

BUDGET SUGGESTIONS

For 2006



Budget Suggestions For 2006

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of Washington**

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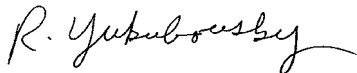
Introduction

Here is your copy of *Budget Suggestions for 2006*. As always, we try to provide you with timely information, within the constraints we face in getting information from the state.

In this publication you will find:

- Descriptions and interpretations of 2005 legislation that may affect your budget.
- CPI and state-shared revenue forecasts, including a look ahead to 2007.
- An article on municipal election laws by Jim Mc Neill of Foster, Pepper & Shefelman.
- An article on changes in the public records act by Jim Doherty of MRSC.
- Three articles on IRS bond audits by staff at Preston, Gates & Ellis and William G. Tonkin of Foster, Pepper & Shefelman.
- Discussions of some budget issues and pension fund increases.

Judith Cox, our public finance consultant, is the author of much of the material in this publication. To the contributors noted above, "Thank you so much for your assistance." Holly Stewart designed and produced the document. Bob Meinig, Connie Elliot, Jim Doherty, Carol Tobin, and Electra Enslow proofed it. We hope this material will assist you as you go through the budget process and into 2006.



Richard Yukubousky
Executive Director

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Budget Calendar for Preparation of 2006 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 2005 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 12
2. Estimates are to be filed with the city clerk.	By fourth Monday in September. ²	September 26
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 3
4. CAO provides the legislative body with current information on estimates of revenues from all sources as adopted in the budget for the current year. CAO also provides the legislative body with the clerk's proposed preliminary budget setting forth the complete financial program, showing expenditures requested by each department and sources of revenue by which each such program is proposed to be financed.	No later than the first Monday in October.	October 3
5. The legislative body must hold a public hearing on revenue sources for the coming year's budget, including consideration of possible increases in property tax revenues. (Chapter 251, Laws of 1995. codified as RCW 84.55.120.)	Before legislative body votes on property tax levy. Deadlines for levy setting are in item 8 below.	

Budget Suggestions for 2006

Major Steps in Budget Preparation	State Law Time Limitations	Actual 2005 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 2
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 2 through November 15
8. Setting property tax levies (HB 1048, Ch. 52 Laws of 2005 and RCW 84.52.070).	November 30 for <i>all</i> cities and towns.	
9. The legislative body, or a committee thereof, must schedule hearings on the budget or parts of the budget and may require the presence of department heads.	Prior to the final hearing.	November 3 through 30 (suggested)
10. Copies of proposed (preliminary) budget made available to the public.	No later than six weeks before January 1.	November 18
11. Final hearing on proposed budget.	On or before first Monday of December, and may be continued from day-to-day but no later than the 25th day prior to next fiscal year (December 7).	December 5
12. Adoption of budget for 2006.	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. The first year of a biennial budget must be an odd-numbered year. **The next year in which you can start a biennial budget will be 2006. If you are planning to do a biennial budget for 2007-2008, remember that you must pass your ordinance by June 30, 2006.** Next year's issue of *Budget Suggestions* will not come out until late July, so a reminder will not do much good then.

The calendar for the initial preparation of a biennial budget is almost identical to that of an annual budget with some obvious differences, such as the substitution of “biennium” for “year.” RCW 35.34.130 and RCW 35A.34.130 require that an ordinance be passed providing for a mid-biennial review and modification of the biennial budget. This must occur no sooner than eight months after the start (September 1, 2005) nor later than the end of the first year of the biennium (December 31, 2005). Notice and hearings are required as outlined in RCW 35.34.130 or RCW 35A.34.130. A complete copy of the budget modification, as adopted by ordinance, must be sent to MRSC and the State Auditor's Office.

Share Your Information Resources Through MRSC

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

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

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

Budget Calendar for Preparation of 2006 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 2005 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 11
2. Filing of estimates with Auditor or Chief Financial Officer by all officials. RCW 36.40.010	Second Monday in August	August 8
3. Preliminary county budget prepared by Auditor or Chief Financial Officer submitted to board of commissioners. RCW 36.40.050	First Tuesday in September	September 6
4. Preliminary budget hearing by board of commissioners. RCW 36.40.070	First Monday in October	October 3
5. Alternative preliminary budget hearing by board of commissioners. RCW 36.40.071	First Monday in December	December 5
6. Final budget adoption by board of commissioners. RCW 36.40.080	Upon conclusion of budget hearing	Practically, December 30

Biennial Budgets (RCW 36.40.250)

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

2005 Legislation That May Affect Your Budget

City and County Financial Assistance (ESSB 6050, Ch. 450, Laws of 2005)

Finally, the cities and counties that were worst hit by the repeal of the motor vehicle excise tax and the resultant loss of sales tax equalization have a permanent source of funding to partially replace what they lost.

ESSB 6050 provides that 1.6 percent of the state real estate excise tax (REET) levied under ch. 82.45 RCW will be deposited in the newly-created city-county assistance account. These funds will be diverted from the Public Works Trust Fund, whose share of the state REET will fall from 7.7 percent to 6.1 percent.

These funds will be distributed according to a number of formulae that appear (and are) complicated, but no more than the sales tax equalization statutes that they replace. Cities and counties each get the same amount for distribution, approximately \$5 million per year.

Assistance to Counties

1. To the extent possible, funds will be distributed to counties to increase the revenues received under RCW 82.14.030(1) (the first half-cent of the sales and use tax)¹ to the greater of \$250,000, or:
 - a. For a county with an unincorporated population of 100,000 or less, an amount equal to 70 percent of the state-wide per capita average collected from the first half-cent of the sales and use tax in the unincorporated areas of all counties in the previous year;
 - b. For a county with an unincorporated population of more than 100,000, an amount equal to 65 percent of the state-wide per capita average collected from the first half-cent of the sales and use tax in the unincorporated areas of all counties in the previous year.
2. For a county with an unincorporated population of 15,000 or less, the county shall receive the greater of the amount in 1 above or the amount the county received in “backfill” for FY 2005 under section 716, ch. 276, Laws of 2004. (amended state budget).
3. For each county with an unincorporated population of more than 15,000 but less than 22,000, the county shall receive, for calendar years 2006 and 2007 ONLY, the greater of the amount in 1 above or the amount the county received in “backfill” for FY 2005 under section 716, ch. 276, Laws of 2004 (amended state budget).

If there are not enough revenues to fund the distributions above, then they will each be reduced proportionately. If there are more revenues than necessary to fund the above distributions, they shall be distributed proportionately on the basis of the unincorporated population among those counties that have received funds under this act and impose the second half cent of the sales and use tax under RCW 82.14.030(2) in the full amount.

¹In the discussion of this legislation, “first half-cent” will be used to mean the sales and use tax collected under RCW 82.14.030(1).

Assistance to Cities

1. Each city with a population of 5,000 or less and with a per capita assessed valuation less than twice the per capita assessed valuation of all cities in the year prior to which the amounts of assistance are certified shall receive the greater of:
 - a. The amount necessary to increase its per capita revenues received from the first half-cent of the sales and use tax up to 55 percent of the per capita revenues for all cities; or
 - b. The amount the city received in “backfill” for FY 2005 under section 721, ch. 25, Laws of 2003, 1st sp. sess. (the state budget); or
 - c. For cities with a per capita assessed valuation less than 55 percent of the state-wide average, an amount equal to 55 percent of the state-wide average less the city’s per capita amount, divided by 1000 and multiplied by the city’s population.

2. Each city with a population of more than 5,000 with a per capita assessed valuation of less than the state-wide average of all cities in the year prior to which the amounts of assistance are certified shall receive the greater of:
 - a. The amount necessary to bring its per capita revenues for the first half-cent of the sales tax up to 50 percent of the state-wide average for all cities; or
 - b. For calendar years 2006 and 2007 ONLY, the “backfill” amount received for FY 2005 under section 721, ch. 25, Laws of 2003, 1st sp. sess. (state budget); or
 - c. For cities with a per capita assessed valuation less than 55 percent of the state-wide average, an amount equal to 55 percent of the state-wide average less the city’s per capita amount, divided by 1000 and multiplied by the city’s population.

The maximum any city may receive per year is \$100,000. If there is not enough revenue to fully fund cities for the amount for which they are certified then all distributions will get reduced proportionately. If the revenues exceed the amount for which cities are certified, the funds will be distributed on the basis of population to those cities that are certified and impose the full amount of the second half-cent of the sales and use tax under RCW 82.14.030(2).

The Department of Revenue (DOR) will certify by March 1 of each year the distribution for each city and county. The distributions will be made on April 1, July 1, October 1, and January 1 of the following year. The first distribution will be made on October 1, 2005, based on a certification that DOR makes by October 1, based on 2004 revenue collections and assessed valuations.

Only cities incorporated as of August 1, 2005 qualify for these distributions.

The \$250,000 amount in 1 above and the \$100,000 maximum distribution to cities will increase by the amount of the increase in the implicit price deflator for personal consumption expenditures for July as published by the Bureau of Economic Analysis in the September issue of its publication, Survey of Current Business.

Changes in Public Records Laws (2SHB 1758, Ch. 483, and SHB 1133, Ch. 274, Laws of 2005)

For a discussion of these bills, see the article on pages 38-39.

Gas Tax Is Increased by 9.5 Cents per Gallon over Four Years (ESSB 6103, Ch. 314, Laws of 2005)

Effective July 1, 2005, the state motor vehicle fuel tax (gas tax) is increased by three cents a gallon. A further increase of three cents will take place on July 1, 2006. The increases on July 1, 2007 and 2008 will be two cents and 1.5 cents respectively. Certain weight fees are also levied or increased.

Of these amounts, cities and counties will each receive a 8.33 percent share of the 2005 and 2006 increases. This amounts to 1/4 cents per gallon for each of those fiscal years. (See pages 24-26 for more information.)

This transportation funding bill includes a 16-year plan which will provide (subject to appropriation) funds for the small city pavement and sidewalk account, other Transportation Improvement Board projects, safe routes to schools, and other projects that benefit local governments.

An initiative to repeal the gas tax increase has been filed with the Secretary of State's office. It received 420,518 signatures and will almost certainly appear on the November 2005 ballot. See pages 55-56 for a discussion of this initiative.

Changing Pension Funding Methodology (ESHB 1044, Ch. 370, Laws of 2005)

This legislation makes a number of changes that result in lower employer contribution rates to PERS 1 for FY 2006 and FY 2007 than those recommended by the Office of the State Actuary.

- Rate increases are being phased in over the four-year period for 2005-2009.
- The rates do not include contributions towards the unfunded liability in the PERS 1 plan.
- The rates do not include contributions toward the future gain-sharing liability in PERS 1.

As a result, the employer rates for PERS 1 are 2.25 percent for FY 2006 (beginning July 1, 2005) and 3.50 percent for FY 2007 (beginning July 1, 2006). The State Actuary's recommended amount had been 5.73 percent for each year.

The Select Committee on Pension Policy is to study the options available to the legislature regarding gain-sharing. When this benefit was created in 1998, the legislature reserved the right to amend or repeal these benefits.

Of course, adopting reduced rates for years in the current biennium means that costs have been pushed forward to future years. See the discussion on pages 52-54 where we recommend that cities and counties anticipate these increased costs in their 2006 budget.

Allowing Counties and Cities One Additional Year to Comply With Certain Update Requirements of the GMA (ESHB 2171, Ch. 294, Laws of 2005)

Prior to the passage of this bill, 2002 legislation amending the Growth Management Act (GMA) had established a seven-year schedule for counties and cities for updating their comprehensive plans, development regulations, and critical areas ordinances. (Some jurisdictions, which are not fully planning under the GMA, are required to update only their critical areas ordinances.) This schedule provided for a

staggered timetable for the updates, with dates ranging from December 2004 through December 2007 depending on the county where the jurisdiction is located.

The 2005 legislature adopted this new timeline extension bill, ESHB 2171, that adds an additional year of eligibility for state grants and loans for those jurisdictions that have not yet completed the required 2004 update. Jurisdictions with plan update deadlines of 2005-2007 will have one additional year to complete work on their critical areas ordinance updates.

Only jurisdictions in compliance with the review and revision schedules of the GMA are eligible to receive funds from the public works assistance and the water quality accounts in the state treasury (including Centennial Clean Water grants and loans). Only those jurisdictions in full compliance with GMA review and revisions schedule may receive preference for financial assistance from these accounts.

This bill included an emergency clause so that it went into effect immediately after the governor signed it, on May 5, 2005.

Job Development Fund Created (ESHB 1903, Ch. 425, Laws of 2005)

The Job Development Fund, to be administered by the Community Economic Revitalization Board (CERB), is created to provide grants for public infrastructure projects that directly create jobs or assist in job retention. "Public infrastructure projects" means projects of a local government or a federally recognized Indian tribe for the planning, acquisition, construction, repair, reconstruction, replacement, rehabilitation, or improvement of bridges, roads, domestic and industrial water, earth stabilization, sanitary sewer, storm sewer, railroad, electricity, telecommunications, transportation, natural gas, buildings or structures, and port facilities, all for the purpose of job creation, job retention, or job expansion.

Fifty million dollars a year will be diverted from the Public Works Trust Fund to the Job Development Fund. CERB will rank projects based on: job creation; the present level of economic activity in the community and the existing financial capacity in the community to increase such activity; the rate of return on the investment to the state, including increases in tax revenue; and other criteria. To qualify for consideration, the community must have entered or expect to enter into a contract with a private developer. No funds will be provided for a project that would displace jobs in other communities in the state. No project will be granted more than \$10 million and the grant may not exceed more than 33 percent of the total cost of the project.

