Evaluation of Fiscal Implications of Growth Management Options in Skagit County, Washington

Prepared for Skagit County, Washington

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Preface

ECONorthwest completed this project under contract with Skagit County Washington. Terry Moore was project director. Lorelei Juntunen was project manager. Tom Soulhas and Whit Perkins provided research assistance. Skagit County's purpose in commissioning this study was to better understand the fiscal impacts of various growth patterns that it is considering.

This project has been funded wholly or in part by the United States Environmental Protection Agency under assistance agreement PO-00J08201 to Skagit County. The contents of this document do not necessarily reflect the views and policies of the Environmental Protection Agency, nor does mention of trade names or commercial products constitute endorsement or recommendation for use.

ECONorthwest gratefully acknowledges the substantial assistance provided by staff at Skagit County and the jurisdictions within it. Many other firms, agencies, and staff contributed to other research that this report relied on. Throughout the report we have identified our sources of information and assumptions used in the analysis. Within the limitations imposed by uncertainty and the project budget, ECO and Skagit County have made every effort to check the reasonableness of the data and assumptions and to test the sensitivity of the results of our analysis to changes in key assumptions. ECO and Skagit County acknowledge that any forecast of the future is uncertain. The fact that we evaluate assumptions as reasonable does not guarantee that those assumptions will prevail.

We have also described our analytic techniques and their limitations. Skagit County and the jurisdictions within it have reviewed our analysis for reasonableness and provided comment. As time passes the results in this report should not be used without correcting for changes in the market and other variables.

We have prepared this report based on our general knowledge of fiscal and growth management policy analysis, and information derived from government agencies, private statistical services, the reports of others, interviews of individuals, or other sources believed to be reliable. ECONorthwest has not verified the accuracy of such information, however, and makes no representation regarding its accuracy or completeness. Any statements nonfactual in nature constitute the authors' current opinions, which may change as more information becomes available.

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Section 1 Summary

Skagit County is evaluating possible patterns and policies for projected population and employment growth, using a land use model called *Envision*. The evaluation is considering the impacts to sensitive lands, vehicle-miles traveled, water quality, and a host of other factors that could be affected as a result of the County's population growth. The project has used the *Envision* model to develop four alternative futures (also called *growth scenarios*) that might result from various policy choices. Those scenarios are:

- **Plan trend.** A continuation of recent growth trends, with most of the County's growth occurring inside of urban growth areas (UGAs) and with lower-density growth on County lands.
- **Ecosystem.** Development with an emphasis on ecosystem outcomes and protection of sensitive lands.
- **Ag-forest.** Emphasis on protection of lands managed for resource extraction and agriculture, and directing growth away from these lands.
- **Development.** Growth occurs in a more dispersed pattern, with less policy constraint. In particular, some of the urban population is shifted from cities and towns to several smaller "urban villages."

Each scenario assumes the same amount and rate of population growth, but changes the location and density of the growth based on the policy objective implied by the theme of the scenario.

As part of its evaluation, the County wants to understand the fiscal implications of each scenario, and how policy choice might affect the costs and revenues that accrue to the County and its partners as growth occurs. The County has asked ECONorthwest (ECO), a consulting firm in planning and finance, to assist with the fiscal analysis of the County's evaluation of alternative futures. This document is ECO's report on its analysis and findings.

Although the intent of the analysis was to describe the impact of the growth scenarios upon the fiscal situation, ECO found that the implications of the scenarios upon the fiscal situation were relatively small, and that the issues that will matter most to the future fiscal health of the County and its municipalities change only slightly with changes in density. This was true for a variety of reasons:

- **The scenarios were fairly similar.** A main driver of fiscal impacts, both positive and negative, is population. In each of the four

scenarios, the total population of Skagit County remained the same; the only difference was the location of the growth. For most services, and within a reasonable geography, the level of services a population demands will remain similar, regardless of how the population is distributed. The exceptions are those that are physically geographic in nature, such as roads, sewers, and water infrastructure, and those that require movement over distance, police and fire services.

