

THE IMPORTANCE OF MAINTAINING THE CITY'S PROPERTY TAX LEVY RATE

The passage of I-747 by Washington voters means that most cities should expect the value of their property tax base to erode over time. Under I-747, absent a public vote to increase a city's levy, the revenues a city is allowed to collect from property taxes cannot grow by more than 1% per year (excluding the effects of new construction).

At the same time that I-747 limits the growth of a city's core property tax base, cities face rapidly increasing costs of doing business. Personnel costs (the principal cost of providing city services) are growing at a rate that exceeds inflation. These costs are driven by 1) large annual increases in the costs of health care and 2) wage increases that exceed the rate of general inflation (driven by long-run increases in worker productivity in the private sector).

Due to compounding effects, the gap between cost and revenue growth can easily erode a city's ability to maintain public services. As a newly incorporating City, the City of Fairwood would have several options for protecting itself from the eroding effects of I-747:

I-747 limits the growth of the most important revenue source for local government - property tax - to an annual growth rate of 1%, plus the city can keep the value of new construction.

1. Establish "banked" property tax capacity (by initially annexing to the fire district); or
2. Ask voters to approve periodic levy lifts to maintain the City's property tax levy.

The more transparent option is for the City of Fairwood to ask voters to approve periodic levy lid lifts to maintain the City's property tax levy. Fire districts already know, and many cities are now learning, that it is very important not to let the levy rate drop because of the need to maintain level of service. Cities are generally better positioned to succeed in passage of a levy lid lift if they are seeking to maintain city levy rates rather than raise them.



COULD THE CITY RAISE TAXES?

Yes, a City of Fairwood could increase tax rates and generate additional revenues. In fact, many cities in King County do raise substantial revenues through utility taxes. Beyond the taxes included in the baseline estimate, the City of Fairwood would have authority to levy utility taxes of up to 6% on utilities including telephone, natural gas, water and sewer, storm drainage, solid waste, and cable television service. (Utility taxes beyond 6% are possible with a public vote.) The City would also have the authority to levy business taxes and/or business license fees.

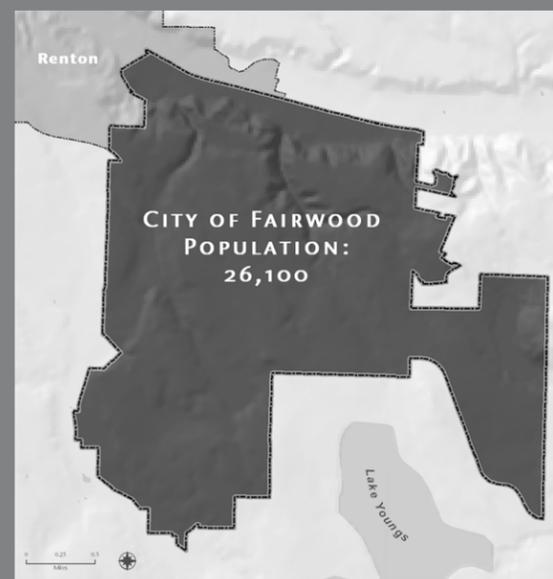


The incorporation feasibility study assumes if the Fairwood City Council chose to levy the full 6% on all utilities then the City could, by action of Council, generate roughly \$2.75 million in utility tax revenues in 2006. The feasibility model only assumes a 1.1% levy, enough to generate slightly more than \$500,000 per year.

City administrations have a great deal of flexibility in how they levy utility taxes. The Fairwood City Council can choose structures ranging from the imposition of a single tax on a single utility, to the imposition of different tax rates on all qualifying utilities.

Utility taxes can provide only short-term relief from the eroding effects of Initiative 747 on property taxes.

What if the Part of Renton's PAA were to...



Under a tax structure that would hold Fairwood residents' tax burdens equal to what they would pay as residents of King County, and assuming the City incorporated in 2007, the City would:

- Generate \$8.3 million in "core" operating revenues in 2007;
- Be able to provide slightly increased levels of service at a cost of \$7.7 million (see page 2); and
- Generate over \$1.7 million in revenue in 2007 dedicated to capital improvements.

A voter in Fairwood would participate in the direct election of the City Council, which would be elected from within city boundaries.

