

## CITY COUNCIL STUDY SESSION ITEM

### SUBJECT

Overview of the Bel-Red Finance Plan approach and proposed guiding principles. Background information on financial tools that might be used to pay for the cost of Bel-Red infrastructure is included.

### STAFF CONTACT

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### POLICY ISSUES

Redevelopment of the Bel-Red area in a manner that achieves the future vision for the area articulated by the project Steering Committee will require significant new investment in basic infrastructure and livability investments to support new development. The Bel-Red Steering Committee recognized the importance of a fully developed implementation strategy and the need for a 'robust finance plan'. The Committee suggested that much of the investment needed for Bel-Red should come from the property undergoing redevelopment. The Committee's work and the magnitude of the needed investment suggest that the City revisit its capital investment approach for the Bel-Red area.

- Should the City utilize a broader range of tools to fund needed infrastructure investment in the Bel-Red area? Should these tools be used only in Bel-Red, or be applied more broadly in other parts of the City?
- Should new development fund a larger share of the cost of the needed infrastructure than has historically occurred in the City? What is the proper allocation of costs between new development and general City tax sources?
- Use of City debt capacity will likely be necessary to finance investment in needed infrastructure. How should the City think about targeting debt capacity for investment in the Bel-Red area?
- Should the City allocate some percentage in the total growth in property tax, sales tax, and Business and Occupation tax from the redevelopment of the Bel-Red area to pay for needed infrastructure investment? What is an appropriate mix of taxes to support these investments?
- What is the relative priority of capital investment directed at redevelopment in the Bel-Red area compared to other needs? How will the City differentiate between benefits for current development compared to benefits for new development?

### DIRECTION NEEDED FROM COUNCIL

Action  
 Discussion  
 Information

The fact that the City is preparing a capital Finance Plan concurrently with Comprehensive Plan and Land Use code amendments represents a significant departure from past practice. This approach will help ensure that development of this area will meet the land use vision advanced by the Steering Committee, and ensure that the development of this area represents a positive addition to the City.

The capital finance policy issues raised by the needed infrastructure investment in the Bel-Red area are significant. Work is underway to properly frame the questions outlined above, and will take several months to complete. Finance principles are proposed to guide development of the Finance Plan. Council approval of these finance principles will be requested in early 2008 and, once adopted, will guide the development of the Finance Plan.

Staff will provide the Council with periodic briefings on the development of the capital Finance Plan, as key work products are completed (see next steps below).

## **BACKGROUND/ANALYSIS**

The City Council initiated work in 2005 to reexamine the long-term land use future for the Bel-Red area. The area's strategic location between Downtown Bellevue and Overlake, signs of economic decline under its existing light industrial and commercial zoning, and the future siting of a light rail corridor created the potential to devise a new vision for the area.

The Council appointed a Bel-Red Steering Committee to oversee the development of a new Bel-Red plan, and the Committee transmitted its recommended final recommendation to the Council on September 24, 2007. The Committee's work was guided by planning principles adopted by the Council, and by the input it received from the general public during the planning process. The Committee's recommendations, in the form of Comprehensive Plan amendments, Land Use Code amendments, and other implementation actions is now being reviewed by the Planning Commission, Transportation Commission, Environmental Services Commission, Parks and Community Services Board, and Arts Commission.

The Council recognized that the development of a Finance Plan for the Bel-Red area would raise many policy issues, and chose to have it reviewed directly by the Council.

### **Land use vision and related capital and operating budget investment requirements.**

The vision for the Bel-Red area is that the land use pattern will change to reflect a more mixed use (housing/office/retail) area that supports the City's economic development and growth management strategy by establishing development opportunities not found elsewhere in Bellevue. This land use pattern will be supported by a robust multi-modal transportation system (including light rail), and would include parks, open space, and environmental amenities that the area currently lacks. The land use vision contemplates a new major employment center, housing that will meet the needs of varied income levels, a connected parks and open space system, environmental enhancements to restore ecological functions lost over the last 50 years, and major new transportation investments.