- **Many of the scenario-based capital costs are covered by revenue sources that scale appropriately.** The costs that rely the most on growth scenarios are infrastructure capital and maintenance costs. Municipal and county staff expressed that these costs have traditionally been covered sufficiently by impact fees and the other designated sources, but our research suggests that this may not be the case in the future.
- **Potential funding shortfalls in personnel and operating costs would occur regardless of scenario.** The costs expected to grow the most rapidly are generally personnel-based. With the exception of police and fire, the demand for government personnel will not change in accordance with the location of the new population. More staffing is not required in areas like city or town councils, planning, libraries, and municipal courts because the city or town has a lower density.
- **In all scenarios, the state-wide 1% cap on property taxes leads to greater pressure on sales tax and other revenue sources to cover increased costs.** Municipal competition for commercial uses that generate sales tax, as well as pressure on utility and other fees, will increase as the property tax limitations begin to pinch municipal and County revenue resources. This situation limits total resources in the future in all scenarios. Different scenarios change the flow of the revenue (to County or to municipalities) at the margins, but no change in growth pattern can overcome the overall shortfall associated with this statewide policy.

In short, taxation policy and external economic factors will have a greater impact on fiscal issues than the range of growth management policies considered through the *Envision* analysis, and those impacts are not likely to be favorable. Many in Washington have suggested that state-wide tax reform will be necessary to overcome some of these challenges.

However, we did find some small differences among the scenarios that the County and its municipalities should consider when setting growth management policy. In general, our findings support a conclusion that, from a fiscal perspective, and especially in the longer-run, higher density

development with a more diverse mix of uses is more fiscally advantageous than lower-density development patterns for the municipalities inside of Skagit County. To a certain extent, all of the four scenarios will increase density. The "ecosystem" scenario has the highest residential density.

Of the four scenarios, the "development" scenario appears to be the least beneficial from a fiscal perspective. This scenario requires the County to fund services and infrastructure, without the benefit of a tax structure designed for the provision of urban-level services. It also reduces the amount of growth that occurs in more cost-efficient locations (i.e., where much of the infrastructure already exists inside of municipal boundaries), and reduces the number of households and businesses from which the municipalities can capture revenues.

More specifically:

- Higher-density development appears to lead to cost savings in the long run, based on a review of state and national literature, as local governments achieve greater economies of scale and development occurs in locations with the infrastructure in place to support it. It will typically be less costly to provide infrastructure in locations where the existing infrastructure has been planned with additional capacity to support future growth, and in locations that are physically closer together. The reason is simple: fewer miles of road, feet of pipe, and pump stations must be funded. Higher-density development can also lead to greater revenue generation potential for local governments from both sales tax and property taxes when measured per-acre as a municipal-wide average.[1]
- The *Envision* model projects a decreased proportion of commercial property relative to population. If this projection is true, it suggests that, in the future, revenue streams may be more stable and predictable, because they will have decreased reliance on volatile sales tax as a source along with a corresponding increase in reliance on more stable property taxes. But this decreased reliance on sales tax means: (1) more competition among municipalities for regionally-serving retail; and (2) more pressure on other revenues streams, such as fees and surcharges, as the 1% property tax cap limits the ability of property taxes to scale to accommodate future growth.
- The fiscal implications for the County government are less clear. The County provides some services (such as some social services) equally to all County residents, whether they are inside a municipal urban

[1] The statewide limitations and other property tax related statutes limit this effect somewhat, as described in more detail in the remainder of this report.

growth area or not. Other services (such as road maintenance) vary, and costs to the County for those services are higher for areas outside of a municipality. The County receives a greater portion of the total sales tax and property tax revenue for properties located outside of municipal boundaries.

- In most scenarios, there may be market-based challenges to achieving the density that *Envision* projects. Higher-density developments are often more costly for the private sector to develop, and in communities where this type of development are not common, the first few buildings can be challenging. Some public-sector support of location-efficient higher-density projects may be warranted in the short-run to achieve longer-term fiscal benefits.
- We see strong motivation in the results of this analysis for municipalities to attract and retain regionally-serving retail inside of municipal boundaries, as the 1% property tax cap results in increasing demand for sales tax revenues to support population growth. However, in the long-run, this strategy will not be sustainable, as there are limits to the amount of regionally-serving retail that can be supported in the Skagit County market. The report recommends revenue sharing to more equitably distribute the benefits of sales tax revenue. Revenue sharing should be structured such that the costs of regionally-serving retail (i.e., additional police force, costs to the transportation system, etc.) are accounted for and only the *net* revenue is shared.

In Skagit County, as in all communities, growth management decisions must account for many considerations, ranging from preservation of open space and resource lands to support of residential units that can house a diversity of income ranges. Fiscal considerations are just one of these considerations, but an increasingly important one for most local governments. The challenge for the County and its municipalities, now and in the future as it grows, will be to achieve a balance among its multiple objectives and enact policies that support the development of complete and healthy communities. From a fiscal perspective, this means encouraging development in locations that take the greatest advantage of existing capacity, and pro-actively seeking solutions to likely future fiscal constraints associated with State policies that limit property tax revenues.

