

# HOUSE BILL REPORT

## 2SSB 5364

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### As Reported by House Committee On:

Finance

**Title:** An act relating to community revitalization financing.

**Brief Description:** Promoting economic development and community revitalization.

**Sponsors:** Senate Committee on Ways & Means (originally sponsored by Senators Zarelli, T. Sheldon, Regala, B. Sheldon, Winsley, McAuliffe, Hale and Rasmussen; by request of Governor Locke).

### Brief History:

#### Committee Activity:

Finance: 4/16/03 [DP].

#### Brief Summary of Second Substitute Bill

- Expands the community revitalization program to allow local governments to finance public improvements within an increment area using increases in local sales and use tax revenues, as well as matching state sales and use tax revenues of up to \$1 million per year per project.
- Limits the annual aggregate amount of new local sales and use taxes that may be credited against the state tax to \$5 million initially.
- Authorizes the use of community revitalization financing only if a local government receives written agreement from taxing districts that in the aggregate would levy at least 60 percent of the regular property taxes within the increment area.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 8 members: Representatives Gombosky, Chair; McIntire, Vice Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris and Roach.

**Minority Report:** Do not pass. Signed by 1 member: Representative Santos.

**Staff:** Mark Matteson (786-7145).

## **Background:**

Tax increment financing or community redevelopment financing is a method of redistributing property tax collections within designated areas to finance infrastructure improvements within these designated areas. However attempts to authorize the use of state property tax revenue in Washington to finance such development have been struck down by the voters and the courts. The main legal impediments under the state constitution include: the requirement that all property taxes must be uniform on the same class property within the territorial limits of the authority levying the tax; the prohibition on the lending of state credit; and the dedication of state property tax revenues to fund the common schools.

### Community Revitalization Financing

Currently, counties, cities, towns, and port districts are authorized to create tax increment areas within their boundaries where community revitalization projects and programs are financed by diverting a portion of the regular property taxes imposed by local governments within the tax increment area.

Community revitalization projects and programs include:

- Traditional infrastructure improvements, such as: (1) street and road construction and maintenance; (2) water and sewer system construction; (3) sidewalks and streetlights; (4) parking, terminal, and dock facilities; (5) park and ride facilities of a transit authority; (6) storm water and drainage systems; and (7) park and recreation facilities.
- Environmental analysis, professional management, planning, promotion, maintenance and security for common areas, and historic preservation.

The creation of a tax increment area involves a number of steps, as follows:

- The county, city, town, or port district adopts an ordinance designating the tax increment area within its boundaries and specifies the public improvements to be financed;
- The tax increment area may not be established unless the local government taxing districts (not including the state) imposing at least 75 percent of the regular property taxes within this area sign written agreements approving the tax increment financing;
- A public hearing on the proposal is held;
- Any fire protection district with territory located in the increment area must approve the creation of the increment area; and

· The county, city, town, or port district adopts an ordinance establishing the tax increment finance area.

Public hearings must be held on the proposed financing of the public improvements through community revitalization financing. The local government must then enact an ordinance:

- (1) establishing the increment area;
- (2) describing the public improvements;
- (3) describing the boundaries of the increment area;
- (4) estimate the cost of the public improvements and portion of these costs to be financed by community revitalization financing;
- (5) estimating the time during which regular property taxes are to be apportioned to finance the public improvement costs associated with the public improvements financed in whole or in part by the community revitalization financing; and
- (6) providing the date when the apportionment of regular property taxes will commence and the benefits will be met.

A county, city, town, or port district may pledge and use the diverted regular property tax collections to pay principal and interest on general obligations issued to finance the community revitalization projects and programs. A nonpublic participant may be required to provide security to protect the public investment in the tax increment area.

Regular property taxes imposed by all local governments within the tax increment area on 75 percent of any increase in assessed valuation occurring in that area after its creation are diverted to finance the projects. Regular property taxes imposed by any local government on all of the remaining value (the assessed valuation in the year before the tax increment area was created plus 25 percent of any increase in assessed valuation in the tax increment area) are distributed to the local governments as if the tax increment area had not been created.

The state's property taxes are not affected. Most regular property taxes imposed by port districts and public utility districts are subject to this potential diversion, but port district and public utility district regular property tax levies that are allowed specifically for bond retirement purposes are not affected.