Unlike other developing areas of the City, Bel-Red was historically developed as a light industrial and general commercial area. It has significant transportation system constraints, and lacks general amenities. For it to redevelop in ways consistent with the proposed land use vision, road and transit infrastructure will need to be upgraded, parks established, and environmental restoration of urban streams will need to occur. Much of this will need to happen as development occurs, and

cannot wait until the area is mature. This need for up-front investment creates infrastructure financing challenges not found elsewhere in the City.

The cost of the investment needed to support this land use vision is significant. While the detailed cost estimates are being developed, they are likely to exceed \$200 million. The investment strategy problem to be solved for Bel-Red has three parts:

1. Substantial new revenue will be needed to pay for the investments,
2. Mechanisms will have to be developed to ensure that needed facilities are built as development occurs, and
3. Financing mechanisms will be needed to pay for these improvements over time, likely utilizing City debt capacity.

Growth in the Bel-Red area will also affect delivery of basic City services. The growth assumptions embedded in the Bel-Red plan were included in the City's long-range operating and capital budget growth assumptions, and are a factor contributing to the need for growth in public safety, transportation, and other operational FTE's. Work is underway to determine whether the City costs for maintaining basic services and capital investment can be supported by growth in the Bel-Red tax base.

## Financial Strategy

Financing principles. Staff developed draft financing principles to guide development of the financial strategy for Bel-Red (See Attachment 1). These principles are based on the assumption that the basic infrastructure and amenities needed to support Bel-Red development will come from four basic sources. These sources include:

- Funding for or direct construction of infrastructure and critical livability investments by new development to support new development;
- Amenities to support the overall Bel-Red redevelopment strategy through use of development incentives. Use of development incentives will be necessary for any new development to achieve the higher densities or building heights contemplated by the Bel-Red plan;
- General City financial investment, where that investment provides City-wide benefits;
- State or federal funding, particularly important for the planned connection of 124<sup>th</sup> Avenue to SR 520.

New development in the Bel-Red corridor will be the primary beneficiary of public infrastructure investment. In fact, new development will not be able to proceed without the necessary infrastructure in place or planned to be built. For this reason, staff views new development as the primary source of revenue to pay for the improvements. ***This represents a change in the City's capital funding philosophy and is embedded in the proposed financing principles.*** This funding philosophy will help ensure that Bel-Red funding does not compel the City to redirect funding anticipated for other areas of the City, but does potentially provide general City financial investment in Bel-Red as a supplemental source of funding for improvements with City-wide benefits, or as a means to bridge revenues generated from development to provide the infrastructure in a timely manner. This strategy is intended to apply only to the Bel-Red area. The Council may want to consider use of the Bel-Red financial tools elsewhere in the City, but that discussion is proposed to happen after the Bel-Red process is complete.

Staff seeks Council feedback on the financing principles, and will seek Council action to adopt these principles at a future Council meeting.

Financial tools. The City has retained a financial consultant to develop a financial plan to support the Bel-Red redevelopment. Their work includes input with regard to the finance principles, identification of potential financial tools, the development of a subset of the alternative financial tools, and case studies around the subset of financial alternatives.

It is clear that the current capital investment tools used by the City are not adequate to meet the requirements of the financing principles. This occurs for several reasons:

1. First, the tools are limited. The City collects revenue from new development only through transportation impact fees, or by direct construction of frontage improvements. Significant up-front investment will be required in Bel-Red, and the current tools used by the City cannot fully accomplish this objective.
2. The share of the cost of new infrastructure directly paid for by new development is currently low. The adopted 2007-2013 CIP includes \$2.6 million in impact fees to fund transportation improvements, compared to a City tax investment of \$42.2 million. **This philosophy will need to be reconsidered if new development is to pay a larger share of the costs of new infrastructure.**
3. The City relies heavily on sales tax, business and occupation tax, and real estate excise tax revenue to pay for capital investments. The City relies primarily on a 'pay-as-you-go' basis for financing infrastructure investment. The method does not take intergenerational equity into consideration. The infrastructure 'deficit' in Bel-Red requires significant up-front investment, and will need mechanisms to accomplish this. The development in Bel-Red will generate substantial new revenues that can provide a funding source to pay for needed capital investment. The City will need to consider the use of debt to deliver the necessary investment at the appropriate time to support new development.