Section 2 Introduction

Skagit County is evaluating possible patterns and policies for projected population and employment growth. That evaluation is occurring in a project looking at *alternative futures*, and using a land use model called *Envision*. The evaluation considers the impacts to sensitive lands, vehicle-miles traveled, water quality, and a host of other factors that could be affected as a result of the County's population growth. The project has developed four alternative futures (also called *growth scenarios*) that might result from various policy choices. Those scenarios are:

- **Plan trend.** A continuation of recent growth trends, with most of the County's growth occurring inside of urban growth areas (UGAs) and with lower-density growth on County lands.
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Each scenario assumes the same amount and rate of population growth, but changes the location and density of the growth based on the policy objective implied by the theme of the scenario.

As part of its evaluation, the County wants to understand the fiscal implications of each scenario, and how policy choice might affect the costs and revenues that accrue to the County and its partners as growth occurs. This type of analysis is typically called a *fiscal impact analysis*. The County has asked ECONorthwest (ECO), a consulting firm in planning and finance, to assist with the fiscal analysis of the County's evaluation of alternative futures. This document is ECO's report on its analysis and findings.

A full cost or fiscal analysis would require detailed engineering, economic, and fiscal work, by jurisdiction, and is beyond the scope of ECO's contract and the needs of the County given its current stage of planning. Given the budget and the Envision project objectives, the County and ECO agreed that ECO's product should provide (1) an economically sound and clear framework for thinking about the issues of development cost and fiscal impacts, (2) an evaluation of the current and possible future fiscal situations in the County and its municipalities given the growth scenarios that the *Envision* model has projected, and (3) answers to some

questions about fiscal issues that are typical in long-run planning exercises like the one the County is engaged in.

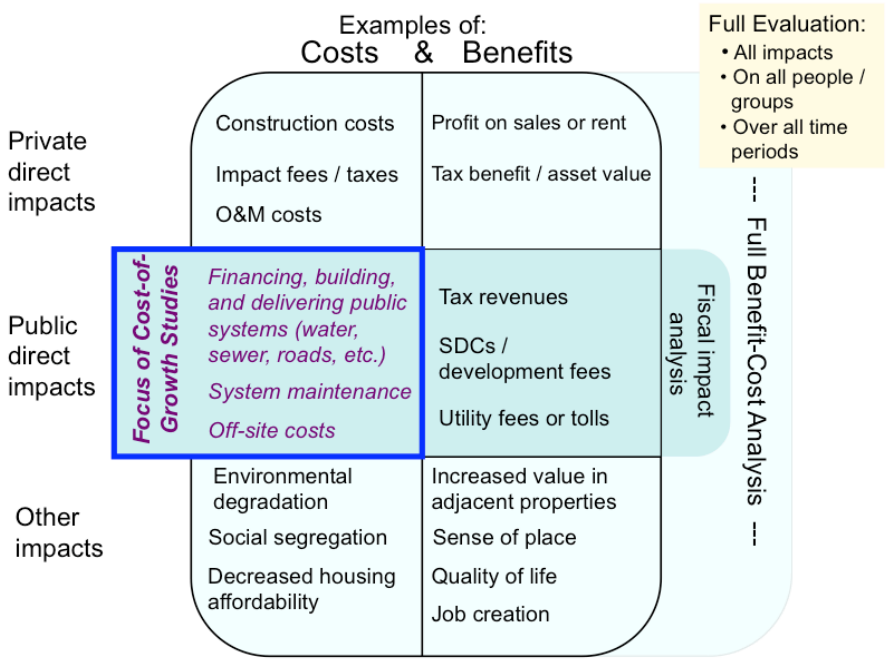
The rest of this report has these sections:

- **Section 3, Framework** provides a general overview of the kinds of questions answered with fiscal impact analyses, the limitations on the ability of such analyses to answer those questions, and the methods of fiscal analysis consistent with the framework and appropriate for the type and level of analysis the County desires in this project.
- **Section 4, Skagit County and Municipal Finance: Baseline Analysis** provides an overview of the major revenue sources and expenditures for the County and the municipalities within it, highlighting common fiscal challenges that all municipalities will face in the future.
- **Section 5, Fiscal Implications of Density** identifies and describes some of the fiscal issues associated with increasing urban density in the County, as all of the future growth scenarios increase urban density to a certain extent.
- **Section 6, Key Findings and Implications** summarizes the findings from the sections above, and ties them to the four growth scenarios projected through the *Envision* model.
- **Appendix 1: Details for operating cost increases.**

Section 3 Framework

A clear discussion of fiscal impact analysis must start with a description of what it is and is not. That description should address where fiscal impact analysis fits into the context of a theoretical, all-encompassing evaluation of the benefits and costs of public action. Exhibit 1 provides that context.

