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City Infrastructure Financing Tools

Washington cities finance infrastructure improvements using a number of traditional and newer tools. The following provides an introduction to these tools.

I. Local Improvement District Assessments

A local improvement district (“LID”) is a method of financing improvements available to certain municipalities for improvement projects that provide “special benefit” to the properties within the boundaries of the LID (chapter 35.44 RCW, chapter 35.51 RCW). LIDs are typically created to finance road and utility improvements. All properties that will benefit from the improvements must be included within the LID boundaries (RCW 35.44.010).

- **Special Benefit.** The improvements must confer a special benefit on the property to be assessed and the assessments cannot exceed the special benefit to the property from the improvements. General benefits cannot be assessed (RCW 35.44.010).
- **Determining Special Benefit.** The amount of special benefit by reason of the improvement is the difference between the fair market value of the property immediately after the special benefits have accrued and the fair market value of the property before the benefits have accrued. Property cannot be assessed in an amount greater than the property’s proportional benefit from a local improvement relative to other property in the LID. A municipality may use any reasonable method to allocate the costs among the various assessed properties, subject to the limitations set forth above. Square footage of property, front footage on the improvements or “zone and termini” are the most common methods (RCW 35.44.040, 35.44.045). Assessments may be determined based upon “some or all of the public land use restrictions or private land use restrictions to which such property may be put at the time the assessment roll is confirmed[.]” (RCW 35.51.030). Property may be classified into office, retail, residential, and any other reasonable classification. Certain classifications may be exempted if they will not specially benefit from the improvements (RCW 35.51.030).

II. Tax Incrementing Financing

Several statutes (including Chapters 39.89, 39.100 (hospital benefit zones), 39.102 (LIFT) and 39.104 (local revitalization areas) RCW) provide formal mechanisms for implementing tax-increment-like financing in Washington. Tax increment financing (“TIF”), as it is popularly understood in other states, is not available in Washington. The Washington Supreme Court has ruled that redirecting the state property tax to fund infrastructure offends the constitutional requirement that the tax be used only for schools. *Leonard v. Spokane*, 127 Wash.2d 194, 897 P.2d 358 (1995). The Washington TIF statutes address this limitation by focusing on local property and excise taxes, and adding a state sales tax credit in lieu of a state property tax contribution (in the case of the hospital benefit zone, LIFT and local revitalization funding statutes). As of the date of this memo, all of the state sales tax credit authority has been allocated to local governments that previously applied for allocations.

City Infrastructure Financing Tools

- **TIF Areas.** Chapter 39.89 RCW allows cities, counties, ports and any combination of the foregoing to designate an increment area, finance public improvements expected to encourage private development within the increment area, and repay this financing with the additional regular property taxes generated by such private development (RCW 39.89.010). Chapter 39.89 RCW presents many challenges: (i) it requires an interlocal agreement among jurisdictions representing at least 75% of the regular property taxes levied in the increment area (RCW 39.89.050); (ii) it fails to provide a mechanism for State funding even though the State is the recipient of a substantial portion of the taxes generated; (iii) it relies on increases in regular property taxes that are subject to limitations on annual increases in total dollar amount; (iii) it does not address excise taxes (sales, lodging and business and occupation taxes, for example) generated by private development, and (iv) it does not provide flexibility for participating jurisdictions to allocate incremental taxes according to relative benefit received .
- **Local Infrastructure Financing Tool (“LIFT”).** The LIFT statute provides a form of tax increment financing for public infrastructure projects within revenue development areas (“RDAs”) created by a local government (RCW 39.102.030). The key feature of the LIFT program is a state sales and use tax credit available to local governments (RCW 39.102.130) that were successful in applying for and meeting the relatively complex ongoing requirements associated with this state support (RCW 39.102.020). The time period for applying for an allocation of the state contribution has passed.
- **Local Revitalization Areas.** The Local Revitalization Areas statute was passed during the most recent legislative session. Similar to LIFT, the statute provides for tax-increment financing for public infrastructure projects. The statute combines a state contribution (through a state sales tax credit), increased local property taxes, increased local sales taxes and federal and private sources of funding. The statute includes counties, cities and ports within local revitalizations areas, if these entities do not opt out within a 30-day notice period. A number of cities and counties were allocated a state contribution as “demonstration projects” in the statute; a competitive pool of state funding was also made available. The competitive pool was allocated to applicants on a first-come first-served basis this past fall.