Staff identified a list of alternative funding tools with the greatest potential for generating revenue from new development or to pay for investments with a City-wide benefit, from a longer list of potential financial tools developed by our consultant team (See Attachment 2). This subset of tools was selected for further analysis based on a number of criteria, including suitability to the types of development likely in the Bel-Red area, revenue generation potential, linkage to the type of investment, and ease of implementation. These tools include:

- GMA Impact Fees
- Transportation benefit district fees and taxes
- Commitment of area taxes to finance capital improvements
- Local Improvement District assessments
- Latecomer Agreements
- Tax abatement
- Developer financing of infrastructure
- Utility rate financing for open stream property acquisition, stream restoration, water quality or flood control improvements
- Water and Sewer investment, recovered through connection charges
- General CIP investment for improvements having City-wide benefit
- Grant revenue
- State and federal investment
- Partnership opportunities.

Background material on these tools is included in Attachment 3. A Council discussion of the specific financial tools will be scheduled for early 2008, after background work is completed. However, if there are any other tools from the consultant list (Attachment 2) that the Council has specific interest in, it would be helpful to identify them now so that background feasibility work can be completed.

Next steps.

The financial plan work is in its early stages of development. Staff anticipates several Council briefings over the next six months. These include:

- February 2008 - briefing on infrastructure costs and financial tools;
- April 2008 - briefing on baseline revenue projections and revenue projections for the new tools;
- May 2008 - preliminary financial plan, including allocation of costs and market feasibility of the plan;
- June 2008 - final financial plan to be adopted with the Bel-Red Comprehensive plan and Land Use Code amendments.

Staff anticipate two stakeholder involvement events. The first event, in February, will be focused on infrastructure costs and financial tools, and the second event, in May, will be focused on the preliminary financial plan.

**ALTERNATIVES**

Staff seeks feedback on the financing principles and revenue tools at the December 10 meeting. Staff will return in January seeking Council adoption of the financing principles.

**RECOMMENDATION**

N/A

**ATTACHMENTS**

1. Financing principles
2. Financial tools matrix
3. Background material on Bel-Red financing tools

## Preamble:

Redevelopment of the Bel Red area represents a unique, dramatic opportunity to shape the future of this corridor, strategically situated between Downtown Bellevue and the Microsoft campus, for the long-term benefit of the community. The scale and scope of redevelopment potential in this area is significant for Bellevue and the region, and represents an opportunity for the City to respond to market demand for office, limited retail, and residential development, and also redevelop the area in a more sustainable, environmentally-friendly manner. The area lacks critical infrastructure to support redevelopment and the overall vision articulated by the project steering committee. Current financing tools are inadequate to enable full potential for high value redevelopment and to leverage that value for amenities that will enhance the public good. For the area to achieve its full potential, all financing alternatives must be evaluated.

*The current list of funding strategies used by the City for public infrastructure should be refined and expanded to include a broader array of tools than currently used by the City, including but not limited to impact fees, transportation benefit districts, local improvement districts, density and other development incentives, dedicated general tax revenue from new development in the area, and state/federal grants. The consultant team is charged with developing a financing plan for the Bel Red area utilizing legally and financially viable financing techniques.*

## Finance Plan principles:

1. The Finance Plan should take the long view, with the understanding that the basic infrastructure, livability investments, and amenities will occur as redevelopment takes place.
2. The Finance Plan should not compromise the City's Aaa bond rating. If City debt is used to finance Bel Red improvements, it should be supported by revenue generated in the area, or to pay for improvements having citywide benefit.
  - a. *City Councilmanic debt capacity is limited and the City must ensure that a sufficient amount of capacity is available for emergencies and citywide uses. Conservative revenue estimates should be built into revenue models developed for this purpose and any funding strategies should preserve the City's debt rating.*
3. Cost for the public infrastructure should be shared based on the relative impacts and benefits of development within the corridor.
  - a. *The planned development of the Bel Red Corridor is likely to result in significant long-term economic benefit to property in the area as well as citywide benefit in the form of an increased and diversified tax base and important through-traffic corridors within the area. New development in the Bel Red Corridor will be the primary beneficiary of public infrastructure improvements required to accommodate the development and, therefore, should be the primary source of revenue to pay for the improvements. To the extent existing properties benefit from the development, they should be asked to contribute in amounts reasonably reflecting their benefit. A general City contribution may be required as a*