Exhibit 1. Fiscal impact analysis in the context of a theoretical, evaluation of the benefits and costs of public action



Source: Juntunen, Moore, Jan-Knapp (2011) Fiscal Impacts of Land Use Types, Urban Public Finance and Governance, Oxford Press, forthcoming 2011.

Exhibit 1 has two columns of impacts: one shows examples of costs, the other examples of benefits. It shows three categories of positive and negative impacts (i.e., of benefits and costs): private, public, and other. The full matrix of six boxes is what economists would refer to as a full *benefit-cost analysis*: it includes, *in theory*, all benefits and costs, public and private, internal and external, monetizable and non-monetizable, quantifiable and qualitative. In concept, it includes everything. The yellow box in the top right corner emphasizes that point: a full evaluation would look at all types of impacts, on all people, over a long time period.[2] In principle, such a full evaluation is what an "alternative futures" project like the one Skagit

[2] In concept, a full analysis looks at those costs over a long time period (not just current costs, but future costs), and fairly incorporates those future costs and benefits into the analysis by bringing them back to a present value at an appropriate discount rate.

County is conducting aspires to. In practice, budgets and schedules always result in analyses that focus on a subset of full benefits and costs.

The middle two boxes show the subset of benefits and costs that is the focus of the literature of fiscal impact analyses: *direct* impacts on *revenues and expenditures* in the *public-sector*. "Revenues" are a subset of "benefits" and "expenditures" are a subset of "costs."[3]

Fiscal impact analysis is typically used in one of two ways:

- To determine the fiscal impacts of a site-specific development. For example, does a new residential development increase the demand for and costs of providing schools, parks, roads, and other public goods more or less than it increases revenues in taxes and fees?
- To evaluate the cost of alternative development patterns. For example, are compact or sprawling developments more likely to pay for themselves?

Skagit County hopes to use fiscal impact analysis for the second purpose. In concept, the County would like the analysis to be able to (1) say that different types, patterns, and locations of development (growth alternatives) have different public-facility and public-service costs, and generate different amounts of revenue to pay for those services, and (2) use that information, in combination with other information about the impacts of those growth alternatives, to inform the selection of a preferred alternative and the public policies that would support its achievement.

Such an analysis is constrained, however, by some practical considerations. Fiscal impact was originally intended to get at the effects of a relatively small development on strictly fiscal concerns over a relatively short period (one to five years). Analysts have tried to expand its applications in all directions ever since. The Skagit County project is typical of the expanded application: not site-based, but regional; not five years, but 50 years; not one project, but every development in the region over a 50-year period. Every expansion of geography and time adds uncertainty (about the type, location, amount, and infrastructure requirements and costs of development, and about local policies relating to how that development will be financed), and simultaneously reduces the likelihood of the "all else being equal" assumption that is critical to the analysis.

[3] We try to use the term *cost* when we mean the full costs (internal and external, whether monetizable or quantifiable or not) of some action, and *expenditure* when we mean the direct, monetizable cost that a public entity incurs to support its actions (which means it is a budget item). That distinction gets fuzzy in some of the literature on "the *costs* of growth," which sometimes address the broader idea of costs and sometimes the narrower idea of public expenditures (i.e., fiscal impacts).

Even if the uncertainty is reduced by examining fiscal impacts for five years instead of 50, modeling all development requires a lot of detail. For example, it is not enough to model just "housing units" or even to disaggregate them further into "single-family" and "multi-family" units. Multifamily units may be apartments or condominiums, and though they might look similar they have different ownership characteristics and different prices that mean they will be occupied by households with different demographic and socioeconomic characteristics, and different demands on and ability to pay for public facilities and services. In short, there are too many dimensions of growth to allow any analysis to come to unambiguous quantitative conclusions about the fiscal impacts of growth, much less its full benefits and costs.

That is not to say that fiscal analysis cannot inform better decision-making: it can, and this report (we hope) will. But if it is to be effective it must start with an awareness of (1) the inherent limitations of theory, technique, and data; and (2) the process into which the results of the analysis will be incorporated. In other words, the analysis must be clear about its perspective and the assumptions on which it is based. Here are some key assumptions and principles on which we build our methods and analysis.