The Bottom Line

- The City would contract for general government services, an approach taken by most new cities.
- The consulting team who analyzed financial feasibility suggested that Fairwood would need to adopt a "go slow" approach to hiring city staff and repay debt quickly to build reserves.
- The City would have between \$500,000 and \$800,000 of operating revenues to be able to provide slightly increased levels of service each year through 2012.
- The new city would need to adapt flexibly to changes in the fiscal environment and build up substantial operating reserves.

INCORPORATE

A CITY OF FAIRWOOD

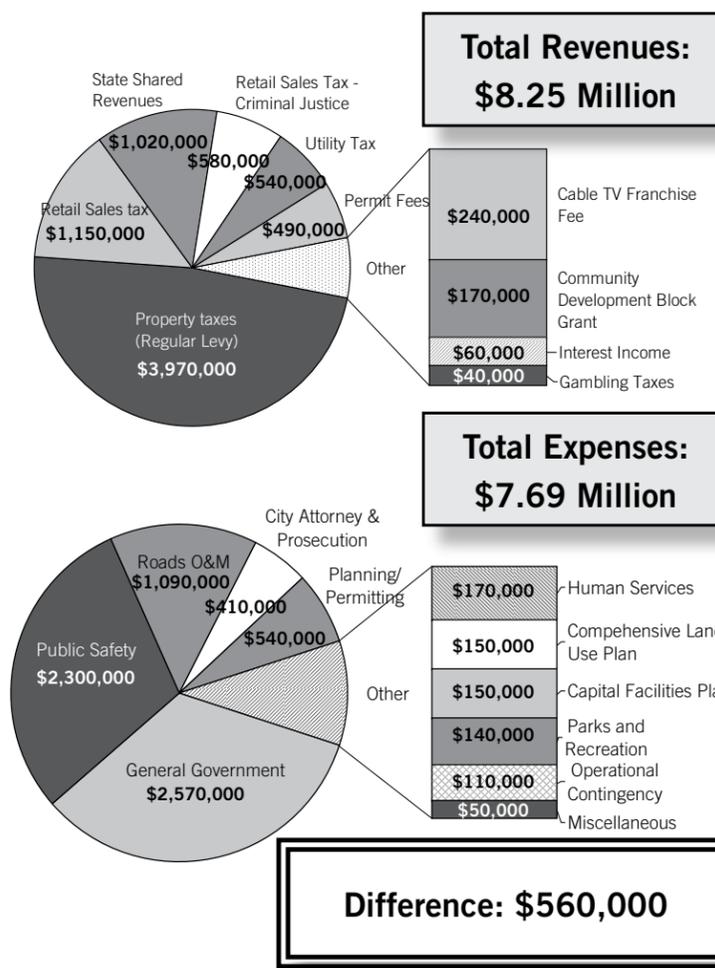
Is it financially feasible for Fairwood to incorporate?

The short answer to this question is: **yes.**

If Fairwood residents are willing to pay the same total combined level of taxes they would pay as part of unincorporated King County, and to preserve that taxing power through public vote to purchase public services over time, then a City of Fairwood would generate enough revenues to provide a slightly higher level of service than Fairwood residents currently receive (see page 2).

Largest expenditures: general government, public safety (criminal justice) and roads operation and maintenance.

Major revenues: property taxes, sales taxes, and state-shared revenues, which includes distribution of state gas taxes and state liquor taxes and profits.



How Would Fairwood Compare with Other Newly Incorporated Cities?

As a primarily residential city, with relatively little commercial activity, the City of Fairwood would have a smaller tax base than the majority of cities in the Puget Sound Region. Compared with other primarily residential cities in the area with similar characteristics, the newly incorporated City of Fairwood would rank above seven existing cities in terms of assessed value per resident, and it would rank last among these cities in retail sales taxes generated per resident.

The table below compares the core tax bases of Fairwood (property and sales taxes) with those of seven cities in King and Pierce counties that have comparable characteristics and provide similar services.

	2005 Population	2005 Assessed Valuation	2005 Regular Levy Rate	Taxes Due - 2005 (Regular Levy)	Property Taxes Due per Resident (2005)	Sales Tax Revenues per Resident (2004)	Property and Sales Taxes Combined (per Resident)
Des Moines	28,960	\$2,183,646,900	\$1.2294	\$2,684,471	\$93	\$59	\$152
University Place	30,980	2,158,674,985	\$1.5685	3,385,830	109	53	162
Edgewood	9,460	792,099,105	\$1.4974	1,186,062	125	39	164
Fairwood	26,100	2,208,000,000	\$1.6000	3,532,800	135	38	174
Covington	16,610	1,328,451,595	\$1.2466	1,656,102	100	92	192
Maple Valley	17,870	1,576,144,300	\$1.3725	2,163,241	121	105	226
Lake Forest Park	12,730	1,682,153,299	\$1.5257	2,566,493	202	40	242
Normandy Park	6,385	\$973,248,609	\$1.3515	\$1,315,312	\$206	\$48	\$254

Source: Washington State Municipal Research & Services Center (based on analysis of Washington State Department of Revenue and Office of Financial Management data) and Berk & Associates analysis.