Each year, CERB will provide a ranking of projects for an amount totaling no more than \$50 million. It also may provide an alternate list of projects totaling no more than \$10 million. The legislature may remove projects from the first list and add some from the alternate list, in order or priority, as long as the total is no more than \$50 million.

The Joint Legislative Audit and Review Committee must make an inventory of all public infrastructure programs in the state by December 1, 2006. By September 1, 2010, it must submit a report to the legislature on the outcomes of the job development programs, including impacts on local government from the diversion of \$50 million each year from the Public Works Trust Fund.

The legislation sunsets on June 30, 2011.

Economic Development Strategic Reserve Account Established (2SSB 5370, Ch. 427, Laws of 2005)

Expenditures may be made from this account by the governor with the recommendation of the Department of Community, Trade, and Economic Development and the Economic Development Commission.

Such expenditures may be made to prevent closure of a business or facility, to prevent relocation of a business or facility out of state, or to recruit such a business or facility to the state.

No expenditure may be made unless: the business or facility will provide long-term economic benefits, resulting in new jobs, job retention or higher incomes; the business or facility will not require long-term state support; and the expenditure will be accompanied by private investment and not supplant private investment.

A maximum of \$3 million per year may be expended from this account for an individual business or facility.

Change in City Motor Vehicle Fuel Tax Distribution (SSB 5969, Ch. 89, Laws of 2005)

Cities have been receiving their gas tax in two separate distributions. One is called the “restricted” portion, which equals 31.86 percent of the total gas tax a city receives. The other is called the “unrestricted” portion.

Cities with a population of under 15,000 have been allowed to deposit both portions of the gas tax in the city street fund and to spend the monies for any street purposes – maintenance or capital. Cities with a population of 15,000 or more have been required to deposit the restricted portion in an arterial city street fund to be used for capital purposes, while the unrestricted portion could go into the city street fund for maintenance.

This bill removes the requirement that cities with a population of 15,000 or more use 31.86 percent of their gas tax funds for capital purposes. The monies cities receive may be used for any highway purpose as set forth in the 18th amendment (article 2, section 40) of the Washington State Constitution. Beginning with the September 2005 distribution, all the gas tax will be distributed under BARS 336.00.87, “MVFT Unrestricted.” Cities may, of course, still deposit some of their receipts in an arterial street fund, but they are not required to do so.

All Cities Now Have Until November 30 to Certify Property Tax Levies to the County (HB 1048, Ch. 52, Laws of 2005)

The above phrase says it all. Now all cities, in addition to Seattle and towns, may submit their property tax levies to counties on November 30 rather than November 15. Cities will still not have information on changes in state-assessed utility valuations by this date, and some cities may still not have complete information on new construction. Still, having these extra 15 days should be helpful.

Performance Objectives for Fire Departments (SHB 1756, Ch. 376, Laws of 2005)

This legislation applies to city fire departments, fire protection districts, regional fire protection service authorities, and port districts.

Each provider of fire protection must maintain a written policy that establishes the services provided, the organizational structure of the department, the expected number of employees, and the functions the employees are expected to perform.

This policy must also state the delivery objectives for the services provided as well as response time objectives for various measures set out in the bill. Performance objectives must be established at no less than 90 percent of the response time objectives.

Annually, beginning in 2007, each provider of fire protection must issue an annual report, evaluating its level of service and its response time performance, noting any deficiencies and addressing any issues that are necessary to achieve compliance.

Ambulance Utilities (ESHB 1635, Ch. 482, Laws of 2005)

Prior to the Washington State Supreme Court ruling in *Arborwood, Idaho, L.L.C. v. City of Kennewick*, 151 Wn.2d 359 (2004), 12 Washington cities funded their ambulance utilities under RCW 35.21.766 with a monthly fee per household. The court found this charge to be a tax rather than a fee and that it exceeded the taxing authority granted to cities under RCW 35.21.768. This bill sets out new requirements for an ambulance utility fee structure.

Before establishing an ambulance utility, a city council must first find that existing private ambulance services are inadequate according to acceptable medical standards and reasonable levels of service and must give that private ambulance service 60 days to meet these standards.

A cost of service study must be done before establishing the rates and charges. Costs must be separated into “availability costs” and “demand costs.” Availability costs include those for dispatch, labor, training, equipment, and supplies – costs that are incurred to be ready to respond to a call for service. Demand costs are those that are incurred in responding to an individual call for ambulance service and vary with frequency of call, distance to hospitals, etc. Fees are set by spreading availability costs over all classes of service and adding demand costs for each separate class.

Additional requirements include: 1) fee exemptions for those who are Medicaid-eligible and who reside in a nursing home, boarding home, adult family home, or who receive in-home services; 2) continued allocation by cities that had utilities prior to May 5, 2004 of at least 70 percent of general fund dollars they were expending at that time toward the total costs of the utility; 3) support from the general fund and/or EMS levy funds of 70 percent of the total costs of the utility for cities that established a utility on or after May 6, 2004; and 4) allocation of revenues received from direct billing toward the demand-related costs.

Alternative Public Works Contracting (ESHB 1830, Ch. 377, Laws of 2005)

The Capital Projects Advisory Review Board is established to evaluate public works construction processes, including the impact of contracting methods on project outcomes, and to advise the legislature on alternative public works delivery methods.

Any city that 1) is located in a county that is authorized to use alternative public works procedures or is located in a county that is a member of the Puget Sound Regional Council, 2) has a total budget of more than \$60 million, and 3) has a population of more than 25,000 and less than 45,000 may use the general contractor/construction manager or design-build procedure for one demonstration project that is valued at more than \$10 million. The contract for such a project must be entered into before March 1, 2006. Puyallup and Bremerton qualify under these criteria.

Fire Protection District Property Tax Levies (SB 5136, Ch. 122, Laws of 2005)

Among the various limitations on property tax levies in Washington are the “\$5.90 limit” and the “one percent limit.” The aggregate levy rates of the city tax, the county tax, and certain special district taxes cannot exceed \$5.90 per thousand dollars assessed valuation within boundaries of any city or county. (RCW 84.52.043(2).) If this limit is exceeded, then the rates of some special districts must be lowered (prorated) until the total does not exceed \$5.90. RCW 84.52.010(2) sets out the order in which prorating must take place.

Fire districts have the authority to do three 50 cent levies. The levy under RCW 52.16.130 is on the top step on the prorating ladder and is unlikely to be cut. The levies under RCW 52.16.140 and .160 are lower on the “ladder” and are more vulnerable to prorating.

Some levies are not subject to the \$5.90 limit but are subject to the one percent limit. They include levies for acquiring conservation futures, affordable housing levies, and emergency medical service levies. The one percent limit requires that the total tax rate, including the state levy rate, including the state rate, cannot exceed one percent or \$10 per thousand dollars assessed valuation. If the one percent limit is exceeded, then prorating must take place in the order prescribed by RCW 84.52.010(1). However, being outside the \$5.90 limit provides a measure of extra protection.

SB 5136 permits the fire district to place 25 cents of the levies under RCW 52.16.140 and .160 outside the \$5.90 limit. It would be the first levy rate cut, however, if the total rate is over the one percent limit.

New Uses for Conservation Futures Revenue (ESHB 1631, Ch. 449, Laws of 2005)

The permitted uses of this tax are broadened to include maintenance and operations of property acquired with these funds. A maximum of 15 percent of the total collections of this tax in the preceding calendar year may be spent for such purposes.

Before July 1, 2008, the commission in a county with a population density of less than four persons per square mile may propose a ballot measure asking the people whether the commission should make a one-time reallocation of unspent conservation futures funds to other county purposes.

The legislative authority in counties with a population of more than 100,000 must develop a process to ensure that, over time, the tax is be used to purchase conservation futures throughout the county.

If the expenditure of these funds reduces the capacity of land to accommodate planned housing and employment growth, measures must be taken to increase such lost capacity.

Homeless Housing Programs, Funded by Document Surcharge, Established (E2SHB 2163, Ch. 484, Laws of 2005)

Cities and counties may choose to participate in the programs established by the Homeless Housing Assistance Act. To implement the homeless housing programs, a \$10 surcharge is levied on each document recorded by the county auditor.

The funds shall be distributed as follows. The auditor shall retain two percent for a collection charge. Sixty percent of the remainder goes to the county for its homeless housing plan, with the county being permitted to deduct six percent for administrative costs. If a city in the county has elected to operate its own homeless housing plan and has passed a resolution to this effect, the county will distribute to the city a portion of this surcharge equal to the percentage of the city's local portion of the real estate excise tax. In such a case, the county would not deduct an administrative fee, but the city could use six percent of the funds it receives for administrative costs of its homeless housing program.

The remainder goes to the state homeless housing account. The state may use 12.5 percent for its administrative costs for the program, with the remaining 87.5 percent being distributed as grants to participating counties and cities.

A local government may subcontract with another local government, housing authority, community action agency, or other nonprofit for the execution of its homeless housing program. If a county chooses not to participate (by forwarding a resolution to that effect to the state), the state will receive the funds that otherwise would have gone to the county and the state may contract with one or more entities eligible to create and execute the homeless housing plan for the county.

Notice for Special Meetings (HB 1000, Ch. 273, Laws of 2005)

RCW 42.30.080 has been amended to permit notice for special meetings to be given by fax or electronic mail (e-mail).

Increase in Surcharge for Preservation of Historical Documents (HB 1386, Ch. 442, Laws of 2005)

The surcharge under RCW 36.22.170 is increased from two to five dollars. One dollar must be deposited in the county general fund to be used at the discretion of the commissioners to promote historical preservation or historical programs.

As is current practice, fifty percent of the remainder is to be remitted to the state treasurer, who distributes it to counties according to RCW 36.22.190. The other fifty percent is deposited into auditor's operation and maintenance fund for preservation of historical documents.

Small City Pavement and Sidewalk Account Created (SSB 5775, Ch. 83, Laws of 2005)

Cities and towns with a population of less than 5,000 may apply for funds to pay debt service on bonds or for grants and loans for pavement and sidewalk projects.

The Transportation Improvement Board will administer the program and in allocating the money will consider: whether the proposed project is in the city's six-year transportation improvement plan; information on the proposed street and sidewalks and traffic conditions; and the ability of the city to provide a local match.

The transportation budget bill appropriated \$2 million for this account.

Volunteer Firefighters' Relief and Pension Fund Fee Increase (SB 5135, Ch. 37, Laws of 2005)

The annual fee to be paid into the fund by participating municipal corporations for each volunteer firefighter is increased from \$10 to \$30.

The pension board is authorized to seek recovery of its benefit costs if a volunteer is injured and sues a third party for damages.

Revenue and Taxation Bill Creates Washington Main Street Program (ESHB 2314, Ch. 514, Laws of 2005)

The two major revenue-generating items for the budget are an increase of \$1.33 per liter tax on liquor sales and an increase of the tax on cigarettes of 60 cents per package.

Of particular interest to cities is the creation in this bill of the Washington Main Street Program to provide technical and financial assistance for the revitalization of downtown and neighborhood commercial districts. The Department of Community, Trade and Economic Development will develop the criteria for the award of such assistance and will give priority to programs in rural counties.

The program will be funded by a B&O tax credit of 75 percent for contributions made to designated local downtown or neighborhood commercial district revitalization programs or official local main street programs and 50 percent for contributions made to the Main Street Trust Fund. Only programs in a city with a population of less than 190,000 qualify for designation.

Total credits may not exceed \$100,000 per calendar year for a contribution to an individual program and the total credit per person may not exceed \$250,000 annually. The total approved credits for all programs per year may not exceed \$1.5 million.

Transportation Benefit District Provisions are Expanded (SSB 5177, Ch. 336, Laws of 2005)

A county or a city outside of King, Pierce, and Snohomish counties may establish a transportation benefit district to fund transportation improvements that are consistent with any existing state, regional, and local transportation plan. The entire area of each participating jurisdiction must be included in the district. Port and transit districts may participate in the establishment of a district, but may not initiate one. No more than 40 percent of a district's revenue may be spent on local street, road, or highway improvements.

New revenue options include a 0.2 percent sales and use tax, vehicle fees of up to \$100 annually, and tolls, all subject to voter approval.

If any improvement exceeds its original cost by more than 20 percent, a public hearing must be held to solicit public comment on how the cost change will be resolved.

Funding for Trial Courts Increased (E2SSB 5454, Ch. 457, Laws of 2005)

This bill increases a number of district and superior court fees and assesses some new ones. One of the latter is a new \$43 fee assessed against a criminal defendant upon conviction or plea of guilty in a court of limited jurisdiction. According to the local government fiscal note published on this bill, on a biennial basis, cities will receive approximately \$2.1 million and counties will receive \$17.7 million from these new and increased fees. \$1.6 million of the county receipts would be dedicated to local law libraries.

The statutes require that a portion of many of these fees be sent to the state treasurer to be deposited in the public safety and education account. This bill establishes an equal justice subaccount in that account to receive the state share of fee increases in this bill.

For the 2005-2007 biennium, the funds will be spent as follows:

- 1) \$2.3 million for criminal indigent defense assistance and enhancement at the trial court level, 1 million dollars of which is provided solely for a criminal indigent defense pilot program;
- 2) \$5 million for representation of parents in dependency and termination proceedings;
- 3) \$3 million for civil legal representation of indigent persons; and
- 4) \$2.4 million for contribution to district court and elected municipal court judges' salaries.

Beginning with the 2007-2009 biennium, 50 percent of this subaccount must be appropriated to the administrator of the courts for contributions to the salaries of district court judges and eligible municipal court judges. Municipal courts are eligible to receive this funding if their judges are elected and receive salaries that are least 95 percent of district court judge salaries.