*supplemental source of funding, directed to improvements with citywide benefits, or as a means to bridge revenues from development to provide the infrastructure in a timely manner*

4. The Finance Plan should enable the Bel Red vision to be fully realized
  - a. *The financing plan should be realistic.*
  - b. *The financial strategy is likely to acknowledge that there is limited capacity for the new development to pay for all required improvements and furthermore that revenues derived from such development may not be available when needed to finance the infrastructure. For those reasons, strategies that spread the cost of facilities over time and supplement and bridge revenues projected to be derived from the development will be critically important. Latecomer agreements or other developer-financing mechanisms should be considered.*
  - c. *This may mean that while new development will be the primary source of infrastructure funding, the practical limits and equity of such revenue streams in the market place need to be understood.*
5. The Finance Plan should be complimentary to the long-term economic development goals for Bellevue and the region.
  - a. *The financing plan should not inadvertently place new development and existing businesses at a competitive disadvantage to other areas in the City or in adjacent cities.*
  - b. *The overall strategy developed to fund Bel Red improvements should be designed to meet the particular challenges and opportunities of the Bel Red Corridor, though the City may elect to apply Bel Red funding mechanisms to other parts of the City.*
6. Public investments should be made strategically in order to leverage them for the greatest public good.
  - a. *Any general City contribution needs to be justified based on the extent to which the infrastructure provides benefit to the City as a whole.*

REVENUE SOURCES - DRAFT BRAINSTORMING LIST: Legality not a criteria, Non-tax priority

	Up Front or Over Time or Mix?	Have Descrip?	Innov. Fin. Strat. ("IFS") 03?	TYPE	Private Pays or All Pay	COMMENTS
1	Over Time	Yes	Yes	Charge or Fee	All	Latecomer agreements possible?
2	Up Front	IFS	Yes	Private money	Private	
3	Mix	Yes	Transport.	Charge or Fee	Private	Transportation, water, wastewater, hard to finance alone
4	Up Front	Yes		Private money	Private	
5	Up Front	Yes		Private money	Private	
6	Up Front	Yes		Charge or Fee	Private	Developer pays amount to City to construct
7	Up Front			Charge or Fee	Private	
8	Up Front			Private money	Private	
9	Over Time	Yes		Organizational has a tax option	All	FCSG doing in Ridgefield
10	Up Front	Yes		Charge or Fee	Private	Developer pays directly for improvements or into a fund
11	Over Time	Yes		Charge or Fee	All	More voluntary, lower amounts
12	Over Time			Financing	Private	Run afoul of laws on lending of credit?
13	Over Time	Yes		Tax Increment	All	Debt would count toward debt limit

REVENUE SOURCES - DRAFT BRAINSTORMING LIST: Legality not a criteria, Non-tax priority

