Tax Increment Financing Resurrected

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On May 7, 2001, Governor Locke signed Engrossed Substitute House Bill 1418 (the "TIF Act"). The TIF Act authorizes cities, counties and port districts to create "increment areas," to issue general obligation bonds to finance "public improvements" within the increment area, and to repay such bonds with "tax allocation revenues," among other things. It will become effective on July 22, 2001, and will "sunset" on July 1, 2010. The original tax increment financing statutes (chapter 39.88 RCW) were enacted in 1982. The TIF Act does not amend or repeal chapter 39.88 RCW. It creates a new chapter in Title 39 RCW. This may have been done to distinguish the TIF Act from the earlier attempts to bring tax increment financing to Washington State. The voters rejected attempts in 1973, 1982 and 1985 to amend the Washington Constitution and authorize tax increment financing. The Washington Supreme Court ruled chapter 39.88 RCW unconstitutional in *Spokane v. Leonard* (1995) on the grounds it diverted tax revenue intended to support the common schools.

The TIF Act authorizes cities, counties and port districts to create "increment areas" and use "community revitalization financing" to finance infrastructure and other improvements in such areas. An "increment area" is a geographic area within the boundaries of the sponsoring city, county or port district. In this sense, increment areas are similar to local improvement districts.

Allocation of Tax Revenues

The TIF Act allows the sponsoring government to capture a portion of the *regular* property taxes imposed on property within the increment area by all taxing districts other than: (i) regular property taxes specifically levied by port districts or public utility districts to pay debt service on general indebtedness; and (ii) regular property taxes levied by the State for the support of the common schools.

Excess property taxes, such as those levied to repay voted bonds and those levied by schools, are not subject to allocation under the TIF Act.

The portion of regular property taxes subject to capture by the sponsoring government is equal to: (i) the aggregate levy mill rate[1] of all regular property taxes to be imposed in the increment area (subject to the exceptions for certain port, PUD and State taxes), multiplied by (ii) 75% of any increase in the assessed value of real property in an increment area that is placed on the tax rolls after the increment area is created. These are referred to as "tax allocation revenues." The first distribution of tax allocation revenues occurs in the year after the increment area is created.

County assessors have the responsibility of allocating assessed values for purposes of the TIF Act. County treasurers have the responsibility of distributing regular property taxes collected within an increment area. The sponsoring government's ability to collect tax allocation revenues terminates when tax allocation revenues are no longer necessary or obligated to pay the costs of the public improvements. Other taxing

[1]Editor's Note: Many people express this as "X" dollars per thousand dollars assessed valuation.

districts may require the sponsoring government to be more specific about the period during which tax allocation revenues will be diverted.

For political reasons, the sponsoring government may wish to distribute a portion of the allowable tax allocation revenues to other taxing districts within the increment area. The TIF Act allows for this, so long as bond debt service, bond reserve, and other bond covenant requirements are satisfied. The balance of tax allocation revenues will be allocated to the other taxing districts in proportion to their regular tax levy rates.

Authorized Purposes

Tax allocation revenues can be spent by the sponsoring government only "to finance public improvement costs associated with the public improvements financed in whole or in part by community revitalization financing."

- "Public improvement costs" are defined to mean "the costs of: (a) Design, planning, acquisition, site preparation, construction, reconstruction, rehabilitation, improvement, and installation of public improvements; (b) relocating, maintaining, and operating property pending construction of public improvements; (c) relocating utilities as a result of public improvements; (d) financing public improvements, including interest during construction, legal and other professional services, taxes, insurance, principal and interest costs on general indebtedness issues to finance public improvements, and any necessary reserves for general indebtedness; (3) assessments incurred in revaluing real property for the purpose of determining the tax allocation base value that are in excess of costs incurred by the assessor in accordance with the revaluation plan under chapter 84.41 RCW, and the costs of apportioning the taxes and complying with this chapter and other applicable law; and (f) administrative expenses and feasibility studies reasonably necessary and related to these costs, including related costs that may have been incurred before adoption of the ordinance authorizing the public improvements and the use of community revitalization financing to fund the costs of the public improvements."

- "Public improvements" are defined to mean: "infrastructure improvements" (including street construction *and maintenance*, parking facilities, water and sewer improvements, and others); and "expenditures" for environmental analysis, professional management, planning, promotion within the increment area, management and promotion of retail trade activities in the increment area, maintenance and security for common or public areas in the increment area, and historic preservation activities.

While maintenance, security and promotion expenditures are defined to be "public improvements" for purposes of the TIF Act, such expenditures are not included within the definition of "public improvement costs." This may create a dilemma for those entities that wish to spend tax allocation revenues on maintenance, security and promotion expenditures. If read literally, the only way tax allocation revenue can be used to pay for maintenance, security and promotion within the increment area is if bonds are issued to finance such expenditures.

Creation of Increment Areas

The TIF Act establishes certain conditions that must be met before the sponsoring government can create an increment area. These include:

- the sponsoring government must expect the proposed public improvements will (i) encourage private development and (ii) increase the fair market value of real property within the increment area;

- the anticipated private development must be consistent with the countrywide planning policy, and the local government's comprehensive plan and development regulations, adopted under the Growth Management Act;

- taxing districts that levy at least 75% of the regular property tax within the increment area must approve the community revitalization financing by means of a written agreement;

- fire protection districts have "veto" power over the creation of the increment areas—a fire protection district must approve its participation in the community revitalization financing if it levies a regular property tax within the increment area; and

- the sponsoring government must hold a properly-noticed public hearing on the proposed financing of the public improvement.

Similar to local improvement districts, the period for challenging the creation of an increment area is relatively short. A 30-day statute of limitations commences once notice of creation of the increment area is published.

Conclusion

Community revitalization financing will provide the greatest benefits when it is used in conjunction with the issuance of bonds. Unlike other tax increment laws around the country, the TIF Act does not authorize the issuance of special revenue bonds or other obligations that do not give rise to indebtedness. Rather, it merely provides an additional source of revenue (i.e., a portion of the regular taxes levied by other taxing districts) to apply toward debt service on the sponsoring government's general obligation bonds. The sponsoring government's general fund likely will be at risk to the extent tax allocation revenues are insufficient to meet these debt service obligations. In light of this fact, any entity considering community revitalization financing may wish to consider the following:

- the sponsoring government will receive *no* tax allocation revenues if the assessed value of the increment area declines below its original amount;

- the sponsoring government will receive no tax allocation revenues if a court determines the TIF Act is unconstitutional;

- because significant increases in assessed value of property must occur in the increment area before tax allocation revenues will be sufficient to finance meaningful improvements, community revitalization financing favors projects involving undeveloped and under-developed property;

- general obligation bonds issued to assist in community revitalization financing will count against the sponsoring government's constitutional and statutory debt limits; and

- in light of the fact the TIF Act expires in 2010 (including the statutes requiring county assessors and county treasurers to allocate assessed value and distribute tax allocation revenues), there is no guarantee tax allocation revenues will be available to meet debt service obligations beyond July 2010.

Nevertheless, we believe the TIF Act provides cities, counties and ports with a new – and potentially powerful – economic development tool.