All cities and counties that receive contributions to their judges' salaries must establish trial court improvement accounts, into which they must deposit an amount equal to one hundred percent of the state's contribution to their judges' salaries. Funds in this account must be used to fund improvements to court staffing, programs, facilities, and services.

Funding for Automated System to Process Real Estate Excise Taxes (2SHB 1240, Ch. 480, Laws of 2005)

This bill provides funding options for counties to develop and maintain an electronic processing and reporting system for real estate excise taxes that is compatible with the system at the state Department of Revenue.

Beginning July 1, 2005 and ending June 20, 2010, two \$5 fees are to be charged for certain real estate excise tax collections. The first \$5 fee will be collected by the county and deposited in the county treasurer's real estate excise tax electronic technology account. The second fee will be collected by the county and remitted to the state and placed in the state real estate excise tax electronic technology account. Three-quarters of these funds will be distributed in equal amounts to all 39 counties. The remainder will be distributed on the basis of population. The county treasurer must place these funds in a special real estate tax electronic technology fund.

In addition, a real estate excise tax grant account is established in the state treasury to be funded by an appropriation from the state general fund. The appropriation for the 2005-2006 fiscal year is \$3.9 million. The Department of Revenue shall administer a grant program to assist counties in developing, implementing, and maintaining an electronic processing system for the real estate excise tax. All funds remaining in this account on July 1, 2010 shall revert to the state general fund.

Beginning July 1, 2006, the amount that the county deposits in its current expense fund, to defray collection costs, increases from one percent to 1.33 percent of its receipts from real estate excise taxes and fees. Also, beginning July 1, 2006, there are changes in the timing of and the accounting for the transmittal of the tax to the state.

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/Subjects/Finance/cpipage.aspx. 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.

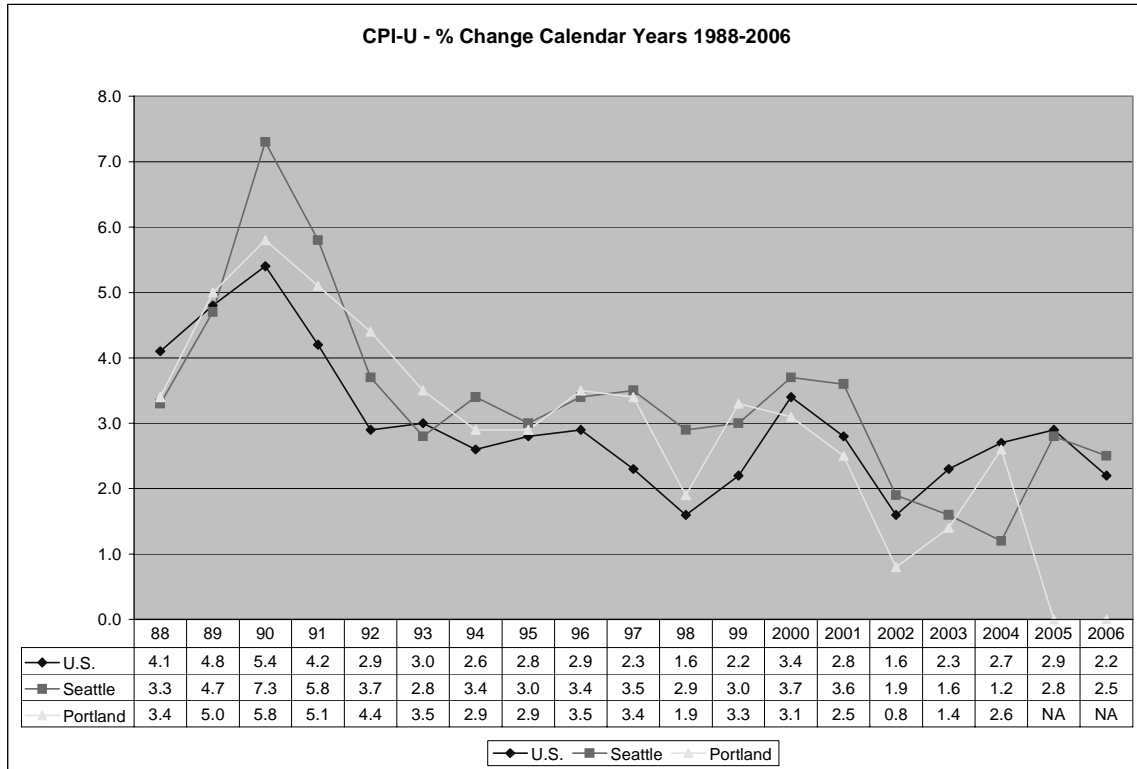
Table 1 on the following pages gives monthly historical information on the U.S. CPI-U and CPI-W, bimonthly data for Seattle, semiannual data for Seattle and Portland, and annual averages. The graphs on page 18 give historical information on the **annual average** CPI-U and CPI-W for the U.S., Seattle, and Portland, as well as some forecasts for 2005 and 2006.

We have forecasts for the national inflation rates from the Philadelphia Federal Reserve Bank, which surveys 46 economists; the Research Seminar in Quantitative Economics at the University of Michigan; The Wall Street Journal, which surveys 56 economists twice a year (probably some of the same economists that the Philadelphia Federal Reserve surveys); Global Insight; and the Office of the Forecast Council for Washington State. The Forecast Council uses the Global Insight estimate for its forecast of the national CPI and we have used that as a guide. 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.

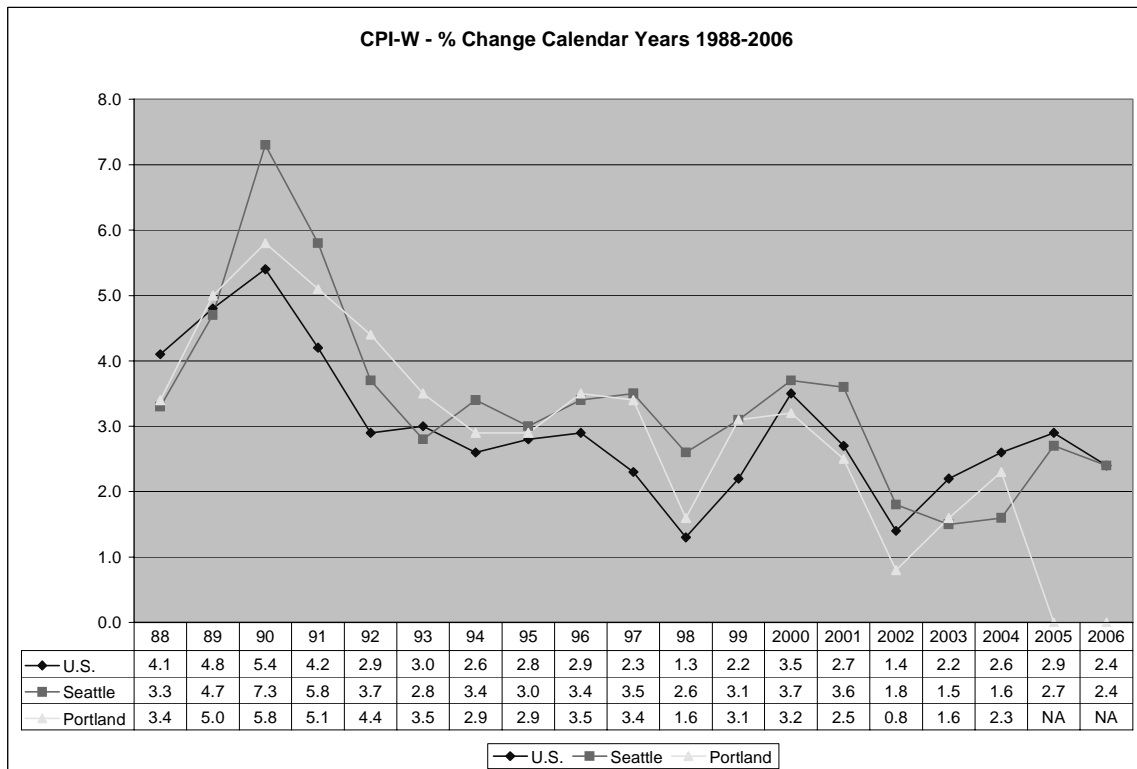
Given the increase in oil prices, economists are somewhat surprised that inflation is not higher than it is. Certainly the Federal Reserve is worried that inflation will be higher in the future because it raised its interest rate target on June 30, making that the ninth consecutive quarter-point increase.

Growth in U.S. gross domestic product is forecast to increase by 3.4 percent for this year. Some economists believe that this rate is sustainable without an increase in inflation. The increase in the price of the dollar is helping by restraining import price increases. We are also seeing a slowing in the rate of growth of prices in commodity markets (except oil), which will move down the supply chain, with a lag, to affect producer prices of finished goods and consumer prices.

Other economists worry about increasing labor costs. For the past twelve months, hourly compensation is up five percent. The question is: can firms raise prices to cover cost increases (from both labor and oil) and maintain their profit margins in the near term? An argument can be made that they cannot do so completely. Cheaper imports provide more competition. And, the Internet and home shopping channels are powerful tools for reaching markets where there may not be much local competition. More competition among sellers is a boon to consumers. In the long run, if profits lag, there will be less investment and lower economic growth. But, for now, lower profit margins keep price increases in check.



Figures for 2005-2006 are Estimates



Figures for 2005-2006 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 2006

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 2006

		All Urban Consumers (CPI-U)			Urban Wage Earners & Clerical Workers (CPI-W)		
Year	Month	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)
	June	189.4 (1.7)		179.9 (1.1)	184.1 (1.5)		175.9 (0.7)
	First half '02	188.3 (2.1)	183.5 (1.3)		183.1 (1.9)	178.7 (1.3)	
	July			180.1 (1.5)			176.1 (1.3)
	August	190.3 (1.9)		180.7 (1.8)	184.8 (1.8)		176.6 (1.6)
	September			181.0 (1.5)			177.0 (1.3)
	October	190.9 (1.6)		181.3 (2.0)	185.5 (1.3)		177.3 (1.9)
	November			181.3 (2.2)			177.4 (2.1)
	December	190.0 (2.1)		180.9 (2.4)	184.6 (1.9)		177.0 (2.4)
	Second half '02	190.3 (1.8)	184.0 (0.2)		184.9 (1.6)	179.3 (0.4)	
	ANNUAL AVE.	189.3 (1.9)	183.8 (0.8)	179.9 (1.6)	184.0 (1.8)	179.0 (0.8)	175.9 (1.4)
2003	January			181.7 (2.6%)			177.7 (2.6%)
	February	191.3 (2.0)		183.1 (3.0)	186.2 (2.0)		179.2 (3.2)
	March			184.2 (3.0)			180.3 (3.2)
	April	192.3 (1.9)		183.8 (2.2)	187.0 (1.9)		179.8 (2.3)
	May			183.5 (2.1)			179.4 (2.0)
	June	191.7 (1.2)		183.7 (2.1)	185.7 (0.9)		179.6 (2.1)
	First half '03	191.6 (1.8)	186.0 (1.4)		186.2 (1.7)	181.7 (1.7)	
	July			183.9 (2.1)			179.6 (2.0)
	August	194.4 (2.2)		184.6 (2.2)	188.2 (1.8)		180.3 (2.1)
	September			185.2 (2.3)			181.0 (2.3)
	October	193.7 (1.5)		185.0 (2.0)	187.8 (1.2)		180.7 (1.9)
	November			184.5 (1.8)			180.2 (1.6)
	December	191.0 (0.5)		184.3 (1.9)	185.3 (0.4)		179.9 (1.6)
	Second half '03	193.1 (1.5)	186.5 (1.4)		187.1 (1.2)	182.0 (1.5)	
	ANNUAL AVE.	192.3 (1.6)	186.3 (1.4)	184.0 (2.3)	186.7 (1.5)	181.8 (1.6)	179.8 (2.2)
2004	January			185.2 (1.9%)			180.9 (1.8%)
	February	193.5 (1.2)		186.2 (1.7)	187.8 (0.9)		181.9 (1.5)
	March			187.4 (1.7)			182.9 (1.4)
	April	194.3 (1.0)		188.0 (2.3)	189.1 (1.1)		183.5 (2.1)
	May			189.1 (3.1)			184.7 (3.0)
	June	195.3 (1.9)		189.7 (3.3)	190.4 (2.5)		185.3 (3.2)
	First half '04	194.0 (1.3)	189.8 (2.0)		188.7 (1.3)	184.9 (1.8)	
	July			189.4 (3.0)			184.9 (3.0)
	August	194.6 (0.1)		189.5 (2.7)	189.6 (0.7)		185.0 (2.6)
	September			189.9 (2.5)			185.4 (2.4)
	October	196.5 (1.4)		190.9 (3.2)	191.6 (2.0)		186.5 (3.2)
	November			191.0 (3.5)			186.8 (3.7)
	December	195.1 (2.1)		190.3 (3.3)	190.3 (2.7)		186.0 (3.4)
	Second half '04	195.4 (1.2)	192.5 (3.2)		190.5 (1.8)	187.0 (2.7)	
	ANNUAL AVE.	194.7 (1.2)	191.1 (2.6)	188.9 (2.7)	189.6 (1.6)	185.9 (2.3)	184.5 (2.6)
2005	January			190.7 (3.0%)			186.3 (3.0%)
	February	197.6 (2.1)		191.8 (3.0)	192.4 (2.4)		187.3 (3.0)
	March			193.3 (3.1)			188.6 (3.1)
	April	201.3 (3.6)		194.6 (3.5)	196.2 (3.8)		190.2 (3.7)
	May			194.4 (2.8)			190.0 (2.9)
	June			194.5 (2.5)			190.1 (2.6)

Implicit Price Deflator for Personal Consumption Expenditures

Monthly Index and Cumulative Percentage Change from July 2004

	Jul 04	Aug	Sep	Oct	Nov	Dec	Jan 05	Feb	Mar	Apr	May
Orig. Index	107.939	107.999	108.111	108.592	108.823	108.773	108.926	109.218	109.725	110.188	
Cum. % Change		0.056	0.159	0.605	0.819	0.773	0.914	1.185	1.655	2.084	
IPD % Proj.		0.667	0.956	2.420	2.457	1.854	1.829	2.031	2.482	2.778	
Prev. 12 Mo. % Change		2.172	2.088	2.512	2.739	2.473	2.219	2.229	2.385	2.670	

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 (IPD) published by the Bureau of Economic Analysis (BEA). (Every month from August to May, the BEA goes back and revises the data for the last three to six months.) The second row represents the cumulative percentage change in the preliminary or revised index from July of 2004. The third row represents the projections of the annual IPD since July of 2004 when using the methodology of dividing the cumulative percentage change since July by the number of months since July and then multiplying the dividend by 12 to obtain an annual estimate. The fourth row represents the actual percentage change over the last 12 months.