- In concept, the County would like to evaluate all the impacts (all types, all subareas, short run and long run) of alternative growth (development) patterns. In the context of this project, that kind of *full evaluation* is being approximated by (1) using a growth scenario model developed by OSU, and (2) adding supplementary analyses for other impacts.

- A fiscal impact analysis is usually conducted from the perspective of a public agency or local government. From that perspective it is the costs to the local government, not the total costs that matter. If developers and property owners pay fees and taxes that support public facilities, the fiscal problems for local governments are smaller than they would be otherwise. If a local government has policies that result in developers building and dedicating high-quality facilities as a condition of development, then "higher cost" development patterns are less of a problem and may be a benefit (because, for example, higher-cost facilities deliver higher-quality and more reliable service).

- Among the costs that a fiscal impact analysis might address are *direct facility and operating expenditures* of alternative development patterns. These costs are a subset of the total costs of alternative development patterns: they would include the direct costs of building and

maintaining roads, but would not include the costs of congestion, crashes, the owner costs of operating and maintaining vehicles, the social costs of emissions of pollutants and greenhouse gases, and other externalities that might differ under alternative development patterns and road designs. Thus, there is much more to a choice about a desired future and policies to support it than simply choosing the future that suggests the greatest excess of public revenues over public costs.

- Even when used correctly to answer narrow questions about fiscal effects on facility and service providers, fiscal impact analysis must contend with many of the theoretical and practical problems that limit conclusions one can draw from it. There are too many dimensions of growth to allow any analysis to come to unambiguous quantitative conclusions about the fiscal impacts of growth, much less its full benefits and costs.

In summary: there are many variables that the County and its municipal partners must weigh when evaluating and selecting a set of policies that will guide future growth patterns. Fiscal impacts are certainly on that list of considerations, but fiscal results should be carefully weighed in the context of their limitations, and carefully along with all other variables that will affect the long-run quality of life in Skagit County.

3.1 METHODS

As economists, we begin measuring fiscal impacts by considering a demand side and a supply side. Where does the demand for public facilities and services come from? In broad terms, from five "P's": people (the number of households and workers), preferences (what they like and want to buy), purchase power (the income and wealth they have that gives them the ability to pay for what they want), price (of both public services and substitutes, which constrains the ability of purchasers to buy all the things they want, given their purchase power), and policy (which can affect all the previous variables but most commonly affects price). On the supply side (the cost side), costs of facilities and services are affected by international, national, and local economic conditions (e.g., increasing real costs of steel, concrete, fuel, and in some cases labor); technology; and federal, state, and local requirements. The interaction demand and supply factors in functioning markets (we consider the market for public facilities and services a more or less functioning market) leads to market-clearing price.

Exhibit 2 describes some of the supply and demand characteristics that we might measure in a long-run, hypothetical fiscal analysis like the one

Skagit County needs. These characteristics have implications both for public sector costs associated with service provision, and for the tax and other revenue streams that help to support those costs.

Exhibit 2. Quantifiable supply and demand characteristics to evaluate in a fiscal impact analysis, and data availability in *Envision* model, Skagit County Washington, 2011

Variable	Description	Measured in *Envision* Model?
Growth in the number of people requiring services	Even if all other factors were unchanged (e.g., the level and quality of service, the cost of service) population and employment growth will mean that more facilities and services will be needed, and total costs and revenues will increase.	**Yes.** All scenarios project the same population growth, but distribute it differently among the municipalities and unincorporated areas.
Changes in preferences and demand by user groups	Consumer preferences correlate with household demographic and socioeconomic characteristics. Growth in certain categories (e.g., households that are elderly, have school-age children, etc), will disproportionately affect the demand for different types of facilities and services (senior services, schools). This affects the mix of services, the level of service, or both, which affects the cost of service.	**No.**
Changes in unit costs	Costs of facilities and services are affected by international, national, and local economic conditions; technology; and federal, state, and local requirements. Even if the mix and quality of service does not change, the unit cost of providing those services may change because of these factors.	**No.**
Capacity and health of current facilities and programs	Consider two different sewage treatment plants: one that is state-of-the-art, well maintained, and has substantial excess capacity; and one that is obsolescent and at capacity. Growth is going to cost more in the second case than in the first.	**No.**
Changes in the location and type of development	The location, type, and density of development affect the costs of public facilities and services. In addition, those costs can be affected by site issues (building on steep slopes has greater infrastructure costs per unit than building on flat land).	**Yes:** changes in location. **No:** changes in type.