The projects financed by property tax increment financing must be expected to encourage private development and increase the fair market value of real property within the tax increment area. Private development that is anticipated to occur within the tax increment area as a result of the public improvements must be consistent with the countywide planning policy adopted by the county under the Growth Management Act and the county's, city's, or town's comprehensive plan and development regulations adopted under the Growth Management Act.

### Sales and Use Tax

There is a 6.5 percent retail sales tax levied by the state on the selling price of tangible personal property and certain services purchased at retail. In general the tax applies to goods, construction including labor, repair of tangible personal property, lodging for less than 30 days, telephone service, and participatory recreational activities. There are some local taxes that are credited against the state sales tax, including 2 percent hotel/motel tax upon accommodations by cities and counties. There are also some exemptions, credits and deferrals to the state retail tax.

There is a 6.5 percent use tax on items not subject to the state retail tax. This includes purchases made from out-of-state sellers, purchases from sellers who are not required to collect Washington sales tax, items produced for use by the producer, and gifts and prizes. The tax is measured by the value of the item at the time of the first use within the state, excluding any delivery charges.

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### **Summary of Bill:**

The community revitalization financing program is expanded to allow local governments to finance public improvements not only using the increased property tax revenues, but also excess excise tax revenues and revenue generated through a sales and use tax, up to \$1 million per year, per project, credited against the state sales and use tax in an increment area.

The proposed public improvement to be financed in part or in whole using the community revitalization financing must be found by the local governing body to be reasonably likely to:

- increase private investment within the increment area; increase the employment within the increment area; and
- generate, over the period of time that the local sales and use tax will be imposed, state and local property, sales, and use tax revenues that are equal to or greater than the respective state and local contributions made under this program.

The governing body of the local government must also make a finding that the community revitalization financing will not be used to attract a Washington business located outside the increment area to relocate to inside the increment area.

The community revitalization financing can be used for public improvement costs as currently defined in statute as well as land acquisition, land clearing and the demolishing of property pending construction of public improvements. The local government may not use the community revitalization financing to finance the costs associated with the financing, design, acquisition, construction, equipping, operating, maintaining,

remodeling, repairing, and re-equipping of public facilities funded by taxes collected through a public facilities district.

#### Creating an Increment Area

A local city, town or county desiring to finance public improvement through community revitalization financing must enter into written agreement with taxing districts that, in the aggregate, levy at least 60 percent of the regular property taxes on real property in the increment area. Such an agreement constitutes concurrence by all taxing districts within the increment area to participate in community revitalization financing. However, a fire protection district may choose not to participate.

In addition to obtaining an agreement with other taxing districts, a local government must enter or expect to enter into a contract with a private developer relating to the development of private improvements within the improvement area.

To conduct community revitalization financing, the local government must adopt an ordinance creating an increment area. The ordinance enacted by the local government must include an estimate of the time during which the excess excise taxes will be collected as well as providing the date when the use of the excess excise taxes will commence and the benefits will be met. The ordinance must also include an estimate of the highest amount of tax revenue to be received in any one fiscal year through the imposition of the state sales and use tax credit.

#### Property Tax Increment

As with the current program, the increment value is 75 percent of any increase, over the tax allocation base value, in the assessed value of real property in an increment area that is placed on the assessment rolls after the increment area is created. In calculating the regular property tax increment, regular property taxes levied by voters for a specific purpose shall not be included.

Tax allocation base value is the assessed value of real property located within an increment area for taxes levied in the year in which the increment area is created for collection in the following year, plus 25 percent of any increase in the assessed value of real property located within an increment area that is placed on the assessment rolls after the increment area is created.

In the second calendar year following the effective date of the ordinance creating the increment area, the county treasurer distributes the receipts from regular taxes on real property in the increment area as follows:

- (1) Each participating taxing district and the local government that created the increment area shall receive the portion of its regular property taxes by the rate of tax levied by or for the taxing district on its tax allocation base value or upon the total assessed value of real property in the taxing district, whichever is smaller; and

(2) The local government shall receive an additional portion of the regular property taxes levied by it and by or for each participating taxing district upon the increment value in the increment area. If there is no increment value, the local government does not receive any additional regular property taxes.

The county assessor shall allocate 25 percent of any increased real property value occurring in the increment area to the tax allocation base value and 75 percent to the increment value.