BEA Revisions and Our Forecast

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

Is there a possibility that the July index will be low enough that the rate of increase in the IPD will be less than the “magic” one percent for property tax increase purposes for taxing jurisdictions with a population of 10,000 or more? Almost certainly not. For the increase to be exactly one percent, the July index number (first row) would have to fall to 109.018.

We will publish the “annual inflation factor” in our Focus section of the MRSC Web site as soon as the September issue of the Survey of Current Business is published on the BEA Web site – sometime near the end of September. **If**, as we revise this table on our site in the coming months, it appears that it is possible that the percentage increase could be as low as one percent, we will call the BEA at the beginning of September and get the numbers before they are published and report what we find.

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

State-Shared Revenue Forecasts

Population Forecast

The official April 1, 2005 **city** population, to be used for distributions in 2006, is 3,817,518. This is 1.2 percent more than the population for April 1, 2004 that was released last year. This low number is not surprising. We have had no incorporations during the past year and annexations are just starting to occur after the Washington State Supreme Court ruling in *Grant County Fire Protection District No. 5 v. City of Moses Lake* that found the petition method of annexation constitutional. In past years, we have adjusted the April 1 numbers upward for annexations we knew were in the pipeline. (Cities that annex qualify for state-shared revenue distributions on their new population base, starting the quarter after the annexation.) We have made no such adjustments this year. The boundary review boards for the largest counties do not see any big annexations on the horizon for next year. The official April 1, 2005 **county** population is 2,438,882. This is an increase of 1.8 percent from 2004. We have used this number, unadjusted, in making the county forecasts for Liquor Board profits and the liquor excise tax.

Motor Vehicle Fuel Taxes

Our gasoline and diesel tax forecasts come from Brian Calkins, a transportation economist with the Department of Transportation.

Higher gasoline prices have reduced gasoline purchases and tax collections, but a recovering state economy has increased consumption of diesel fuel. Diesel fuel currently comprises about 19 percent of total state motor fuel consumption. Revenue distributions to cities for calendar year 2004 were down by about \$0.7 million compared to the forecast done in June 2004 because higher than expected gasoline prices reduced gasoline consumption.

New transportation funding enacted by ESSB 6103, passed by the 2005 Washington Legislature and signed into law by Governor Gregoire, will provide additional revenues to incorporated cities and towns. Cities and towns will receive 8.333 percent of a three cent tax increase beginning July 1, 2005, and 8.333 percent of another three cent tax increase beginning July 1, 2006. ***[Editor's note: See the box on page 26 for an explanation of the timing of the revenue distributions associated with the tax increases.]*** Revenue distributions to cities and towns from the initial three cent increase in CY 2005 are forecasted at \$2.79 million. This is in addition to the \$78.38 million distributed from the 23 cent base of our motor fuel tax. The 23 cent portion is about \$1 million less than forecasted in June 2004 and results from the higher gasoline prices incurred so far in CY 2005 and forecasted for the remainder of the year.

Further editor's note: We apparently forgot to tell Brian that we wanted forecast narrative for counties also. However, we have his spreadsheet and can follow his model above. The 2004 actual distribution to counties was down \$1.3 million compared to the forecast done in June 2004 because higher than expected gasoline prices reduced gasoline consumption.

The counties will receive the same gross percentage shares of the gas tax increases (8.333 percent of each three cent increase beginning July 1, 2005 and July 1, 2006) as the cities. However, the net amount that counties will receive will be lower than that of the cities because the counties' share is subject to more deductions. For CY 2005, this net amount is forecast to be \$2.68 million. This is in addition to the \$135.5

million distributed from the 23 cent base of the motor vehicle fuel tax, making a total of \$138.2 million. The counties' share of the 23 cent portion is about \$1.8 million less than forecast in June 2004 and results from the higher gasoline prices incurred so far in CY 2005 and forecast for the remainder of the year.

Remember that the gasoline and diesel tax is a flat amount per gallon rather than a percentage of the price at the pump, so even when gas and diesel fuel prices increase as they dramatically have recently, the tax revenue may decrease if the number of gallons sold decreases by a greater percentage amount.

The county distribution formula includes annual road costs and “need” in addition to population. The estimates for the coming year, based on these factors, is done by the County Road Administration Board (CRAB). Counties will receive their estimates in the mail. The CRAB board must approve the distributions, and they do not meet until after we go to press. City forecasts are in Tables 2 and 3.

“Wait a minute, what’s this ‘Gas Tax (NEW unrestricted)’ column and where are the estimates for ‘Gas Tax (unrestricted)’ and ‘Gas Tax (restricted)’?” Read the discussion of SSB 5969 on page 9. With the passage of SB 5969 all gas tax funds are “unrestricted” for all cities. In fact, beginning with your September 2005 distribution, you will receive only a single distribution. It will be under “BARS 336.00.87 – MVFT Unrestricted.” Cities with a population of 15,000 or more no longer have to spend a portion of their gas tax on capital expenditures if they do not wish to do so. They can spend any portion of their gas tax on maintenance. Of course, all the gas tax monies must be spent for street purposes.

Timing of the Revenue Distributions from the Gas Tax Increases

Cities and counties are each allocated revenues from 1/4 cent of the three cent gas tax increases that take effect on July 1, 2005 and July 1, 2006. The distributions they receive in September 2005 will be the first to include the new taxes. (The revenue collected from the new taxes in July is sent to the state in August and distributed to cities and counties in September.)

Cities. For CY 2005, approximately 74 cents of the \$21.52 estimated per capita gas tax revenue in table 3 are a result of the July 1, 2005 tax increase. During the last four months of the year, revenues will be approximately 10 to 11 percent higher than for the same months in CY 2004, and almost all of that will be due to the tax increase. The distributions received during the first eight months of CY 2006 will also reflect the July 1, 2005 tax increase and will continue to be about 10 to 11 percent higher than the corresponding months in CY 2005.

The July 1, 2006 tax increase starts providing revenues in September 2006. For the last four months of CY 2006, this tax increase is estimated to provide revenue growth of 10 to 11 percent over the same months in CY 2005. For CY 2006 as a whole, \$2.13 of the \$23.69 per capita estimate in table 3 is a result of the two tax increases. In CY 2007, the July 1, 2006 tax increase continues to provide “new money” (an estimated additional \$1.43 per capita) through August 2007, with the revenues in the first eight months growing, again, at approximately 10 to 11 percent over the same months in CY 2006. Starting with September 2007, the rate of growth of revenues will settle back to its normal one to two percent a year. All the tax increases are now in the base. The estimated total tax increase over the three years is \$4.30 per capita.

Counties: Counties will receive an estimated \$2.68 million from the July 1, 2005 tax increase in CY 2005, beginning with the September distribution. Because of decreased consumption due to higher gasoline prices, the forecast for CY 2005 **without** the tax increase has fallen to \$135.5 million from the \$137.3 million estimate in last year’s June forecast. (The latter amount was used in the CRAB estimates counties received last July.) Adding the estimated revenues from the tax increase to the lowered forecast of the base without the tax increase provides a total revenue estimate of \$138.2 million for CY 2005, just slightly more than the \$137.3 million that was expected in the June 2004 forecast. Remember that the \$2.68 million is going to be received during the last four months of the year. Revenues for the first eight months of CY 2005 have been lower than expected. But, during the last four months of CY 2005, you should see revenues that are approximately six percent higher than for the same months in CY 2004. Do not be surprised by this “bump.”

The forecast for total gas tax revenue for counties in CY 2006 is \$147.5 million. That number includes the increase from the July 1, 2005 tax that continues through the first eight months of CY 2006 and the effect of the new tax increase on July 1, 2006 for the last four months of CY 2006. Just as in the last four months of CY 2005, there will be a bump up in the receipts of the last four months of CY 2006.

A year from now, when counties get their forecast for CY 2007 from CRAB, it will include the effect of the continuation of the July 1, 2006 tax increase through August 2007. After that date, all the tax increase will have been “rolled” into the base for future forecasts.

Liquor Revenues

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.

Effective July 1, 2005, the tax per liter of liquor increased by \$1.33 as a result of the passage of HB 2314. The effects of this tax increase on liquor profits and liquor excise tax revenues are difficult to forecast, because the increase in price from this tax is not a uniform percentage. Assuming there are no other changes, this tax will, for example, increase the price of a \$10 liter of liquor by 13.33 percent, while the increase in a \$20 liter will be only 6.65 percent.

Rob Kirkwood of the Liquor Control Board gives the following forecast:

The liquor excise tax account is projected to increase by 6.35 percent in 2005. We attribute this to (a) an increasing population, (b) a continued movement in consumer preferences towards spirits, and (c) increase in prices. In 2006 we are expecting a slight decrease in the liquor excise tax due to a decrease in demand caused by the \$1.33 liquor liter tax approved by HB 2314. (Liter taxes are applied after the sales taxes calculation and therefore do not increase the retail price of spirits). The reduction in demand we anticipate for 2006 should turn around in 2007, when we expect to see another increase of 6 percent in the liquor excise tax collections.

Liquor profits are projected to increase by 8.87 percent in 2005, the result of a robust economy, an increasing population, and cost controls. The \$1.33 liter tax will have a dampening effect on liquor profits in 2006, but we expect this will turnaround in 2007.

For those who have their own opinions on how this price increase will affect liquor excise taxes in 2006, each one percent change in the growth rate will change the city receipts by four cents per capita and county receipts by a little less than one cent.

City forecasts are in Tables 2 and 3; county forecasts are in Tables 4 and 5.

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.

With the passage in 2003 of SSB 5780, a total of 70 percent of the revenue distributed under RCW 82.14.330 is now handed out on a purely per capita basis. As in the past, RCW 82.14.330(1)(b) distributes 16 percent of the pot on a per capita basis, with each city receiving a minimum of \$1,000, no matter how small their population. RCW 82.14.330(2) was amended to delete the language that allocated certain percentages to innovative law enforcement programs, domestic violence prevention programs, and child abuse prevention programs, with the requirement that the cities send in funding requests for each program to CTED. The funds for these three areas, totaling 54 percent of the pot, are now distributed by the Office of the State

Treasurer on a strictly per capita basis. There is a requirement that these funds be spent on some combination of innovative law enforcement programs, domestic violence prevention programs, and child abuse prevention programs, but no requirement of how much must be spent in each area. All the money can be spent in one area if a city wishes. In Tables 2 and 3, we identify the 16 percent distribution as “Criminal Justice – Population,” which is what the treasurer’s office calls it. The 54 percent distribution is labeled “Criminal Justice – Former CTED Programs.”

The distribution of 10 percent of the revenues to cities that contract for law enforcement services remains unchanged. Language was added to say that once the allocations are made in December for the coming year, they will not be changed. There will be no retroactive payments.

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

In spite of the passage of Initiative 695, **counties** are continuing to receive some state-shared criminal justice funding from the state general fund under the provisions of RCW 82.14.310. The initial appropriation, made for the state fiscal year 2000, was \$23.2 million. It is increased every 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. The county funding formula includes population, the crime rate of the county, and the annual number of criminal cases filed in superior court. Because revenues are not handed out on a strictly per capita basis, MRSC can provide no forecasts.

Summary of Local Share of State-Shared Revenues Total Dollar Amounts – 2003 to 2006 <i>(All Cities and Towns)</i>				
	2003	2004	2005 Revised	2006 Estimate
Gas Tax (unrestricted)	\$52,392,592	\$52,464,655	NA	NA
Gas Tax (restricted)	24,497,035	24,530,730	NA	NA
Gas Tax (NEW unrestricted)*	NA	NA	81,167,000	90,418,000
Profits of Liquor Board	23,110,626	27,093,780	28,030,000	28,270,000
Liquor Tax	13,181,154	14,472,780	15,096,000	15,012,000
Criminal Justice - former CTED programs	NA	2,706,831	2,788,000	2,870,000
Criminal Justice – Population-based	776,381	802,024	826,000	850,000
Total	\$113,907,788	\$122,070,800	\$127,907,000	\$137,420,000

Table 2

*To get numbers comparable to those for 2005 and 2006, add the two rows above.