Variable	Description	Measured in *Envision* Model?
Changes in financial policy	Most directly, the public sector has the ability to change what it charges for facilities and services Many jurisdiction have net revenue problems because they have never charged users the full cost of service: they have subsidized those costs with federal or state grants, or with general fund revenues from property taxes. Policy also affects costs when the federal or state government changes service standards that it requires local governments to implement.	**No.**
Changes in spending power / habits	Both the amount and location of spending affect revenues to the municipalities. People that are able to (and choose to) buy more expensive housing pay more property tax. The amount and location of retail spending affects sales tax revenues.	**No.**

Exhibit 2 is not meant as a criticism of the *Envision* model: the model was not built to determine fiscal impacts, but rather to project the location of future development given the constraints of possible policy choices that the County and its municipalities might choose to implement. The main point of the table is that the future it describes does not provide sufficient detail to conduct the analysis required for this report.

ECO therefore supplemented the analysis with:

- A detailed review of current and recent past budget documents from the municipalities and Skagit County, to better understand the current and recent-past fiscal profile of the Skagit County community
- A review of relevant State and local policies regarding taxation
- A series of interviews with budget and finance directors in the County, as well as with major utility providers

Through these supplemental evaluations, ECO was able to gather and evaluate additional information to better contextualize the possible fiscal effects of the various growth patterns suggested in the *Envision* model. The results presented in this report use all data available from the model, budget and policy documents, and interviews to:

(1) Identify the probable fiscal challenges associated with the growth that the model projects in each scenario

(2) Draw some qualitative and (when possible) quantitative conclusions about the fiscal effects that might result for the County and the municipalities in each scenario

(3) Suggest some possible measures that the County might consider to address those possible effects

All municipalities and the County were given an opportunity to review and comment on this report in draft form. While Skagit County funded this analysis, their influence over its findings and conclusions was no greater than that of the other participating municipalities.

3.2 LIMITATIONS

Many of the limitations of this analysis are described earlier in this section. To summarize:

- Fiscal impact analysis is most effective for shorter-run, site-specific evaluation. While it can be used for evaluations such as this one, results must be considered to be order-of-magnitude rather than exact, and qualitative (but informed by mathematic evaluation) rather than quantitative.

- The *Envision* model does not project many of the variables that matter for evaluating public sector costs and revenues. This analysis has not evaluated the results of the model, and implicitly assumes that the results accurately reflect growth patterns (including population and employment projections) in the County.

- In this report, we focus on **local government revenues and expenses**. Different growth scenarios will have fiscal implications for school districts and utilities, as well as for the State of Washington. However, the local governments have the most control over their own budgets, and in this research, were interested in better understanding the implications of growth scenarios to their own budgets.

- The costs of facilities and operations (1) depend on local standards and conditions, and (2) are typically estimated by engineers, not planners or economists. ECO's role is not to estimate those costs, but to discuss how those costs might vary given the growth scenarios that the *Envision* model projects.

- ECO's work does not try to create inputs for the growth-alternative model. For example, the fiscal analysis will not attempt to estimate fiscal deficits or surpluses so that those estimates can be used to change forecasts of the amount or type of development.

- Changes in policy around taxation have the potential to change the fiscal profile for local governments in ways that may have greater long-run effects than any possible growth policy. The State of Washington's one percent cap on growth in assessed value (described in more detail later in this report) is an example. This analysis does not attempt to predict changes in policy that may or may not occur in the future.

Section 4 Skagit County and Municipal Finance: Baseline Analysis

Each local government in Skagit County has a different *fiscal profile*, or combination of revenues, costs, and policies related to covering the costs associated with growth. Because each is starting in a slightly different position and has a different set of resources available with which to address the costs associated with growth, each will absorb the projected population with different fiscal impacts. This section provides an overview of the current fiscal profile of the County and the jurisdictions within it, as a necessary precursor to understanding the implications of the *Envision* growth scenarios that are analyzed later in this report. It describes the baseline issues and trends that the County and its municipalities must address from a fiscal perspective.

This section has the following subsections:

- **Overview: major revenue sources and expenditures** describes the revenue sources that are available to all local governments in the County and are most important to the analysis of the fiscal impacts of growth.
- **Fiscal snapshot** shows the differences among the jurisdictions in terms of the distribution of revenues.
- **Common challenges** describes the fiscal challenges that are likely to affect all Skagit County local governments, regardless of their future development patterns.
- **Summary: baseline issues and challenges** highlight the key findings from this baseline analysis, and begins to tie them to discussion of the Envision scenarios.