	Up Front or Over Time or Mix?	Have or Descrip?	Innov. Fin. Strat. ("IFS") 03?	TYPE	Private Pays or All Pay	COMMENTS
14	Incremental Taxes - Conventional Property Tax	Over Time	Yes	Tax Increment	All	Debt would count toward debt limit
15	LIFT Increment Financing	Over Time	Yes	Tax Increment	All	Not currently on state list; Debt would count toward debt limit; LIFT accesses some matching state funds
16	Parking Fees and Charges	Over Time	Yes	Charge or Fee	All	
17	Tax Abatement - SIP (Strategic Investment Program) Approach	Mix	Yes	Abatement	Private	Affects overlapping entity tax collections
18	Tax Credit or Tax Abatement program	Over Time	Yes	Abatement	Private	Private can use abated tax revenues to fund projects or their own financing
19	Assessments - ULLID	Over Time		Charge or Fee	All	Utilities
20	Fees In-Lieu of Constructing On-site Facilities	Up Front	Yes	Charge or Fee	Private	Developer pays amount to City to construct
21	In-Lieu Fees and/or Taxes	Over Time		Charge or Fee	Private	
22	Mileage Fees - Commute Based	Over Time	IFS	Charge or Fee	All	
23	Payments in Lieu of Parking	Up Front		Charge or Fee	Private	
24	Tax Credits: Multifamily Housing (MFTEP) Tax Exemption Program	Over Time	Yes	Abatement	Private	
25	Assessments - Walkway and Bikeway Improvement Zones	Over Time	IFS	Charge or Fee	All	
26	Connection Charges	Up Front		Charge or Fee	All	Utilities

REVENUE SOURCES - DRAFT BRAINSTORMING LIST: Legality not a criteria, Non-tax priority

	Up Front or Over Time or Mix?	Have Descrip?	Innov. Fin. Strat. ("IFS") 03?	TYPE	Private Pays or All Pay	COMMENTS
27	Over Time	Yes		Private Assistance	Private	Mostly conservation; uses utility revenues
28	Over Time	IFS	Yes	Tax	All	Debt would count toward debt limit
29	Over Time	IFS	Yes	Tax	All	Debt would count toward debt limit
30	Over Time	IFS	Yes	Tax	All	Debt would count toward debt limit
31	Up Front			Other	Private	
32	Over Time			Charge or Fee	Private	
33				NA	NA	Not available – Based on income levels by zip code and Bellevue can't meet

**K&L | GATES****MEMORANDUM**

**TO:** Lori Riordan, Jan Hawn, and Matt Terry  
**FROM:** Jay Reich and Stacey Crawshaw-Lewis  
**DATE:** December 4, 2007  
**RE:** Bel-Red Financing Tools; Summary Legal Analysis

You asked us to provide background information regarding the availability, from a legal perspective, of various financing alternatives being considered in connection with the development of the Bel-Red Corridor. The following memorandum identifies the primary legal characteristics of various financing tools and explores their applicability to the Bel-Red Corridor.

**Part A: Local Sources of Revenue for Bel-Red Improvements.****A.1. GMA Impact Fees.**

*Overview.* The Growth Management Act (“GMA”) provides for the imposition and collection of impact fees by cities planning under the GMA.

- **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. 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
  - fire protection facilities in jurisdictions that are not part of a fire district.
- **Types of expenditures.** Impact fees may be used for traditional “bricks and mortar” expenditures, land acquisition, and “soft” 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.
- **System improvements permitted.** Impact fees may be used to finance “system improvements” that will “reasonably benefit” the new development. The use of GMA impact fees, therefore, is not limited to on-site project-level improvements.

- **Required relationship between improvements and development.** GMA impact fees can only be imposed for system improvements that are “reasonably related to the new development.”
- **May have more than one service area.** The ordinance imposing impact fees must establish one or more reasonable service areas within which impact fees for various land use categories per unit of development will be calculated. Most jurisdictions establish several different service areas for their impact fee. Depending on the factual record, it may be possible to have one service area for a particular impact fee (e.g., for park improvements) and one or more for other impact fees (e.g., transportation impacts). An impact fee can be imposed at one or more points in the development approval process.
- **Cannot fully fund system improvements.** The GMA forbids local jurisdictions from using impact fees to fund completely the system improvements needed to serve new development. 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.
- **Determining the appropriate share.** The determination of the proportionate share shall be made through the use of a formula or other method that incorporates the following:
  - the cost of public facilities necessitated by new development;
  - an adjustment to the cost of the public facilities for past or future payments made or reasonably anticipated to be made by new development to pay for particular system improvements in the form of user fees, debt service payments, taxes, or other payments earmarked for or proratable to the particular system improvement;
  - the availability of other means of funding public facility improvements;
  - the cost of existing public facilities improvements; and
  - the methods by which public facilities improvements were financed.
- **Time limit for expenditures.** Generally, impact fees must be spent or encumbered within six years of receipt, unless there exists an extraordinary and compelling reason to hold them longer. Impact fees are often applied to pay debt service on bonds issued to pay system improvements costs. If these bonds are limited tax general obligation bonds, the bonds will count towards the city’s nonvoted debt limit.
- **Mitigation under SEPA.** In addition to GMA impact fees, the City has authority to impose project specific impact fees pursuant to SEPA.