Per Capita Amounts – 1999 to 2006 <i>(All Cities and Towns)</i>								
	1999	2000	2001	2002	2003	2004	2005 Rev.	2006 Est.
Gas Tax (unrestricted)	\$15.30	\$15.12	\$14.66	\$14.38	\$14.19	\$14.03	NA	NA
Gas Tax (restricted)	7.15	7.07	6.85	6.72	6.64	6.56	NA	NA
Gas Tax (NEW unrestricted)*	NA	NA	NA	NA	NA	NA	21.52	23.69
Profits of Liquor Board	5.34	6.06	5.36	5.46	6.26	7.24	7.43	7.41
Liquor Tax	3.14	3.27	3.35	3.51	3.57	3.87	4.00	3.93
Criminal Justice - former CTED programs	NA	NA	NA	NA	NA	0.72	0.74	0.75
Criminal Justice – Population-based	0.46	0.27	0.21	0.21	0.21	0.21	0.22	0.22
Total	\$45.39	\$34.47	\$30.43	\$30.28	\$30.87	\$32.63	\$33.91	\$36.00

Table 3

*To get numbers comparable to those for 2005 and 2006, add the two rows above.

Summary of Local Share of State-Shared Revenues Total Dollar Amounts – 2003 to 2006 <i>(All Counties)</i>				
	2003	2004	2005 Revised	2006 Estimate
Profits of Liquor Board	\$6,256,783	\$7,254,836	\$7,489,000	\$7,585,000
Liquor Excise Tax	2,913,035	3,233,695	3,292,000	3,359,000
Total	\$9,169,818	\$10,488,531	\$10,781,000	\$10,944,000

Table 4

Per Capita Amounts – 1999 to 2006 <i>(All Counties)</i>								
	1999	2000	2001	2002	2003	2004	2005 Rev.	2006 Est.
Profits of Liquor Board	\$1.83	\$2.16	\$2.17	\$2.23	\$2.64	\$3.03	\$3.13	\$3.11
Liquor Excise Tax	0.94	1.00	1.10	1.14	1.23	1.35	1.42	1.38
Total	\$2.77	\$3.16	\$3.27	\$3.37	\$3.87	\$4.38	\$4.55	\$4.49

Table 5

Fire Insurance Premium Tax

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

For the distribution in 2005 the amount of premium tax for all categories of insurance was, for once, just about what we expected. The reason the "ratio value" per firefighter rose to \$683 compared to the forecast of \$655 was that the number of covered firefighters decreased.

For 2006 we are assuming there will be no growth in the number of firefighters and that insurance premiums increase by eight percent. We have also assumed that the percent of losses due to fire follow their historical norms. These assumptions produce a ratio value of \$696.

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

Distribution of Fire Insurance Premium Tax – RCW 41.16.050 <i>May 2005</i>			
City/District	Ratio Value	Number of Paid Firefighters as of January 1, 2005	Amount¹
Aberdeen	\$683.05	35	\$ 23,906.89
Anacortes		18	12,294.97
Auburn		77	52,595.17
Bellevue		190	129,780.28
Bellingham		134	91,529.25
Bothell		48	32,786.60
Bremerton		56	38,251.03
Camas		34	23,223.84
Centralia		21	14,344.14
Chehalis		13	8,879.70
Edmonds		52	35,518.81
Ellensburg		21	14,344.14
Everett		181	123,632.79
Hoquiam		22	15,027.19
Kelso		12	8,196.65
Kennewick		74	50,546.00
Kent		138	94,261.47
Kirkland		69	47,130.73
Longview		43	29,371.33
Lynnwood		53	36,201.87
Mercer Island		29	19,808.57
Moses Lake		27	18,442.46
Mountlake Terrace		33	22,540.79
Mount Vernon		26	17,759.41
Olympia		79	53,961.27
Pasco		47	32,103.54
Port Angeles		22	15,027.19
Port Townsend		11	7,513.60
Pullman		21	14,344.14

Distribution of Fire Insurance Premium Tax – RCW 41.16.050 <i>May 2005</i>			
City/District	Ratio Value	Number of Paid Firefighters as of January 1, 2005	Amount¹
Puyallup		56	38,251.03
Raymond		13	8,879.70
Redmond		128	87,430.93
Renton		106	72,403.73
Richland		52	35,518.81
Seattle		1,015	693,299.91
Shelton		7	4,781.38
Spokane		291	198,768.74
Sumner		17	11,611.92
Sunnyside		14	9,562.76
Tacoma		406	277,319.97
Toppenish		5	3,415.27
Tukwila		60	40,983.25
Vancouver		177	120,900.58
Walla Walla		46	31,420.49
Wenatchee		34	23,223.84
Yakima		80	54,644.33
King County #2		35	23,906.89
King County #10		121	82,649.55
Spokane County #1		150	102,458.12
Totals		4,399	\$3,004,755.02
<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 6

What's Ahead for Cities and Counties in 2007?

This is usually the section in which we report on the possibilities of incorporations and annexations that might result in significant changes in state-shared revenues for the year after next. The one such possible event out there is the incorporation of Fairwood, near Renton. If a vote is taken in the spring of 2006 and is successful, the new city would probably incorporate in early 2007 and qualify for nine months of state-shared revenues. A March 2007 incorporation of Fairwood would lower the numbers in the table below by 0.5 percent, a very small amount, given that all the number are estimates. The estimated total would decrease from \$38.62 to \$38.43.

City Per Capita State-Shared Revenue Estimates – 2007	
Gas tax (NEW unrestricted)	\$25.44
Liquor board profits	8.06
Liquor excise tax	4.13
Criminal Justice (former CTED programs)	0.76
Criminal Justice (population)	0.23
Total	\$38.62

County Per Capita State-Shared Revenue Estimates – 2007	
Liquor board profits	\$3.28
Liquor excise tax	1.42
Total	\$4.70

Some Things to Remember for Fall 2005 and 2006 Municipal Elections

by Jim McNeill, Foster Pepper & Shefelman PLLC

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Planning for municipal elections in Fall 2005 and 2006 begins now. This article will briefly list some things to remember for those municipalities planning to go before the voters within the next 16 months.

2006 Election Dates and Ballot Proposition Filing Deadlines

The Fall 2005 and 2006 election dates and deadlines for filing the ballot proposition resolution or ordinance are listed below. These are the dates permitted under current law, which may be changed by the Legislature. Bills are introduced during every legislative session to change the available election dates (e.g., cancellation of 2004 Presidential Primary). Please Note: The county auditor is required to mail absentee ballots at least 18 days prior to an election date.

<u>Election Date</u>	<u>Ballot Proposition Filing Deadline</u>
September 20, 2005	August 5, 2005
November 8, 2005	September 23, 2005
February 7, 2006	December 23, 2005
March 14, 2006	January 27, 2006
April 25, 2006	March 10, 2006
May 16, 2006	March 31, 2006
September 19, 2006	August 4, 2006
November 7, 2006	September 22, 2006

Changes to Ballot Title Laws

The laws governing ballot titles for most bonds and levies may have changed since you last submitted a ballot title to the voters. Municipalities intending to submit bond or levy propositions in Fall 2005 or 2006 should consult with bond counsel familiar with these changes before proceeding. UNDER NO CIRCUMSTANCES SHOULD OLD BALLOT TITLES SUBMITTED AT ELECTIONS OCCURRING PRIOR TO SEPTEMBER 2000 BE USED AS MODELS.

Open Public Meetings Law

Municipalities must comply strictly with the Open Public Meetings Law (chapter 42.30 RCW). Any action taken at meetings failing to comply with the Open Public Meetings Law shall be null and void.

Public Disclosure Laws

Municipalities must also comply strictly with the Public Disclosure and Campaign Reporting Laws (chapter 42.17 RCW). The Public Disclosure Commission (the “PDC”) has a variety of useful publications to assist municipalities in complying with Public Disclosure Laws. Specifically, the PDC has published election campaign guidelines for school districts entitled Guidelines for School Districts in Election Campaigns (“School Guidelines”) to implement RCW 42.17.130. That statute prohibits the use of public facilities to support a ballot proposition. The PDC also published similar guidelines for local governments entitled Guidelines for Local Government Agencies in Election Campaigns (the “Local Government Guidelines”).

Recently, the Washington State Supreme Court validated the PDC’s use of the School and Local Government Guidelines. By way of background, the Washington Education Association (the “WEA”) challenged the School Guidelines and ultimately obtained an order from the King County Superior Court declaring that the School Guidelines were unconstitutional and constituted an unlawful agency action. The PDC appealed to the Supreme Court. The Court, in a closely divided opinion (5-4), reversed the superior court’s order (Washington Education Association v. Public Disclosure Commission, 150 Wn.2d 612 (2003)). The Court determined that the School Guidelines are an interpretative statement meant only to aid and assist in compliance with the law, and do not purport to have the effect of law or regulation. The Court concluded that the School Guidelines are advisory, do not purport to be anything more, and do not implicate the WEA’s legal interests. Consequently, the Court dismissed the WEA’s claims without reaching the constitutionality of the School Guidelines.

There are three important lessons to be learned from the Court’s decision. First, all local governments would be well-advised to strictly adhere to all public disclosure laws, including those governing the use of public facilities in local government election campaigns. The result of an election might be voided if a court finds that a violation of the public disclosure laws probably affected the outcome of the election. Also, any person who violates those laws could be subject to a civil penalty up to \$10,000 for each violation. Second, expect the PDC to continue to rely upon the School Guidelines and the Local Government Guidelines as its interpretation of the public disclosure laws governing the use of public facilities in local government election campaigns. At recent meetings, the PDC approved modifications to both the School Guidelines and the Local Guidelines, and re-published them on the PDC website. The PDC also agreed that PDC staff may proceed with RCW 42.17.130 enforcement complaints, and resume reviewing facts sheets, conducting training and providing assistance to the public on compliance with the law. Third, all local governments are strongly encouraged to consult both the School Guidelines and the Local Government Guidelines regarding the use of public facilities in local government election campaigns because they represent an interpretation of a statute by the agency whose task it is to interpret and enforce that statute. A local government that ignores the PDC’s interpretation does so at its own risk. Copies of the School and Local Government Guidelines are available online (<http://www.pdc.wa.gov>). Any questions regarding compliance with RCW 42.17.130 should be directed to legal counsel.

Local Voters’ Pamphlet

If a county, or first-class or code city authorizes the publication of a local voters’ pamphlet under chapter 29A.32 RCW, a municipality seeking voter approval of a ballot proposition may need to prepare an explanatory statement and appoint committees to prepare statements for and against the ballot proposition. Municipalities should consult with the county auditor or city clerk, as applicable, to determine (i) whether a local voters’ pamphlet will be authorized; and (ii) the necessary administrative rules that govern the pamphlet’s content, including, most importantly, the deadlines for submitting the explanatory statement and statements for and against the ballot proposition.

Other Suggestions

Other practical suggestions when planning for an election include the following:

- assemble the financing team early.
- allow ample time for preparation, review and approval of documents.
- set realistic priorities for actions to be taken.
- strive for consistency and accuracy in public statements.
- never try to write your own ballot title, especially for a bond issue.
- never hesitate to ask questions.

Please contact any of the Foster Pepper & Shefelman PLLC municipal finance attorneys if you have questions regarding bond or levy elections.

Public Records Act - Significant Changes Made

by Jim Doherty, Legal Consultant, Municipal Research and Services Center

Two legislative bills amending the public records act passed the legislature this session. One bill contains significant substantive changes; the other bill reorganizes and renumbers the public records disclosure statutes.

SSHB 1758

This is the bill that created a lot of stress for local governments as it proceeded through the legislative process. The original legislation proposed to modify the attorney-client privilege, and that caused significant concern among city attorneys and prosecutors. Another section of the proposed bill would have significantly increased the financial penalties for documents not properly disclosed, including per day penalties that could have quickly mounted to large sums. Effective lobbying by our city and county organizations, and many volunteers, resulted in the elimination of those onerous provisions and the modification of several other provisions. The final version of this legislation preserved the attorney-client privilege in its present form and did not increase the penalties portion of the law.

Highlights of SSHB 1758

Cities and counties are allowed, but not required, to respond to records requests on a partial or installment basis as records that are part of a larger set of requested records are assembled or made ready for inspection or disclosure. In addition, the new law specifically provides that if an installment is not picked up or reviewed, the public agency is not obligated to fulfill the balance of the request. This clarifies an issue that has arisen quite often and may help to eliminate unnecessary work if the requestor fails to follow through and pick up or review partial installments as they become available.

Local governments are now prohibited from denying requests solely on the basis that the request is overbroad. Requestors may be asked to clarify exactly what they are looking for, and the benefits of narrowing the request may be explained to them - such as reducing the amount of time required to fill the request and reducing the copying costs. But if a person requests, for example, "all of the documents related to land use decisions and the comprehensive planning process over the past ten years," the jurisdiction cannot refuse to respond solely because the request is overbroad or voluminous.

Cities and counties are now specifically permitted to require a deposit in an amount not to exceed ten percent of the estimated cost of providing copies for a request. They are also allowed to charge for each part of a request provided on an installment basis. Some jurisdictions had previously adopted local procedures requiring deposits; that procedure is now clearly permitted as long as the deposit does not exceed ten percent of the estimated cost.

The law now requires that each city and county appoint and maintain an individual to serve as the point of contact for members of the public requesting disclosure of public records and to oversee compliance with all disclosure requirements. Though some jurisdictions had done this before, it is now required.

The legislation directs the state Attorney General to adopt an advisory model rule for public agencies that addresses issues relating to assisting requestors, fulfilling large requests, fulfilling requests for electronic records, and other issues as determined by the Attorney General. The obvious intent is to provide more uniformity on the disclosure process throughout the state. However, this model rule will be advisory only; it is not required that local jurisdictions adopt the model rule or any of its specific provisions.

The legislation clarified that the venue provisions for lawsuits filed against counties on public records disclosure issues is the same as for other lawsuits (RCW 36.01.050).

The statute of limitations in regard to public records disclosure matters had been unreasonably long. The legislation changes the statute of limitations for court actions from five years to within one year of an agency's claim of exemption or the last production of a record on a partial or installment basis.