4.1 Overview: Major Revenue Sources and Expenditures

Local governments must apply their tax and fee revenues to infrastructure and service provision for existing and future residents. Utilities are important partners in covering those costs, and they have their own set of revenue sources, and project their revenues to cover expected costs. Developers / private sector are also partners, and they provide revenues to cover costs of new development. In this report, we focus on **local government revenues and expenses**.

4.1.1 REVENUES

The four most important revenue sources for Skagit County and its municipalities[4] are service charges, sales taxes, property taxes, and developer impact fees[5] [6]. This analysis will focus primarily on sales taxes and property taxes. Municipalities can (and, we learned in interviews, typically do) adjust rates and fees within the County to match the costs associated with the services in question.[7]

The dynamics of the remaining revenue sources are described below:

- **Sales tax.** The total sales tax rate in most of Skagit County is 8.2%. After the State of Washington and local emergency communications and transit districts receive their 7% share, Skagit County and its municipalities split the remaining 1.2% on every taxable purchase. Outside of incorporated cities and towns, the County receives the entire 1.2% - 1% for the general fund and 0.1% each for mental health and criminal justice services. For all sales within a city, the city receives 0.85% of the County general fund's 1%. All changes to sales tax rates must be voter-approved.
- **Property taxes.** Skagit County and its municipalities have separate, unrelated property tax rates. Property anywhere within the County pays $1.4592 per $1,000 in taxable value to Skagit County. The County also collects a County Road tax on properties outside of city limits at a rate of $1.57 per $1,000 of taxable value. If a property is located in an incorporated city or town, the owner pays an additional amount determined by the municipalities. For cities and towns in Skagit County, this amount usually ranges from $1.70 to $2.50, and may be increased with bonds or additional levies. In total, property owners pay from $11 to $15 per $1,000 assessed value to jurisdictions ranging from local parks districts to the State general fund.

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[4] Note that Skagit County has both towns and cities within it. In this report, we have tried to refer to them generically as "municipalities" or "cities and towns".

[5] Municipalities and other districts in Skagit County can assess impact fees to developers in order to recover the costs incurred providing facilities necessary to serve the new development. Each set of impact fees is collected from all development within the jurisdiction assessing them. The Skagit County jurisdictions currently assessing impact fees are Anacortes (fire, transportation, and parks); Burlington (fire, parks, transportation, and schools); Mount Vernon (fire, parks, transportation, and schools); Sedro-Woolley (parks, fire, transportation and schools.); and Skagit County (parks only).

[6] There are, of course, other revenue sources, ranging from a real estate excise tax to intergovernmental transfers. The four sources listed here are the largest categories.

[7] The County only assesses park impact fees on development in unincorporated Skagit County but it collects impact fees on behalf of school districts and one city (Mount Vernon) for development within the unincorporated urban growth areas.

Exhibit 3 summarizes implications to property taxes, sales taxes, and impact fees depending on where a property is located.

Exhibit 3. Property location implications on revenue sources, Skagit County, Washington

	If property is outside of city limits	If property is inside city limits
Property tax	$1.46 per $1,000 AV to County $1.57 per $1,000 AV for County Road Tax **A $250,000 house would pay $758 in taxes to Skagit County**	• $1.70 - $2.50 per $1,000 AV to city • $1.46 per $1000 AV to County **A $250,000 house would pay $365 in taxes to Skagit County, plus between $425 and $625 to its city or town, for a total of between $790 and $990.**
Sales tax	1.2% to Skagit County*	• 0.35% to Skagit County* • 0.85% to city or town

*Note: 0.2% of all sales taxes for Skagit County are designated to mental health and criminal justice services. The remainder goes to the County general fund: 1.0% outside municipalities and 0.15% within municipalities.

**Note: Tax revenue collected by the County for Fire Districts in unincorporated areas is not included because the County merely collects taxes on behalf of the Districts and does not administer the service.

4.1.2 EXPENDITURES

Exhibit 4 shows expenditures for Skagit County's main programs and services according to its 2009 Budget Book. The largest expenditure category (27% of total) was for general government, which covers basic functions like property appraisal, tax collection, elections, and other general administration. Public safety (16% of total) includes law enforcement, jails, emergency aid, fire prevention, and probation and parole services. With a few exceptions, services are provided County-wide, both inside and outside of the urban growth areas of the cities and towns in the County.