## **A.2. Transportation Benefit District Fees and Taxes.**

*Overview.* 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". The governing body of a city TBD consists of the city council, but the TBD is a municipal entity independent of the city.

- **Available to King County cities in December 2007.** The statute limits the ability of King, Snohomish and Pierce Counties and the cities located within those counties to establish TBDs prior to December 1, 2007. Following December 1, 2007, however, cities and counties may form TBDs throughout the state.
- **City-wide or a portion of the city.** A TBD may include all or a portion of the territory within the jurisdiction or jurisdictions that formed the TBD.
- **Voted tax authority.** Once formed, a TBD has taxing authority and can implement various funding measures with voter approval: excess property taxes, local sales and use taxes and vehicle tolls and annual vehicle fees of up to \$100 per vehicle registered within the TBD's territory. A TBD is not required to obtain voter approval prior to implementing the \$20 per vehicle fee and impact fees, as discussed below. Voter approval consists of approval by a majority of the voters in the TBD voting on a proposition at a general or special election.
- **Fund transportation improvements within the TBD.** A TBD may fund transportation improvements necessitated by existing or reasonably foreseeable congestion levels, located within the TBD.
- **Nonvoted \$20 vehicle fee if city-wide.** As amended in the 2007 legislative session, 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.
- **County imposition of vehicle fee.** A city TBD in King, Snohomish or Pierce County must wait until May 23, 2008 to impose the vehicle fee unless the applicable county passes a resolution declaring that it will not impose the vehicle fee on a county-wide basis. The county also has the option of creating a TBD to impose the nonvoted vehicle fee itself. 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.
- **Impact fees on non-residential property.** 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. Recent legislation removed existing authority allowing TBDs to impose transportation impact fees on residential property. A prohibition against "double dipping" requires that a credit be applied to account for other transportation impact fees on the same development.
- **Voted Bonds.** A TBD may issue voted general obligation bonds subject to a voter-approved debt limit of 5% of the taxable property within the TBD. The statute also provides TBDs with a 1-1/2% nonvoted debt limit. Bonds issued by a TBD within its debt limits should not consume city debt capacity.
- **Revenue bonds.** In addition to general obligation bonds, a TBD may issue revenue bonds, or may pledge the revenues of a revenue-producing facility to pay its general

obligation bonds. The City may also contract with the TBD to jointly finance transportation improvements that each is authorized to complete.

### A.3. Incremental Taxes.

*Overview.* Two statutes (Chapter 39.89 RCW and Chapter 39.102 RCW (“LIFT”)) provide formal mechanisms for implementing tax-increment-like financing in Washington. Alternatively, the City can apply the concept of tax-increment financing outside of these statutory schemes to recapture City investments in publicly-financed infrastructure that will generate additional taxable activity. Tax increment financing, as it is popularly understood in other regions, is not available in Washington.