All of the above changes go into effect on July 24, 2005.

SHB 1133

This bill, though making no substantive changes in the public disclosure act, completely reorganizes the statutes relating to public disclosure. The disclosure exemptions will be organized into several discrete topics. The intent is to make it easier for agencies and the public to understand and use the public disclosure act. This bill does not go into effect until July 1, 2006. The new edition of the RCW published by the Code Reviser this fall should contain the public disclosure statutes as amended by the substantive bill (SSHB 1758) and also the reorganized public disclosure act in a new chapter.

IRS Bond Audits in Washington State

Introduction

State and local government finance officers in Washington State have been aware for a number of years of the Internal Revenue Service reorganization that produced the unit that has been providing classes on topics such as the taxation of fringe benefits, 1099 forms, and pay advances and employment taxes.

The same reorganization resulted in the formation of the Tax Exempt Bond Program. Agents from the Enforcement Group have been auditing tax-exempt municipal bonds issued by local governments in the State. The audits are intended to determine whether the selected bond issues are in compliance with applicable requirements of the Internal Revenue Code, as necessary to maintain the tax exemption for the bonds.

The following three articles, written by prominent local bond attorneys, provide information on what kinds of things the IRS might audit, information on record retention requirements to make certain you have the proper documents in order if you are audited, and advice on how to prepare for and respond to an audit.

Note that “small issuers” – those that reasonably expect, at the time the bonds are issued, to issue \$5 million or less of tax-exempt bonds (\$15 million for school districts) in the calendar year – are exempt from the arbitrage rebate requirement for bonds issued in that calendar year. However, **every** issuer is subject to the “change in use” regulations. If property that was financed by tax-exempt municipal bonds is sold to a nongovernmental person or its use is changed to a “private business use” before the bonds are paid off, the bonds could lose their tax exempt status and become taxable bonds.

Our advice: if you get a notice of an IRS audit, call your bond counsel immediately. If you are going to sell property or change its use from a municipal purpose, call your bond counsel before taking action. There may be steps that can be taken to prevent the bonds from becoming taxable. If you have any other questions on your bonds, your bond counsel can provide guidance.



A Guide to Tax Compliance After Municipal Bond Issuance by Preston, Gates & Ellis, LLP

Internal Revenue Service rules require municipalities that have issued tax exempt bonds or notes (“bonds”) to monitor the spending and investment of bond proceeds and the use of facilities financed with bond proceeds. Certain failures in monitoring can result in the bonds being declared taxable. We recommend ongoing monitoring to comply with these rules.

Spending & Investing Bond Proceeds

Three-Year Temporary Investment Period. Most municipal bond issues that finance capital expenditures qualify under IRS rules for a “three-year temporary investment period.” (The only bond issues that generally do not qualify for this investment opportunity are bonds issued for capital projects that are anticipated to take

longer than three years to complete.) During this three-year period following the issuance of bonds, a municipal issuer may invest the bond proceeds at the highest yields available and the investment yield may be higher than the yield on the bonds. As discussed below, however, the IRS “arbitrage rebate” rules do not necessarily allow the municipality to keep arbitrage earnings.

To ensure compliance with the IRS rule regarding the three-year temporary investment period, a municipal issuer should monitor its schedule for spending bond proceeds. If bond proceeds (and investment earnings on the bond proceeds) remain unspent at the end of the three-year period, the issuer may do one of the following:

- Invest the remaining bond proceeds in investments that will yield less than the yield on the bonds, or
- Make “yield reduction payments” to the IRS, which requires the issuer to complete IRS Form 8038-T and periodically pay to the IRS the earnings that exceed the bond yield.

Arbitrage Rebate & Exceptions from Rebate

The opportunity to invest bond proceeds for three years at yields higher than the bond yield does not necessarily mean that the bond issuer can keep those higher investment yields (the “arbitrage”). The general IRS rule is that such arbitrage must be paid back – or rebated – to the IRS. A municipal issuer does not have to pay arbitrage rebate if it qualifies for one of the following “rebate exceptions.”

Small Issuer Exceptions. If, at the time bonds were issued, the issuer expected to issue \$5 million or less of tax-exempt bonds during the calendar year, then the bond issue qualifies for a rebate exception. For school bonds issued in 2002 and later, the \$5 million limitation is increased to \$15 million, but only for bonds issued for school construction projects. If an issuer fits within one of these exceptions, no ongoing rebate compliance is necessary.

Six-Month, 18-Month and Two-Year Construction Exceptions. If an issuer does not qualify for the small issuer exception, then three other rebate exceptions are available. The issuer does not have to make an election to take advantage of any of these rebate exceptions, but must monitor construction expenditures to see if the bond issue qualifies. The rebate exceptions are related to how fast the bond proceeds (and investment earnings from the proceeds) are spent.

- The shortest rebate exception allows the bonds to escape from arbitrage rebate if all of the bond proceeds are spent within six months of the date the bonds are issued.
- The next-shortest rebate exception allows the bonds to escape from arbitrage rebate if the bond proceeds are spent according to the following schedule: 15% within six months, 60% within one year and 100% within 18 months. All of these periods are measured from the date the bonds are issued.
- The rebate exception allowing the longest period for expenditure of the bond proceeds is available only if at least 75% of the bond proceeds are spent for construction projects. The exception requires that the bond proceeds be spent according to the following schedule: 10% within six months, 45% within one year, 75% within 18 months and 100% within two years (all measured from the date of bond closing). This exception is available only for governmental bonds, qualified 501(c)(3) bonds and private activity bonds in which the financed property is owned by the governmental unit. It is not available for other private activity bonds.

Failing to meet any one of the targeted expenditure dates results in failure of the entire rebate exception. For example, if an issuer met the 10% and 45% expenditure requirements for the two-year construction rebate exception, but failed the 75% expenditure requirement, the whole rebate exception is failed, and the bond issue is subject to rebate.

There are some nuances involved in computing rebate exceptions, so the issuer should review the Arbitrage and Tax Certification prepared at the time the bonds were issued to determine the exact dates and amounts by which the bond proceeds (and the investment earnings on the bond proceeds) need to be spent.

Qualifying for a rebate exception means that an issuer does not have to pay the IRS the arbitrage earned during the three-year temporary investment period. However, if bond proceeds remain unspent at the end of that period, the issuer must either “yield restrict” those proceeds or make yield reduction payments, as described above under “Three-Year Temporary Investment Period.”

Calculating Arbitrage Rebate

If a bond issue does not qualify for any rebate exception, then the bonds are subject to certain arbitrage rebate requirements. Arbitrage rebate is not owed to the IRS unless the investment earnings average more than the bond yield. To satisfy the IRS rebate rules, an issuer should keep track of the investments made with bond proceeds from the date the bonds are issued until all of the bond proceeds are spent. (It is important for an issuer to do this even if the issuer believes that it will qualify for one of the three timed rebate exceptions. If none of the exceptions are satisfied, the issuer should compute any rebate payments owed.)

Arbitrage rebate payments are due to the IRS at least every five years from the date the bonds were issued. If the issuer makes the rebate payment once all of the bond proceeds have been spent, it does not have to track making any future computations. Rebate payments are made by filing IRS Form 8038-T. If no rebate is owed, then no filing with the IRS needs to be made. It is important, however, to keep the records of construction expenditures and investments for at least three years from the date all of the bonds are completely paid off (or six years from the date of the record, if longer).

Reserve & Guaranty Funds

Revenue bonds and local improvement bonds are often issued with reserve or guaranty funds. Such funds provide money to pay the debt service due on bonds if revenues or assessments are insufficient. Bond proceeds may or may not be deposited into such reserve or guaranty funds. Reserve and guaranty funds may generally be invested for the term of the bonds at yields that exceed the bond yield, because the amount of money in the reserve or guaranty fund does not exceed the smallest of:

- 10% of the principal amount of the bonds,
- An amount equal to maximum annual principal and interest requirements on the bonds, or
- An amount equal to 125% of average annual principal and interest requirements on the bonds.

If money accumulates in a reserve or guaranty fund in excess of this limitation, the investments in the reserve or guaranty fund must be limited to the bond yield or else yield reduction payments must be made to the IRS.

Unless the issuer qualifies for one of the small issuer rebate exceptions, reserve and guaranty funds are subject to arbitrage rebate regardless of whether they are funded with original bond proceeds and regardless of whether such fund qualifies to be invested at yields that exceed the bond yield.

Some revenue bonds also have repair, replacement and revenue funds. These funds generally are not subject to the arbitrage rebate rules and may be invested at yields that exceed the bond yield.

Bond & Debt Service Funds

Most bond issues also have bond funds or debt service funds (often containing principal and interest accounts) that are used to make the regularly scheduled debt service payments. Most bond and debt service funds qualify for an exemption to the arbitrage investment and rebate rules because the bonds have an average maturity of at least five years and the bonds have a fixed rate of interest that does not vary over their term, or the average annual debt service is not in excess of \$2,500,000. They generally may be invested at the highest rate of return available, and arbitrage rebate is not required.

Change in Use

In addition to the investment and arbitrage rebate rules summarized above, the other federal tax issue that municipalities must consider after issuing tax-exempt bonds are the IRS “change in use” regulations. Issuers need to monitor projects financed with the tax-exempt bond proceeds to ensure that they are not sold or changed from a qualifying municipal use to a private business use before the bonds are completely paid off. If property financed with tax-exempt bonds is sold or the use changes to a private business use, then IRS rules require that the issuer redeem the bonds within 90 days or defease them to the first date on which they may be redeemed. In some instances, the rules also require that the issuer notify the IRS of this action. It is important to contact bond counsel for advice when a municipality considers changing the use of a facility financed with tax-exempt bond proceeds.

This provides brief and general information on the actions municipalities should take following the issuance of bonds to ensure that they remain tax-exempt. IRS rules are complex and detailed, so it is important to review the specific guidance provided by the Tax and Arbitrage Certificate prepared for bond closing and seek the advice of bond counsel if you have any questions. The following Preston Gates & Ellis LLP bond tax practitioners may also be contacted:

Seattle Office (206) 623-7580
Andrew R. Kintzinger
Tina Kyle Livingston

Portland Office (503) 228-3200
Edward A. (Mac) McCullough



IRS Record Retention Requirements for Tax-Exempt Bonds

by William G. Tonkin, Foster, Pepper & Shefelman, PLLC

IRS Guidance on Frequently Asked Questions

In January 2004, the Internal Revenue Service (IRS) issued a series of frequently asked questions and IRS answers (Q&A's) regarding record retention requirements for tax-exempt bonds. These Q&A's highlight the importance that the IRS attaches to an issuer's maintenance of records sufficient to show continuing

compliance with federal tax law requirements that must be satisfied so that interest paid on outstanding tax-exempt bonds continues to be excluded from gross income of the owners of the bonds. The Q&A's are summarized below.

Why Keep Records For Tax-Exempt Bond Transactions?

Although state and local governments are not themselves subject to tax under the Internal Revenue Code, the IRS interprets the Code and applicable Treasury Regulations as imposing record retention requirements on governmental units because they are required to file certain information returns for their bond issues. These returns include Forms 8038-G, 8038-GC and 8038, the information returns, and Form 8038-T, which is used to pay arbitrage rebate amounts when due in respect of a bond issue.

Section 6001 of the Code simply provides that “every person liable for any tax. . .shall keep such records. . .and comply with such rules and regulations as the [IRS] may from time to time prescribe.” Treasury Regulations §1.6001-1(a) then provides that:

Any person subject to tax under. . .the Code, or any person required to file a return of information with respect to income, shall keep such permanent books of account or records...as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

Because bond owners themselves generally do not have records supporting the exclusion from gross income of interest on tax-exempt bonds they own, the IRS believes that issuers are required to retain sufficient records for that purpose.

Who should maintain the records?

The IRS says the issuer should maintain the records. For this purpose, “issuer” includes any conduit borrower of bond proceeds in a conduit bond financing.

What are the basic records that should be retained?

In general, the retained records should include basic records relating to the bond transaction (which typically would be those in the bond “transcript”); documentation evidencing expenditure of bond proceeds; documentation evidencing use of the bond-financed property by public and private users, such as copies of management contracts and research agreements; documentation evidencing all sources of payment or security for the bonds; and documentation pertaining to any investment of bond proceeds, including purchases and sales of securities, actual investment income from investing bond proceeds, yield calculations for investments, if necessary, guaranteed investment contracts, and rebate calculations. Other records may be required for particular types of bond issues, such as various types of tax-exempt private activity bond issues. The IRS further says that all of these records should be kept in a manner that ensures their complete access by the IRS for so long as they are material (see the next Q&A below). While this is typically accomplished through the maintenance of hard copies, records may be kept in electronic form if certain requirements are satisfied, as set forth in section 4.01 of Revenue Procedure 97-22, 1997-1 C.B. 652. One of those requirements is that, during an audit, the taxpayer must retrieve and reproduce hard copies of electronically stored books and records requested by the IRS and provide the IRS with the resources necessary to locate, retrieve, read and reproduce any such records.

How long should records be kept?

Based upon a regulation that provides that records should be retained for so long as their contents are material in the administration of any internal revenue law, the IRS says that records generally should be retained “for as long as the bonds are outstanding, plus 3 years after the final redemption date of the bonds.” The IRS takes this approach because it views bond records as material as long as the bond owners are excluding from their gross income the interest received on outstanding tax-exempt bonds.

Furthermore, according to the IRS, because a *refunding bond issue* is treated as replacing the original new money issue for certain federal tax purposes, and the tax-exempt status of a refunding issue may depend upon the tax-exempt status of the refunded bonds, all material records relating to both the original new money issue and the refunding issue should be maintained until 3 years after the final redemption of *both issues*.