#### Excess Excise Taxes

A local government that creates an increment area may use annually any excess excise taxes received by it from taxable activity within the increment area to finance the public improvement costs financed in whole or in part by community revitalization financing. When tax allocation revenues are no longer necessary or obligated to pay the costs of the public improvements, the local government may no longer retain the excess excise taxes.

The excess excise tax is the amount of excise taxes received by a local government within the increment area over and above the amount of excise taxes received there during the base year from taxable income within the increment area. The base year is the first calendar year following the creation of the increment area and the measurement year is a calendar year, beginning with the calendar year following the base year, that is used annually to measure the amount of excess excise taxes required to be used to finance the public improvement costs.

However, if no excise taxes were received in the increment area in the 12 months prior to the creation of the area, then the excess excise taxes are the total amount of excise taxes received in each calendar year after the area is created.

If a local government is solely a port district, the port district may use excess excise taxes only to the extent that any other taxing authority that receives excise tax from taxable activity in the increment area allocates excess excise taxes to the local government.

If a port district and a city, town or county is the increment area, excess excise taxes may only be used if the city, town or county realize excess excise taxes from taxable activity within the increment area or any other taxing authority that receives excise taxes from taxable activity in the increment area allocates excess excise taxes to the local government.

Boundary information of increment area is due to the Department of Revenue (DOR) at least 75 days before effective date of ordinance creating increment area.

#### New Local Sales & Use Tax Credited Against the State Tax

A city, town or county that creates an increment area and finances the public

improvements under the community revitalization program may impose a sales and use tax. The tax is in addition to other taxes authorized and will be collected from those who are taxable by the state retail sales tax and use tax for any taxable event within the jurisdiction. The rate cannot exceed 6.5 percent less the aggregate rates of any other taxes imposed on the same event that are already credited against the state sales and use taxes. The tax shall be deducted from the amount of taxes otherwise required to be collected or paid to the DOR for the state sales and use tax.

The sales and use tax cannot be imposed until after January 1, 2006, and the local increment jurisdiction must first have received tax allocation revenues derived from either real property taxes or excess excise taxes or both during the preceding calendar year. This tax expires when bonds issued are retired, but not more than 25 years after being imposed.

In order to enact a sales and use tax, the local jurisdiction must first enact an ordinance imposing tax that provides:

- (1) The tax shall first be imposed on the first day of a calendar year;
- (2) The amount of the tax received by the local government in any calendar shall not exceed the state contribution;
- (3) The tax shall cease to be imposed for the remainder of any calendar year in which either:
  - (a) The amount of tax receipts totals the amount of the state contribution;
  - (b) The amount of the tax receipts totals the amount of local public sources dedicated in the previous calendar year to finance the authorized public improvements; or
  - (c) The amount of the revenue from taxes imposed under this section by all cities, towns, and counties totals the annual state credit limit.
- (4) The tax will be reimposed at the beginning of the next calendar if it ceased to be imposed; and
- (5) Any revenue generated by the tax in excess of the amount of the state contribution limit will go to the state.

Then the jurisdiction must apply to the DOR at least 75 days before the effective date of any such tax. The DOR will accept and approve applications beginning August 1, 2003, through September 30, 2006. Application information shall include: information establishing the jurisdiction is eligible to impose such a tax; the anticipated effective date of the tax; the estimated number of years that the tax will be imposed; and a copy of the ordinance creating the increment area.

The DOR will rule on an application within 60 days of receipt. The sales and use tax authority will be granted on a first-come first-served basis. Priority among approved applicants shall be based on the date that the approved application was received by the DOR. When the annual limit is reached, no new applications will be approved.

The DOR will approve the amount of the sales and use tax that an applicant may impose. The amount shall not exceed the lesser of \$1 million or the highest amount of tax revenue the applicant estimates it will receive in any one fiscal year through the imposition of the sales and use tax.

If both a city and a county impose the sales and use tax under this program, the amount is credited based on which jurisdiction created the increment area first.

State contribution means the less of \$1 million or an amount equal to the state property tax allocation revenues received by the state during the preceding calendar year and the excess state excise taxes received by the state during the preceding year.

