRtrn/AmendingYourCETR.pdf>.

Referendum 51

Referendum 51 (ESHB 2969) provides for various revenue sources that will generate \$7.7 billion for transportation and transit projects in the next ten years. If passed by the voters in November,

- the tax on gasoline and special fuels will be raised by five cents a gallon on January 1, 2003, and four cents on January 1, 2004.
- a one percent sales tax surcharge will be levied on motor vehicle sales beginning April 1, 2003.
- a 30 percent surcharge on gross weight fees on trucks over 10,000 pounds will be added, to be phased in over two years.
- the state will be authorized to issue \$4.5 billion of general obligation bonds for highway and ferry projects with the debt service to be first paid by the new gasoline tax revenues, but backed by the full faith and credit of the state general fund revenues.
- the state will be authorized to issue \$100 million in general obligation bonds, the receipts of which will be deposited in the multi-modal transportation account, which can be used to fund transportation projects, including transit, rail, and passenger-only ferries.

The proposed \$7.7 billion dollars of projects include \$5.4 billion for highway improvements, \$819 million for public transportation, \$680 million for ferries, \$294 million for rail, and \$447 million for local governments.

In addition to the revenue measures, the bill establishes a Legislative Transportation Accountability Committee for project review and oversight.

Local Government Funding

If the initiative passes, both **cities with a population of 10,000 and over** and counties will receive a 4.3366 percent share of the new five cent per gallon tax that will be levied in 2003. Based on the Department of Transportation gas tax forecast for 2003, 4.3366 percent of the new five cent tax would generate an estimated \$7.1 million in 2003. However, since the distribution of the tax is made two months after it is collected, cities and counties would receive their first distribution in March of 2003 and total **distributions** would be about \$5.9 million, less than the \$7.1 million collected. This is purely a timing issue. In future years, they would receive distributions in all 12 months.

The county money would be distributed on the same basis as their current funding, which considers population, a money need factor, and a road cost factor. The cities' share would be allocated strictly on a per capita basis to cities with a population of 10,000 and would amount to approximately \$1.95 per capita in 2003. A portion of the money the cities would receive would have to be used to match corridor grant money allocated to cities by the Transportation Improvement Board.

For cities with a population of under 10,000, the Main Street Pavement Program would receive \$2 million in the remainder of this biennium and \$23 million in future biennia. The Rural Economic Vitality Program run by the CERB would get \$2 million for the remainder of this biennium and another \$28 million in the

future. The School Safety Enhancement Program would be allocated \$1 million in the coming year and \$14 million more in future years.

Five million dollars would be allocated to both cities and counties for corridor congestion relief in the coming year and \$50 million in future biennia. The Freight Mobility Account would receive \$8.4 million for the remainder of the biennium and \$107.6 million in future years.

Initiatives

Initiative 776

On July 3, Tim Eyman submitted petitions, which he claimed had more than 250,000 signatures, for Initiative 776 to the Secretary of State. To appear on the November ballot, an initiative needs 197,734 valid signatures, so this initiative probably will be certified.

Section 3 of the initiative would reduce the license fee that the state collects on light trucks (up to 10,000 lbs.) to \$30.

Section 6 repeals the voter-approved 0.3 percent motor vehicle excise tax collected by Sound Transit in parts of King, Pierce, and Snohomish counties for light rail, commuter rail, and express bus services under RCW 81.104.160(1). It states, in part, “Any motor vehicle excise tax previously imposed under the provision of RCW 81.104.160(1) shall be repealed, terminated and expire on the effective date of this act.”

Section 8 repeals the \$15 local vehicle license fee that is currently collected in King, Pierce, Snohomish, and Douglas counties and shared with the cities in those counties under RCW 82.80.020. In 2001, this revenue source brought in over \$31 million.

Sound Transit has issued bonds, pledging the motor vehicle excise tax under RCW 81.104.160(1) for debt service. Repealing the tax would impair those contracts, and the courts would almost certainly find this to be unconstitutional. Section 7 of the initiative tries to address this problem:

If the repeal of taxes in section 6 of this act affects any bonds previously issued for any purpose relating to light rail, the people expect transit agencies to retire these bonds using reserve funds including accrued interest, sale of property or equipment new voter approved tax revenues, or any combination of these sources of revenue.

However, voter expectations (as expressed in Section 7) do not provide a legal remedy for impairment of contracts.

An initiative could be written that would repeal any future increase in the motor vehicle excise tax. (The statutes give Sound Transit the authority to go to the voters and ask for an additional amount of up to 0.51 percent.) This would mean that the only source on new revenue in the future would be the sales tax under RCW 81.104.160(2). And, an initiative could be written that would repeal the current tax once the bonds are paid off. But, it cannot repeal the existing tax immediately without unconstitutionally impairing contracts. Conceivably, if I-776 were passed, the courts might treat it as repealing future increases in Sound Transit’s MVET, and eliminating that MVET when Sound Transit’s bonds are retired. However, the tax would continue so long as the bonds were outstanding.

In similar fashion, if any city or county has issued bonds based on its revenue from the \$15 license fee, it must be allowed to collect that fee until the bonds are retired.

Commentators have noted that it is questionable whether voters across the state can vote to repeal a tax approved by the voters in these three counties. Or, that voters across the state could repeal a license fee passed by the legislative bodies in the four counties that assess this fee. However, an initiative to the people can do what the legislature can do. The legislature could repeal the relevant statutes (in a manner that did

not impair existing contracts, of course). Therefore, it is probably legal to have a state-wide initiative to do the same thing, even if it is flawed.

Initiative 790

Supporters of Initiative 790 turned in approximately 350,000 signatures to the Secretary of State on July 3, almost certainly enough to get it certified for the November ballot.

This initiative would create a new board to oversee the pensions of LEOFF 2 police and firefighters. The board would consist of eleven members: three police officers, three firefighters, three local government officials, one member of the Senate and one of the House of Representatives, all appointed by the governor.

Within certain cost limits the board would recommend increases in benefits each year to the legislature on January 1. Unless the majority of each house voted to repeal the benefits within 90 days, they would become effective. If the board proposed benefits that are outside these limits, a vote of the legislature would be required. The legislature could only vote to accept or reject the proposal. It could not be amended.

Since local governments contribute 30 percent of the pensions and the state contributes 20 percent, some state and local government officials have expressed concerns of rising pension costs if this initiative passes.