These views may present serious legal and practical problems for state and local governments who are subject to various state law requirements or recommended policies on record retention that are inconsistent with these guidelines, especially given the broad scope and detailed nature of records the IRS expects issuers to retain, as noted in the preceding Q&A. Also, many refunded original new money tax-exempt bond issues were issued before the enactment of the current requirements of the Code, and the record retention requirements now described by the IRS could not have been reasonably anticipated when those bonds were issued.

What happens if records aren't maintained?

During the course of an audit of a tax-exempt bond issue, the IRS will request material records and information to determine whether the bond transaction meets the requirements of the Code. If the issuer has not maintained sufficient records, it may have difficulty demonstrating compliance with all federal tax law requirements applicable to that transaction. A determination by the IRS of noncompliance can have various outcomes, including that the interest paid on the bonds should be treated as taxable or that an additional arbitrage rebate amount may be owed to the United States. In addition, the IRS could assert certain penalties for failure to maintain accurate records, unless the issuer shows that the failure was due to reasonable cause and it acted in good faith.

Recommendations for Change Proposed by IRS Advisory Committee on Tax-Exempt and Governmental Entities

In June 2005, the IRS Advisory Committee on Tax-Exempt and Governmental Entities recommended that the Treasury Department and the IRS develop a revenue procedure or other formal guidance on record-keeping requirements for tax-exempt bonds to reduce the scope of the types of documents required to be maintained and shorten the time period for which they must be retained. It was suggested that this might be accomplished by focusing the record-keeping requirements on documents that are really “material” for tax-exempt bond issuers.

For example, if general summaries of expenditures of bond proceeds are kept, it should not be necessary to keep all invoices supporting the expenditures, as least for contracts below a significant threshold amount. Also, for arbitrage rebate purposes, it was suggested that records of investments and expenditures should have to be retained for no more than three years after the applicable rebate computation date. For example, if all gross proceeds of a general obligation bond issue are fully spent within three years after the issue date of the bonds, and the issuer calculates and pays the rebate amount, if any, in full as of the fifth anniversary of the issue date, the supporting investment records should not have to be maintained for more than an

additional three years. The Government Finance Officers Association also has been working with the IRS to narrow the scope and reduce the burden of these record-keeping requirements.



Preparing for and Responding to IRS Audits

by William G. Tonkin, Foster, Pepper & Shefelman, PLLC

In the Internal Revenue Manual's chapter on Tax Exempt Bond Examination Procedures, the IRS describes its procedures for examining arrangements purporting to involve debt obligations of states, their political subdivisions and other entities entitled to issue tax exempt debt instruments under section 103 of the Code. The stated goals of the tax exempt bond examination program are to combine compliance initiatives and enforcement measures to (a) achieve significant levels of pre-issuance and post-issuance compliance with tax exempt bond requirements; (b) respond promptly to abusive transactions; (c) increase the effective use of information returns (such as IRS Form 8038-G for tax exempt governmental bonds and Form 8038 for tax exempt private activity bonds); (d) encourage transaction participants to take an active role in ensuring that their bond issues comply with the Code and applicable IRS regulations; and (e) promote voluntary compliance with the Code and applicable IRS regulations.

Bond issues may be selected for examination based upon the IRS's own information gathering projects and compliance initiatives, such as random audits for rebate compliance, or other sources of information, such as IRS information returns or referrals from other federal agencies, informants, news articles and other media reports, and information items prepared by other TEB Program revenue agents for follow-up action. Generally speaking, to begin the examination, the TEB Program agent will inform the issuer of the specific tax exempt bond issue that is under examination, request a copy of the bond issue transcript, develop factual and legal questions, and then request any other information and data from the issuer as necessary to answer the questions posed.

The initial letter from the TEB Program will explain, for example, whether the examination is simply a routine examination undertaken at random, whether the bond issue is of a particular type that has raised general concerns about possible noncompliance with federal tax requirements, or whether the bond issue was selected because the IRS has received specific information about that particular bond issue that raises a concern that it does not meet one or more requirements for tax exemption. An issuer who receives one of these letters should review it carefully for any implications it may have with respect to the continuing disclosure requirement under SEC Rule 15c2-12 for material events affecting an outstanding bond issue, one of which is "adverse tax opinions or events affecting the tax-exempt status of the security."

The initial letter from an IRS auditor usually will be an information document request ("IDR") that asks the issuer to provide copies of a list of documents relating to a bond issue, such as the Form 8038-G, the Official Statement for the bonds, and the bond authorizing ordinance or resolution. If the audit is focused upon rebate compliance, for example, the IDR will ask for a copy of rebate calculations or calculations showing that a spending exception or the "small issuer" exception to the rebate requirement was satisfied. An issuer should respond promptly to an IDR, but if additional time is needed to gather documents and respond, the issuer should ask the agent for additional time and provide documents on a "rolling" basis if that will be helpful to the agent. All of this shows the importance of have appropriate documentation that can be produced promptly to show the agent that tax requirements have been satisfied.

It also will be helpful if the issuer contacts bond counsel as soon as an audit letter is received. Bond counsel can assist in determining whether the audit appears to be random or targeted in some respect and what documents need to be furnished in response to an IDR. If an issuer wants bond counsel to represent it in connection with the audit, the issuer will have to execute a power of attorney, IRS Form 2848, authorizing bond counsel to do so. In some cases, especially if the audited is targeted in some respect, a conflict of interest may be perceived to exist between the issuer and bond counsel who provided the tax opinion for the bonds, and in that case bond counsel probably will not be able to represent the issuer in the audit, at least not without a waiver by the issuer of any potential conflict of interest. However, a real conflict may not exist in many cases, and each situation needs to be reviewed carefully.

The increase in random IRS audits of municipal bond issues in Washington underscores the need for issuers themselves to have procedures in place that will enable them independently to monitor their own compliance with federal tax law requirements that apply to any particular bond issue.

In the current environment of burgeoning federal deficits, an obvious area of potential audit inquiry is whether an issuer has timely calculated and paid any arbitrage rebate amount that may have been due and owing to the United States with respect to a bond issue. In this respect, if a rebate amount was due but not timely calculated and paid, IRS regulations provide that, if the overdue rebate amount plus interest thereon at the federal underpayment rate is paid within 180 days after the failure to pay was discovered by the issuer, the penalty otherwise applicable (an additional 50% of the unpaid amount, plus interest, for a governmental issue) is automatically waived “unless. . .the issue is under examination” by the IRS at any time between the original due date and the date 90 days after the IRS receives payment. The 50% penalty also is not automatically waived if the failure to pay was the result of “willful neglect.” The Code does not specifically define “willful neglect,” but the IRS has recently signaled that it may be taking a more aggressive approach to what it views as “willful.” This clearly makes it imperative for an issuer itself to remedy any failure to calculate and pay an overdue rebate amount as promptly as possible before the bond issue becomes the subject of an audit, random or otherwise.

Similarly, as described in the IRS record retention requirements summarized above, issuers need to maintain financial and accounting records that can be used to demonstrate clearly to any TEB Program agent that the bond proceeds were spent for the intended governmental purposes of the bond issue, when the proceeds were spent, and what investment payments and receipts were made with and received from bond proceeds up to the time all bond proceeds (including investment earnings on bond proceeds) were fully spent. This will be important, for example, in demonstrating that any spending exception to the rebate requirement that the issuer expected to meet in fact was met.

Finally, issuers need to monitor the uses of bond-financed property to ensure that the bond-financed property has not become subject to private business uses that were not expected to occur at the time the bonds were issued but subsequently may have developed to an extent greater than permitted by the Code. In this respect, the Code makes certain “remedial actions” available to issuers that, if timely taken, will preserve the tax exemption for bonds that financed the property. Also, since private business use of bond-financed property is measured on an average basis over the term of the bond issue, early discovery of unexpected private business use arrangements could enable the issuer to terminate those arrangements before the applicable private business use limits of the Code would be exceeded.

In conclusion, it is not surprising that the TEB Program of the IRS is interested in testing the level of compliance by issuers with the federal tax law requirements that enable them to issue tax exempt bonds under the Code. The main goal of the examination program is to promote voluntary compliance by issuers and not to punish innocent bondowners by declaring interest on bonds taxable.

Budget Questions

Each year we are asked many questions about budgets and budget procedures. Here are some of the most popular of those recently asked. You may view others on our Web site at <http://www.mrsc.org/askmrsc/finance.aspx#finance1>.

When Are Budget Amendments Required and by What Vote must They Be Passed?

Cities

Budget amendments are required for cities **only** when the appropriation level in a fund is being changed. The statutes give four different examples.

1. RCW 35.33.081, RCW 35.34.140, RCW 35A.33.080, and RCW 35A.34.140 discuss “nondebtable” emergencies, such as natural disasters and wars, and say that the council may approve expenditures incident to these events with the vote of a majority of the entire council plus one, without notice or a hearing.
2. RCW 35.33.091, RCW 35.34.150, RCW 35A.33.090, and RCW 35A.34.150 all deal with “emergencies” of a lesser sort. The city finds it needs or wants to make some expenditures that were not foreseen at the time the budget was adopted. Because this will require increasing the appropriation level in one or more funds, an amendment is needed. The statutes stipulate that the budget-amending ordinance must be introduced five days before being voted on, that citizens must be heard, and that the vote be by a majority of the entire council plus one.
3. RCW 35.33.121(4), RCW 35.34.200(1)(d), RCW 35A.33.120(4), and RCW 35A.34.200(1)(d) discuss the situation where a city receives more revenue during the year than anticipated in the budget. If the city council chooses, it may spend the money during the year. However, since the appropriation level in a fund is being changed, a budget amendment is required. Only a simple majority vote is needed, presumably because spending unanticipated revenue requires less scrutiny than, for example, spending reserves under RCW 35.33.091, RCW 35.34.150, RCW 35A.33.090, or RCW 35A.34.150.

Note that a city need not pass a budget amendment to recognize unanticipated revenue unless it wishes to spend it during the current year. If “ignored,” it will simply “drop down” into ending fund balance and will be available for appropriation in the next year.

4. If a council wishes to decrease the appropriation levels in any fund during the year, it may do so by a vote of a majority of the entire council plus one. It is not completely clear why this level of approval is required, but since a council sometimes reduces the appropriation level in one fund and transfers it to another fund, perhaps the legislature thought this higher level of approval to be necessary. See final paragraph in RCW 35.33.121 and RCW 35A.33.120; and RCW 35.34.200(3) and RCW 35A.34.200(3).

RCW 35.33.121(5) and RCW 35.34.200(2) address the situation where the appropriation level in the fund is **not** changed. They state:

Transfers between individual appropriations within any one fund may be made during the current fiscal year by order of the city's or town's chief administrative officer subject to such regulations, if any, as may be imposed by the city or town legislative body. Notwithstanding the provisions of RCW 43.09.210 or of any statute to the contrary, transfers, as herein authorized, may be made within the same fund regardless of the various offices, departments or divisions of the city or town which may be affected.

There is similar language in RCW 35A.33.120(5) and RCW 35A.34.200(2). Except when restricted from doing so by the council, the chief administrative officer may make transfers within a fund without a budget amendment.

Counties

Counties have similar language. RCW 36.40.180 discusses nondebtable emergencies, such as disasters and threats to public health. A unanimous vote of the commissioners present at the meeting is required, and no public notice or hearing is necessary. "Emergencies," such as those described in item 2 for cities above, are addressed in RCW 36.40.140. The commissioners must adopt a resolution, stating how much money is required to meet the emergency. The resolution must be published with a notice of a public hearing to be held not less than one week after the publication.

Unique to counties is a procedure set out in RCW 36.40.150 - .170 by which any taxpayer may petition the superior court to review the order issued under RCW 36.40.140 stating the emergency and authorizing the expenditure. The filing of such petition will suspend the order until the court determines it propriety.

RCW 36.40.100 somewhat parallels the city statutes listed in item 3 above, but limits any increase in appropriations to revenues from unanticipated federal or state funds. The commissioners must provide notice for two consecutive weeks prior to the meeting at which the supplemental appropriation will be adopted. The statute provides for this same procedure for transfers or revisions **within** departments.

There is no explicit discussion of transfers **between** departments. We believe that those fall under the emergency provisions of RCW 36.40.140. Finally, there is no county statute that discusses what must be done when an appropriation level in a fund is decreased. Presumably the board or council passes a resolution to that effect with a simple majority.

How Many Hearings must Cities and Counties Have on Budgets?

Cities

RCW 35.33.071, RCW 35.34.110, RCW 35A.33.070, and RCW 35A.34.110 require a final budget hearing. RCW 35.33.061, RCW 35.34.100, RCW 35A.33.060, and RCW 35A.34.100 provide that, after the filing of the preliminary budget (no later than 60 days before the beginning of the next fiscal year), the clerk must publish notice of the hearing once a week for two consecutive weeks. The hearing takes place on or before the first Monday in December. (This notice also includes the information that the budget has been filed and is available in the clerk's office.)

So, a hearing on the final budget is clearly required. But, what about hearings on the preliminary budget?

We believe that cities must have such hearings. RCW 35.33.057, RCW 35.34.090(2), RCW 35A.33.055, and RCW 35A.34.090(2) all provide:

Prior to the final hearing on the budget, the legislative body or a committee thereof shall schedule **hearings** on the budget or parts thereof, and may require the presence of department heads to give information regarding estimates and programs. [Emphasis added, note plural.]