It is worth noting that, although Fairwood would not generate as much in revenues as Maple Valley, Lake Forest Park, Normandy Park, or Covington, a City of Fairwood would have substantially greater population than any of these four cities.

Service Level Assumptions

The feasibility study assumes that the City would use a contracting model – securing most services under contract from other jurisdictions, rather than staffing up to provide them directly. This is the approach taken initially by every city to incorporate in King County in the last 15 years. The City of Fairwood would contract for all general government services except:

- General administration and city council;
- Parks and recreation; and
- Planning and building/permitting services.

This approach generates a slightly increased level of service which, depending on the decisions of the elected City Council, could include a dedicated police chief and recreational programming.



Tax Burden

Key Assumption: The Same-Cost Framework

If the City received the same total dollars of tax revenue that Fairwood residents currently pay to the County, the City could provide residents with equivalent services compared to what they now receive. This analysis models the tax burden and level of service of the new City to reflect what residents would see if they remained part of unincorporated King County.

There are many ways that a City of Fairwood *could* structure its taxes and fees to generate the revenues that allow the City to run. Because taxing tools are different for cities and counties, the mix and types of taxes will vary, but the revenue structure is designed to result in a combined total tax burden for residents that is the same as what they would pay if they continued to be part of unincorporated King County.

In particular, the table to the right shows that if incorporated, Fairwood residents would see a slight decrease in property taxes, while seeing a slight increase in utility taxes (a taxing mechanism that is provided to cities in Washington State, but not to counties).

	Stay Unincorporated	Incorporate	Annex to Renton
PROPERTY TAXES			
Consolidated Levy	\$4.33	\$4.33	\$4.33
Property Tax (City)	0.00	1.60	3.23
Road Levy (County)	1.83	0.00	0.00
School Levy	4.80	4.80	4.80
Fire Levy	0.99	0.99	0.00
Hospital Levy	0.09	0.09	0.09
Library	0.53	0.53	0.05
EMS	0.23	0.23	0.23
Flood Levy	0.00	0.00	0.00
Total Regular Levy	\$12.80	\$12.57	\$12.72
Total Property Tax	\$3,674	\$3,607	\$3,651
OTHER TAXES AND FEES			
Utility Taxes	\$0	\$66	\$190
Fire District 40 Benefit Charge	\$142	\$142	\$0
Surface Water Fee	102	102	65
Cable Franchise Fee (5%)	24	24	24
Total Other Taxes & Fees	\$268	\$334	\$279
SERVICE COSTS			
Soos Creek Water & Sewer charges	\$0	\$0	\$0
Cedar River Water & Sewer charges	1,027	1,027	1,027
Solid Waste Collection Charges	256	256	256
Total Service Costs	\$1,283	\$1,283	\$1,283
TOTAL TAXES/FEES/SERVICE COSTS	\$5,225	\$5,225	\$5,213
Difference from Unincorporated		\$0	-\$11

This table is based on actual 2005 taxes and fees, and is for illustration purposes only. Individual tax experiences will vary by household based on consumption. There are 16 levy codes in Fairwood. This tax burden was based on levy code 5160 and a house valued at \$287K.

In order to maintain a balanced “same cost” framework, the assumption is that a new Fairwood City Council will impose utility taxes at a rate of 1.1% to make up the difference between the disappearing road tax levy and the new City property tax that is limited by state law. The 2005 King County road tax levy is \$1.83 per \$1,000 of assessed value, while the assumed City levy is set at \$1.60. In 2005, this difference of \$0.23 between the two levies translated into utility taxes of \$66 per year. Based on estimates of taxable utility revenues in Fairwood, a tax of 1.1% on all taxable utilities would generate approximately \$510,000 annually, the amount necessary to “make up” the reduction in property taxes.

The City of Fairwood will have the option of imposing utility taxes that would generate more revenues than assumed above - please see the section of this profile titled *Could the City Raise Taxes?*