The first year aggregate limit for credit against the state sale and use tax is \$5 million. In each of the three subsequent years, the total amount credited against the state sales and use tax shall increase by the percentage increase in the assessed value of all property within the state as determined by the DOR. In the fifth year and thereafter, the aggregate limit will be the same as that calculated for the fourth year. The DOR will tell the jurisdiction to stop imposing tax once the jurisdiction's annual state contribution limit is reached or the aggregate state contribution limit is reached.

Local government must tell the DOR by December 20 the amount of local public sources dedicated in the current calendar year to finance the authorized public improvement and the tax allocation revenues derived in the current calendar year from the regular property taxes on the increment value and distributed to finance the public improvements.

Money must be used only for the purpose of principal and interest payments on bonds issued for a project and must be matched with an amount from local public sources dedicated through December 20 of the previous calendar year to finance the authorized public improvements. Local public sources can include private monetary contributions and tax allocation revenues. The money generated from the sales and use tax must actually be expended to pay public improvement costs or are required by law or an agreement to be used exclusively to pay public improvement costs.

The new tax is available to a local jurisdiction as long as the jurisdiction has outstanding indebtedness under the community revitalization program.

#### Accountability

The local government utilizing the sales and use tax must provide an annual report to the DOR by March 1 of each year. The report must include:

- (1) The amount of tax allocation revenues, sales and use tax and local public sources received by the local government during the preceding calendar year, and how these revenues were expended;
- (2) The names of any business located within the increment area as a result of the



public improvements undertaken by the local government and financed in whole or in part by this program;

(3) The total number of permanent jobs created as a result of the public improvements undertaken by the local government and financed in whole or in part by this program; and

(4) The average wages and benefits received by the employees of businesses located within the increment area as a result of the public improvements.

The DOR shall make the report available to the public and the Legislature by June 1 of each year. The report shall include a list of the public improvements undertaken by the local governments and financed in whole or in part by community revitalization financing. The report should also include a summary of the information provided by the local governments.

#### Bond Authorization

A local government designating an increment area and authorizing the use of community revitalization financing may incur general indebtedness, and issue general obligation bonds, to finance the public improvements and retire the indebtedness in whole or in part from tax allocations it receives.

Local government can annually pay into a fund to be established for the benefit of bonds issued for this program a fixed proportion or fixed amount of any tax allocation revenues derived from property or business activity within the increment area containing the public improvements funded by the bonds. The payments continue until all bonds payable from the fund are paid in full.

A local government can annually pay into a second fund a fixed proportion or fixed amount of any revenues derived from the credit of the state sales and excise tax, such payment continuing until all bonds from the fund are paid in full.

A local government that issues bonds to finance public improvements may pledge for payment of such bonds all or part of any tax allocation revenues derived from the public improvements. It can also pledge the revenues of the credit of the state sales and excise tax.

The bonds issued by the local government to finance the public improvements do not constitute an obligation of the state.

#### Miscellaneous

Nothing in the community revitalization act gives port districts the right to impose a local sales or use tax.

The DOR may adopt rules required to administer the community revitalization financing program.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** (In support) The Senate made a few changes to refine this economic development tool. The adjustment from current law to require approval of taxing districts that levy 60 percent of the regular property taxes in an increment area allows a bit more flexibility, while protecting taxpayer dollars. In addition, we added a provision that requires that private participation is ensured so it does not allow local governments to simply build infrastructure without a purpose. This bill will enhance local economies and create jobs. It is important to get this tool in place.

One of port districts' principal purposes is economic development. We believe that this will be a useful tool for funding economic development in the future.

(Concerns) The Governor believes that local communities should have additional tools and flexibility to invest in infrastructure, stimulate the economy, and create jobs, and this bill is an important piece of the Governor's economic development agenda. We support this bill and most of the changes, but have some concerns. The delay in the use of the state matching revenues will allow additional development of projects and for them to be more fully vetted. However, the current 75 percent participation requirement, which has been changed to 60 percent in the version that came out of the Senate, seems still likely to be a stumbling block to the formation and use of this tool. The Governor's approach was to allow for voluntary participation, and we would like to see the opt-in/opt-out provisions put back in the bill.

**Testimony Against:** None.

**Testified:** (In support) Senator Zarelli, prime sponsor; and Scott Taylor, Washington Public Ports Association.

(Concerns) Sheila Martin, Office of the Governor.