Because these statutes make no reference to notice, it is likely that less cumbersome notice requirements are necessary for the preliminary budget hearings than for the final budget hearing. RCW 35.22.288, RCW 35.23.221, RCW 35.27.300, and RCW 35A.12.160 require the council to “establish a procedure for notifying the public of upcoming hearings,” but they do not specify a particular kind of notice.

If a city council holds workshops at which citizens may comment and ask questions, it is likely that these workshops would satisfy the hearings requirement for the preliminary budget.

Counties

There is no statutory requirement for preliminary budget hearings for counties. Only a final hearing on the budget is required. RCW 36.40.060, RCW 36.40.070, RCW 36.40.071. As a practical matter, citizens can listen to the commissioners deliberate budget matters during their meetings and, in most cases, contribute comments. This is not a hearing, but input is provided.

Do We Really Need A Separate Ordinance or Resolution to Set Out the Property Tax Increase in Dollars and Percent?

Ever since the passage of Referendum 47, we have been asked this question. Section 209 of the referendum (codified as an amendment to RCW 84.55.120) states, in part:

No increase in property tax revenue, other than that resulting from the addition of new construction and improvements to property and any increase in the value of state-assessed property, may be authorized by a taxing district, other than the state, except by adoption of a **separate** ordinance or resolution, pursuant to notice, specifically authorizing the increase in terms of both dollars and percentage. The ordinance or resolution may cover a period of up to two years, but the ordinance shall specifically state for each year the dollar increase and percentage change in the levy from the previous year. [Emphasis added.]

In an October 9, 1998 memorandum, addressed to “All Interested Parties,” Sandra Guilfoil, Assistant Director, Property Tax Division, Department of Revenue, stated:

It is clear that any district. . . must pass a **separate** resolution to increase its property tax levy above the previous year (other than the increase due to new construction, improvements to property and increase in the value of state assessed property, hereinafter referred to as “add-ons”). [Emphasis added.]

At the time Referendum 47 was passed, many attorneys decided not to draft a separate resolution or ordinance. They argued that they could give the required information – the increase of the property tax levy in dollars and percent – as a separate section in the ordinance they already were drafting to levy property taxes for the coming year. Some assessors sent the levy ordinance back and requested a separate document for compliance with Section 209. Other assessors accepted what they were sent.

Last autumn, we got calls from a number of “non-complying” cities, saying: “We have just received a letter from our assessor. He wants a separate ordinance or resolution.” The Department of Revenue had apparently sent out a letter asking assessors to enforce this requirement.

Our advice: do a separate ordinance or resolution. It’s an easy way to satisfy your assessor. If you do the latter, you do not even have to worry about the costs of publication.

Anticipating Pension Fund Contribution Increases

The discussion of ESHB 1044 on page 7 describes the changes in pension funding methodology adopted by the legislature this year. They were:

- Rate increases being phased in over the four-year period for 2005-2009.
- The rates not including contributions towards the unfunded liability in the PERS 1 plan.
- The rates not including contributions toward the future gain-sharing liability in PERS 1.

All these changes lowered the employer rate for pension contributions in FY 2006 and 2007 below those initially recommended by the State Actuary. In an article published in May 2005 in the Association of Washington Cities (AWC) *Personnel News* <http://news.awcnet.org/awcpers/issues/2005-05-18/index.html>, a table reproduced below shows the following comparisons of what the State Actuary recommended and what the legislature adopted.

	Employer Rate (PERS 1 / 2 / 3)	Member Rate (PERS 2)
Current Contribution Rate	1.19%*	1.18%
State Actuary's Initial Contribution Rate Recommendation for the 2005-07 Biennium	5.73%*	3.38%
Adopted Contribution Rate, effective 7-1-05 through 6-30-06	2.25%*	2.25%
Adopted Contribution Rate, effective 7-1-06 through 6-30-07	3.5%*	3.5%

**Note: these employer rates do not include the DRS administrative expense rate, currently set at 0.19%. Also, any benefit enhancements adopted by the legislature could cause rates to increase beyond the adopted basic rates shown here.*

What's in Store for the Future?

Now, the Pension Funding Council must set rates for the 2007-2009 biennium. We do not know what they will be, but the AWC article makes the following observations:

As part of **ESHB 1044**, the Pension Funding Council has been directed to set rates for the 2007-2009 biennium by September 30, 2006. What will those rates be? Well, we can't say for sure, but we can give you some indication of what you might expect.

The State Actuary had initially recommended a PERS employer rate of 5.73%¹ for the 2005-07 biennium and a rate of 7.28% for the 2007-09 biennium. When the Select Committee on Pension Policy (SCPP) first recommended phasing in the 2005-07 rates over four years, the Actuary calculated that that proposal would require employer contribution rates of 2.5% effective 7-1-05,

¹To this percentage amount, and all those given, the DRS administrative fee of 0.19 percent must be added.

5.5% effective 7-1-06, **8.25% effective 7-1-07, and 9.96% effective 7-1-08**. These projections assumed that the gain-sharing benefit would be accounted for in the rates and that employers would resume payments for the unfunded liability of PERS 1, which had been suspended for the 2003-05 biennium (again, to save money).

The pension funding changes passed by the Legislature this session reduced the employer contribution rates for the first and second year even further, from 2.5% to 2.25% for 2005-06, and from 5.5% to 3.5% for 2006-07. In addition, they put off more of the “pain” into the future – by continuing to defer the employer payments towards the unfunded liability of PERS 1 until after the 2005-2007 biennium, and by deciding not to recognize the cost of future gain-sharing distributions until after the 2005-2007 biennium. **These actions will cause the rates for the 2007-09 biennium to be even higher than the projections in the previous paragraph.**

Well, maybe the rates will not be higher. The legislature could again decide not to set rates high enough to fund unfunded liabilities, pushing the day of reckoning even further into the future. And, the Select Committee on Pension Policy could recommend eliminating or modifying gain-sharing. (See the box on page 54 for an explanation of “gain-sharing.”)

It is enlightening to do a little budget exercise. Assume that your annual reportable compensation for calculating PERS contributions is \$1 million. And, assume, to make the math easier, that it stays constant for the next couple years. (Do we see a person in the back of the room waving her hand and hear her saying, “Don’t we wish?”)

Also assume that the employer rate in FY 2008 will be the 8.25% and that the FY 2009 rate is 9.96% – the figures given above. (The rates for FY 2005, 2006, and 2007 are known numbers and is in the table above.)

1. **Calendar year 2005 PERS contribution:** The contributions for this year are a known number, \$17,200. They were calculated as \$1,000,000 times 1.72% ($(1.19\% + 2.25\%)/2 = 1.72\%$) equals **\$17,200**. The 1.19% for FY 2005 and the 2.25% rate for FY 2006 come from the table above. The average increase is used because the rate changes in the middle of the calendar year.

Now, make similar calculations for the next few years.

2. **Calendar year 2006 PERS contribution:** \$1,000,000 times 2.857% ($(2.25\% + 3.5\%)/2 = 2.875\%$) equals **\$28,750**.
3. **Calendar year 2007 contribution:** \$1,000,000 times 5.875% (the average of 3.5% and 8.25% – the rates for FY 2007 and 2008) equals **\$58,750**.
4. **Calendar year 2008 contribution:** \$1,000,000 times 9.105% (the average of 8.25% and 9.96%) equals **\$91,105**.

To each of these figures must be added the Department of Retirement administrative fee of 0.19 percent, \$1,900, in this example.

A suggestion: Using your jurisdiction’s payroll for the next few years (probably not constant as it was in this example) estimate your future contributions to PERS. The state legislature decided that its best choice was to defer contribution increases to future years. You do not need to make the same choice. You may decide, in the 2006 budget process, that you want to anticipate these increases and put some funds aside in reserve to lower the pain in future years.

“What is ‘gain-sharing?’” Is there ‘loss-sharing?’”

No, there is no “loss-sharing,” but some might argue there should be some symmetry.

The information on gain-sharing presented below is reprinted from the Final Bill Report for ESHB 1044. Our thanks to the staff person who wrote it.

Gain-sharing was created by the 1998 legislature as a mechanism to increase member benefits in PERS 1, PERS 3, TRS 1, TRS 3, and SERS 3. These increases occur whenever there are extraordinary investment gains, which are defined as compound average of investment returns on pension fund assets that exceeds 10 percent over a period of four fiscal years. Once each biennium, the State Actuary determines whether gain-sharing benefits will be made. Any distributions occur in January of even-numbered years. In Plan 1, half of all extraordinary gains are used to enhance the Uniform Cost-of-Living Adjustment (Uniform COLA) that is given to eligible retirees each year. In Plan 3, half of the extraordinary gains are paid directly into eligible members' and retirees' defined contribution accounts. There have been two gain-sharing distributions since 1998, which resulted in combined benefit improvements costing roughly \$1.1 billion. When the gain-sharing benefit was created by the 1998 Legislature, language was included in the law to reserve the right of the Legislature to amend or repeal the gain-sharing benefits.

The cost of future gain-sharing has never been reflected in the basic contribution rates for the affected systems and was not included in the 2002 actuarial valuation, as the funding methodology and materiality of the gain-sharing provisions were under review. The recent 2003 Actuarial Valuation Report (prepared in December 2004) identified gain-sharing as a material liability and included this liability in calculating the basic contribution rates recommended by the State Actuary to the PFC (Pension Funding Council).

Initiatives

Initiative 900 - Performance Audits

(Note: Material in this section has been adapted, with permission, from the Web site of the Association of Washington Cities.)

An estimated 303,000 signatures were submitted for Initiative 900 and this number may be enough to certify it for the November 2005 ballot.

The initiative directs the state auditor to conduct performance audits of every state and local government agency and entity, including executive, legislative, and judicial agencies, and to report annually. The audits would include reviews of the economy, efficiency, and effectiveness of each agency's policies, management, fiscal affairs, and operations. To fund the audits, 0.16% of the state's portion of sales and use tax collections would be placed in a new state treasury account and used only for performance audits.

The Department of Revenue has estimated the state fiscal impacts from the diversion of the state sales and use tax to be \$5.5 million in FY 2006 (partial collections due to December 8, 2005 effective date), \$11.5 million in FY 2007, \$12.1 million in 2008, and \$12.8 million in 2009. Direct costs to local governments have not been estimated and would include staff time to comply with audits (pulling documents, discussions relating to internal processes, correcting reported findings, etc).

“On the books” already are two bills passed during the 2005 legislative session that provide for performance audits. ESHB 1064 amends the state budgeting, accounting and reporting systems act to authorize the state auditor to contract for performance audits of the executive branch of state government, excluding transportation-related agencies. Section 104 of the transportation revenue bill (SSB 6103) authorizes performance audits of the Department of Transportation, Transportation Improvement Board, County Road Administration Board, and Traffic Safety Commission.

In the 2005-07 biennium, the legislature appropriated \$2.8 million for a statewide performance review under ESHB 1064 and \$4.0 million to do a performance audit of transportation-related agencies under SSB 6103.

Initiative 912 - Repealing the Gas Tax Increase

The proponents of this initiative submitted 420,518 signatures. It is likely to be on the November ballot since only 225,014 are necessary for certification.

This initiative would repeal the motor vehicle fuel tax (gas tax) increases passed by the legislature during the past session. ESSB 6103 provided for three cent increases on July 1, 2005 and July 1 2006 with additional increases of two cents on July 1, 2007 and 1.5 cents on July 1, 2008. Weight fee increases provided for in the bill would not be repealed.

For the state, passage of the initiative would mean the loss of \$8 billion in revenues to fund transportation improvements over the next 16 years. (For information on what projects are included in this package, see <http://www.transinfo.state.wa.us/Projects/CapProjWeb.asp>.)

Effect of a Repeal on City and County Revenues

Because cities and counties currently are revising their 2005 budgets and estimating revenues for 2006, our focus on the effects of passage of this initiative are on city and county losses.

Cities and counties are allocated 1/4 cent from both the three cent July 1, 2005 and July 1, 2006 tax increases. The July 1, 2005 tax increase is already in effect and is being collected. If the initiative passes, it will go into effect on December 8, 30 days after its passage. We are assuming that the earliest the gas pumps could be reprogrammed to reflect the repeal would be January 1, 2006.

There would be no effect on forecasted CY 2005 revenues from a repeal of the tax. Cities and counties would already have received, by that time, four months worth of revenue in CY 2005 from the tax increase. This means that the 2005 estimated per capita revenues of \$21.62 shown for cities in Table 3 on page 29 would be unaffected. In addition, in our discussion on pages 24-25, we report a forecast of \$138.2 million for counties in CY 2005, including the tax increase. This forecast would be unaffected by passage of the initiative.

In the “bank,” cities and counties would also have revenues from the tax increase levied in November and December 2005, to be distributed in January and February 2006. Without any tax increase, the city per capita estimate for CY 2006 would be \$20.81. With the revenues from the tax increase that would be distributed in January and February 2006, the estimated per capita amount would be \$21.16. This can be compared with \$23.69, the amount cities would receive in CY 2006 if the initiative does not pass, to measure CY 2006 losses from a repeal.

The county revenue share in CY 2006 without a tax increase would be \$137.0 million. Adding revenues from the distributions in January and February 2006, the total for CY 2006 if the tax is repealed comes to \$138.3 million. If the initiative passes, counties should scale down the estimates they received for CY 2006 from the County Road Administration Board in July. Those estimates assumed that the revenue to be allocated among the counties was approximately \$147.5 million, which is almost seven percent more than they will receive if the tax is repealed.

In 2007, cities would lose an estimated \$16.65 million if the tax were repealed and counties would lose an estimated \$15.93 million. These amounts would grow in future years.

Note that if the gas pumps are reprogrammed on some date other than the assumed January 1, 2006, cities and counties should adjust the CY 2006 revenue estimates proportionally.