III. Impact Fees

The Growth Management Act (“GMA”) provides for the imposition and collection of impact fees by cities planning under the GMA (chapter 36.70A.040 RCW).

- **Facilities Funded.** Impact fees can be used only for public facilities that are addressed in a capital facilities plan element of a comprehensive land use plan adopted under the GMA (RCW 82.50.050). Impact fees can be used only to fund public facilities that are designed to provide service to service areas within the community at large, not for a particular development project. The following capital facilities may be funded with impact fees under the GMA: public streets and roads, publicly owned parks, open space, and recreation facilities, school facilities, and fire protection facilities in jurisdictions that are not part of a fire district (RCW 82.02.090).
- **Types of Expenditures.** Impact fees may be used for traditional building and construction costs, land acquisition expenditures, and administrative costs for design, engineering, and permitting. In addition, impact fees may be spent on renovation projects that increase the capacity of existing facilities to serve new development, as long as the renovation may be capitalized. Finally, impact fees may be used to buy some equipment and supplies necessary for new or expanded facilities.

City Infrastructure Financing Tools

- **System Improvements Permitted.** Impact fees may be used to finance “system improvements” that will “reasonably benefit” the new development (RCW 82.02.050). The use of GMA impact fees, therefore, is not limited to on-site project-level improvements. GMA impact fees can only be imposed for system improvements that are “reasonably related to the new development” (RCW 82.02.050).
- **Funding Limitations.** The GMA forbids local jurisdictions from using impact fees to fund completely the system improvements needed to serve new development (RCW 82.02.060). An impact fee ordinance may require the payment of impact fees for previously incurred system improvement costs. The improvements must be demonstrably capable of serving new growth and development.
- **Expenditure Time Limit.** Previously, impact fees were required to be spent or encumbered within six years of receipt, unless there existed an extraordinary and compelling reason to hold them longer (RCW 82.02.070). This past legislative session, the time frame was extended from six to ten years under certain circumstances.
- **Mitigation under the State Environmental Policy Act (“SEPA”).** In addition to GMA impact fees, cities may impose project specific impact fees pursuant to SEPA (RCW chapter 43.21C).

IV. Transportation Benefit District Fees and Taxes

Under chapter 36.73 RCW, cities and counties may establish transportation benefit districts (“TBDs”) to fund transportation improvement projects.

- **Quasi-municipal Corporation.** A TBD is a quasi-municipal corporation, an independent taxing “authority”, and a “taxing district” (RCW 36.73.040). A TBD may include all or a portion of the territory within the jurisdiction or jurisdictions that formed the TBD (RCW 36.73.070).
- **Transportation Improvements.** A TBD may fund transportation improvements necessitated by existing or reasonably foreseeable congestion levels, located within the TBD (RCW 36.73.020).
- **Funding Sources.** Once formed, a TBD can implement various funding measures with voter approval (approval by a majority of the voters in the TBD voting on a proposition at a general or special election) including: excess property taxes, local sales and use taxes and annual vehicle fees of up to \$100 per vehicle registered within the TBD’s territory (RCW (36.73.040, 36.73.060). A TBD is not required to obtain voter approval prior to implementing a \$20 per vehicle fee. A TBD that includes all of the territory within the jurisdiction(s) that established the TBD may implement an annual vehicle fee of up to \$20 per vehicle without voter approval. The fee cannot exceed \$20 per vehicle even if more than one TBD operates in the area in which the vehicle is registered (RCW 36.73.065).