- **Chapter 39.89 RCW: 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.
- **Chapter 39.89 RCW: Challenges.** The statute presents a number of legal and practical challenges: it requires an interlocal agreement among jurisdictions representing at least 75% of the regular property taxes levied in the increment area, it does not provide a mechanism for state funding even though the state reaps the lion’s share of any incremental taxes generated, it relies on increases in regular property taxes that are subject to limitations on annual increases in total dollar amount (see discussion of Initiative 747 below), it does not address transactional taxes (sales, lodging and business and occupation taxes, for example) generated by private development, and it does not provide flexibility for participating jurisdictions to allocate incremental taxes according to relative benefit received.
- **Interlocal Agreement; Informal TIF.** Given these challenges, the City may choose to craft its own tax-increment financing package by interlocal agreement. Because cities, counties and ports are all authorized to levy regular property taxes and to apply such taxes to public improvements for economic development purposes, they are authorized to agree to use these powers jointly by interlocal agreement. Because the City for the most part can only take advantage of increased property values due to new construction, any tax-increment financing program focused on property taxes should focus more narrowly on new construction. Also, rather than establishing an increment area that includes all areas expected to benefit (in the form of increased property values) from new private development, it makes sense to establish an increment area that consists only of the new construction to be generated. The Washington Supreme Court recently ruled Initiative 747 unconstitutional, but the Legislature reinstated the 101% limitation in its special session.
- **City LTGO bonds.** Cities can issue LTGO bonds payable from all property taxes but sized to be paid on a cash flow basis from the incremental tax revenues derived from new construction through interlocal agreement or internal segregation. The interest rate on the bonds would be significantly lower than if the sole source of repayment was the incremental taxes (because of the full faith and credit pledge of the

City), but such pledge would cause the bonds to be counted against the City's nonvoted debt capacity.

- **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. The key feature of the LIFT program is a state sales and use tax credit available to local governments that are successful in applying for and meeting the relatively complex ongoing requirements associated with this state support. These funding sources interact and are subject to limitations under the LIFT statute, as illustrated on the attached chart. [http://www.klgates.com/files/upload/LIFT\\_Financing\\_Chart.pdf](http://www.klgates.com/files/upload/LIFT_Financing_Chart.pdf). A fuller description of the LIFT statute is attached for reference as Exhibit C.
- **LIFT legislative action.** The 2007 legislature recently passed amendments to the LIFT statute. Most notably, the 2007 amendments increase the amount of the state contribution available through the state sales and use tax credit mechanism from \$5 million to \$7.5 million per state fiscal year. As amended, the LIFT statute generally limits the creation of RDAs to one per county. Federal Way has received approval for its RDA, foreclosing an opportunity for the City, absent further legislative action.

#### **A.4. Local Improvement District Assessments.**

*Overview.* A local improvement district ("LID") is a method of financing improvements constructed by a municipality and that provide "special benefit" to the properties within the boundaries of the LID. LIDs are typically created to finance road and utility improvements. The City levies assessments against the property equal to the cost of the improvements to be paid by the property owners, and such assessments become liens on the properties. All properties that will benefit from the improvements must be included within the LID boundaries. If an appraiser will determine special assessments, the boundaries are drawn based upon the appraiser's determination of which property will be benefited.

- **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.
- **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. 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." 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.

- **Cost to property owners.** Property owners rather than general taxpayers pay the costs of improvements that specially benefit their property. The interest rate on the assessments is based on the tax-exempt bond rate (tax-exempt rates are typically about 2% less than taxable rates), and interest paid by property owners is deductible from their gross income for federal income tax purposes. Assessments are payable in up to 10 annual installments, with the first installment not due until one year after the assessment roll is confirmed. Unlike latecomer charges, assessments are owed whether or not property is ever developed. Latecomer charges are payable in a lump sum.

## **Part B: Financing Techniques to Maximize Revenues or Debt Capacity.**

### **B.1. 63-20 financing of City-occupied facilities.**

*Overview.* A nonprofit corporation may issue tax-exempt bonds “on behalf of” the City. This method of financing is commonly referred to as “63-20” financing (Revenue Ruling 63-20 and all of the subsequent positions of the Internal Revenue Service, have been compiled in a subsequent official announcement, Revenue Procedure 82-26).

- **Title to City.** If 63-20 bonds are issued on behalf of the City, the City must receive full legal and unencumbered title to the facilities upon retirement of the bonds for no additional consideration.
- **Credit for the bonds.** In a traditional municipal bond financing, the issuer is the party primarily responsible for the repayment of the debt. This is not required, however, in a 63-20 financing. If an issuer with substantial assets is available, the issuer may issue debt and pledge its assets. More likely, however, the project seeking tax-exempt financing (outside of the government umbrella) is intended to be financed on the basis of “cash-flow from the project. The project cash flow typically comes from the lease of the facility to the governmental agency (or 501(c)(3) organization). Because the bonds are tax-exempt, restrictions upon private use and private payments apply.
- **Finance capital costs.** All of the original and investment proceeds of the bond issue must be applied to tangible real or personal property, costs of issuance, underwriters’ discount, interest during construction, or to fund a reserve.
- **City’s beneficial interest.** The political subdivision on whose behalf the bonds are being issued (i.e. the City) must have a “beneficial interest” in the nonprofit corporation. This is satisfied if the City has exclusive use and possession of 95% or more of the facilities financed by the bonds, the City has control over the nonprofit corporation through board member appointment and removal or the City has the right to acquire, at any time, unencumbered title and exclusive possession of the property financed by the bonds by paying a sum sufficient to defease the bonds.
- **City lease obligation.** The City may lease the facility, providing the lease revenues to repay the bonds. The form of the City lease may determine whether the lease is a “debt” for the purposes of the City’s debt limitations.

## **B.2. 63-20 Financing of Infrastructure.**

*Overview.* It may be possible for a developer to use tax-exempt 63-20 bonds to finance infrastructure, but any such arrangement would need to be carefully vetted to comply with federal tax requirements.

## **B.3. Latecomer Agreements:**

*Overview.* “Latecomer Agreements” provide a mechanism for developers to be reimbursed for street or utility improvements mandated by the City as prerequisites to the development.

- **Developer “overbuilds.”** Reimbursement may be sought for those improvements that go beyond what is strictly necessary for the initial developer’s 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 or “latecomer” charges proportionate to the benefit of the improvement to their property.
- **City collects from latecomers.** The City would collect the charges on behalf of the initial developer.
- **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. The latecomer charges may only be applied to property owners who apply for permits and approvals after the Latecomer Agreement comes into effect.
- **City may participate.** The City can be a participant in latecomer agreements for street improvements. Certain utility latecomer agreements are authorized under Chap. 35.91 RCW, and permit use of the latecomer agreement mechanism to finance water and sewer facilities. Cities may not be participants in utility latecomer agreements.
- **Term.** The contract may provide for partial reimbursement over a 15-year period.

## **B.4. Property Tax Abatement.**

*Overview.* Chap 84.14 RCW permits cities with a population over 15,000 (among others) to provide a multi-unit housing property tax exemption to encourage such residential development in residential targeted areas within urban centers.

- **New construction and rehabilitation.** The property tax exemption may be applied to the value of new housing construction, conversion, and rehabilitation (but not to the value of land or non-housing improvements).
- **Statutory requirements.** There are detailed statutory requirements associated with designating a residential targeted area, timeframes for qualifying construction and rehabilitation and other requirements. According to the Final Bill Report on E2SHB 1910, 16 Washington cities have imposed the exemption (including Seattle and Kirkland, which have opted to impose additional affordability requirements).

- **Term.** Under the 2007 legislative amendments, a 10-year exemption period is replaced, on an ongoing basis, by either an 8-year or 12-year exemption (which requires inclusion of a minimum affordability component).

#### **B.5. Developer Financing.**

Rather than having the City finance and construct public improvements, an alternative may be to encourage or permit developers to privately finance the improvements for conveyance to the City upon completion. A variation of this approach may be accomplished by having the City participate as a latecomer under a developer latecomer agreement. Another more straightforward approach would be for the City to lease or purchase the completed improvements. The terms of the City lease or purchase agreement may or may not create City debt.

#### **B.6. Utility Financing.**

The City continues to have the option of financing utility system improvements with revenue bonds payable from rates and charges imposed by users of the utility. The City's combined waterworks utility bond ordinance permits issuance of additional bonds to finance improvements to the waterworks utility. Revenue obligations do not consume City debt capacity. Likewise, the City could finance other revenue-producing facilities (such as parking) with revenue debt.