If the TBD is countywide, the county must attempt to agree by interlocal agreement to distribute the fee revenues to each city within the county, upon the terms set forth in the interlocal agreement. The interlocal agreement is effective when approved by the county and 60% of the cities representing 75% of the population of the cities within the county. If the county cannot reach an interlocal agreement with the requisite percentage of cities, the county may impose the fee only in unincorporated areas (RCW 36.73.065, 82.80.140).

City Infrastructure Financing Tools

- Nonresidential impact fees (RCW 36.73.065). A TBD may impose an impact fee on commercial development. The fee must be used exclusively for transportation improvements constructed by a TBD and must be reasonably necessary as a result of the impacts of the development on transportation needs (RCW 36.73.120).

V. Levy Lid Lifts

Chapter 84.55 RCW limits the total dollar amount of regular property taxes levied by a taxing district without voter approval to the highest amount of such taxes levied in the three most recent years (adjusted to account for new construction, improvements, newly annexed property and state-assessed property), multiplied by a limit factor (RCW 84.55.010). Taxing districts with a population over 10,000 can increase the dollar amount of their regular property taxes annually by the lesser of inflation or 101% of the highest levy in the three previous years; taxing districts with a population less than 10,000 are subject to a flat 101% limitation (RCW 84.55.005).

- **Mechanics.** A simple majority of voters can approve a “levy lid lift,” allowing the taxing district to levy an amount approved by its voters up to the applicable statutory rate limitations (RCW 84.55.050). The new base can apply for a limited or unlimited period (except that if the levy lid lift was approved for the purpose of paying debt service on bonds, the new base cannot apply for longer than nine years).
- **Time Period.** With a majority vote of its electors, a taxing district may lift its levy for the following year or for up to six consecutive years, within statutory rate limitations (RCW 84.55.050). In approving a multi-year (up to six years) levy lid lift, voters may approve the amount of the initial lift plus a growth factor (such as the consumer price index) for calculating the amount of increases in subsequent years.

VI. Latecomer Agreements

- **Joint Effort with Developers.** The legislative authority of a city, town or county may contract with developers for the construction or improvement of street projects as a result of ordinances requiring that the projects are a prerequisite to any further property development (RCW 35.72.010). A county, city, or town may join in the financing of improvement projects and may be reimbursed in the same manner as the participating developers (RCW 35.72.050). This past legislative session, the statute was amended to authorize municipalities to participate in financing local water/sewer facilities and to receive reimbursement via latecomer agreement.
- **Own Effort.** Alternatively, a county, city, or town may create a reimbursement area on its own, finance the project, and become the sole beneficiary of the reimbursements, though only for costs of improvements that benefit the public (RCW 35.72.050). No county, city, or town costs for improvements that benefit the general public may be reimbursed.
- **Reimbursement.** Reimbursement may be sought for those improvements that go beyond the strict necessities of the development, and that will provide benefit to nearby property owners. Property owners that seek to develop their properties subsequent to the agreement becoming effective will be charged reimbursement fees proportionate to the benefit of the improvement to their property (RCW 35.72.020).

City Infrastructure Financing Tools

- **Set by Ordinance.** The authorizing ordinance should provide specific legal descriptions of the properties to be included, and set forth the rationale for the boundaries (essentially, that those properties would require similar street improvements upon development but for the initial developer's street improvements). The ordinance should also explain how the reimbursement assessments reflect the benefits to properties within the boundaries, and should include the formula used to determine the assessments.
- **Term.** The contract may provide for partial reimbursement over a 20-year period (plus up to 20-year extension) (RCW 35.72.020). The maximum reimbursement period was extended to 20 years this past legislative session.

VII. American Recovery and Reinvestment Act of 2009 (ARRA)

The federal stimulus law, ARRA, included a number of new financing tools for municipalities. Certain of these tools are well suited to financing public infrastructure, including Build America Bonds ("BABs") and Recovery Zone bonds.

Attached please find a summary of the ARRA tools, including BABs and Recovery Zone bonds.

Please contact any of our Public Finance lawyers should you have any questions.

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