Exhibit 4. Skagit County expenditures on programs and services, 2009

Program/Service	Expenditures (millions)	Percent of total
General government	$45	27%
Public safety	$26	16%
Capital expenses	$24	15%
Transportation	$23	14%
Physical environment	$15	9%
Health and human services	$13	8%
Economic environment	$8	5%
Interfund transfers	$7	4%
Culture and recreation	$3	2%
Principal and interest	$1	1%
Total	**$165**	**100%**

Source: Skagit County 2009 Budget Book

Skagit County's expenditures are divided into General Fund Departments and Other Funds.

- General Fund Departments are the smaller group, totaling about $49.4 million in expenditures in the 2009 budget, $31.4 million of which (64%) were classified as salaries and benefits. These departments are mostly personnel-intensive.
- Other Funds' expenditures totaled $115.5 million in 2009, $26.7 million of which (23%) were classified as salaries and benefits. The largest cost category was Other Services with $40.8 million, or 35% of all expenditures. Behind salaries, capital costs were the third-largest expense with $17.5 million, or 15% of all expenditures.

Towns and cities provide additional services to residents that live inside of their corporate limits. Expenditures categories vary widely for these municipalities within the County. The major operating cost categories for municipalities include police, fire, streets, parks, libraries, and essential city or town personnel such as mayor, council, municipal court, attorney, human resources, planning, and more. On top of these operating costs, capital costs exist as both capital outlays and, if necessary, debt service in the form of bond payments.

4.1.3 INSIDE OR OUTSIDE OF MUNICIPALITIES?

As is clear in the overview above, the costs and revenues associated with development are different depending on the location of that development. If the County and its municipalities were interested in creating a growth management policy that maximized revenues and minimized costs, where would they each try to encourage development to locate? Clearly this goal would never be the only goal of a local

government, which cares about many factors (environmental impacts, economic development opportunities, quality and mix of development, equity, etc.) that go beyond fiscal impacts. Further, Statewide growth management policy guides decisions about where and how new development should happen in Washington State. But fiscal considerations are increasingly critical to local governments everywhere. If fiscal priorities were the only goal of the County and the governments within it, what would the growth management policy look like?

If the County were interested only in improving its ratio of costs to benefits:

- The County gets $1.46 for every $1,000 dollars of assessed value no matter where it locates (in unincorporated areas or inside of city or town corporate limits).
- The County gets 0.85% more in sales tax for commercial development that is located outside of a municipality.
- The County provides roughly the same set of services to all residents regardless of where they locate. However, because it does not currently impose a developer impact fee to offset the costs of new infrastructure for new development (other than for parks), it must build and maintain that infrastructure either with its own resources, or through relationships with overlapping utilities. Roads, however, have a separate funding stream in the County.
- Therefore, if the County is interested in maximizing revenues, it will generally prefer residential development to locate *inside* of municipal limits, where it does not pay for supporting infrastructure, but will want to encourage commercial and retail enterprises to locate *outside* of UGAs and in unincorporated Skagit County (ideally on roadways with sufficient existing capacity) to capture the additional revenues from sales tax.

If the municipalities were interested only in improving their ratio of costs to benefits, the story appears to be much more straightforward. These local governments receive impact fees, property taxes, and sales tax revenues for all development within their corporate limits, but no revenues for development outside of the city limits. They have to provide services to all of those people and businesses, but the County provides many of the key social services, and development-related capital costs are at least partially offset by impact fees. Cities and towns would be motivated to encourage as much growth of all types to locate inside their boundaries as possible.

The key assumption that underlies these motivating factors, though, is that **each new resident or business generates tax revenues and fees that are at least equal to the costs that it imposes to the overall system**. As the rest of this report will show, even if that is the case for a particular jurisdiction now, it may not be in the future. The future ratio of costs to revenues is likely to be dependent on state taxation policy, the mix of residential and commercial businesses in the jurisdiction as a whole, and other factors that are extremely difficult for local governments to control or predict. In short: the motivations may be less obvious than the logic train above makes them appear, especially over the long-run.

4.2 MUNICIPAL FISCAL SNAPSHOT

To begin to evaluate the per-person revenues, and therefore evaluate the impacts of adding residents and development, this section provides a more detailed look at the fiscal situation of each of the communities in the County. Exhibit 5 shows annual per-resident revenues for Skagit County and its four major cities. These figures are an annual average for the past few years given the available budget data.

Exhibit 5. Per person annual revenues by source, Skagit County and its major cities

	Major annual revenue sources	
Municipality	**Rev/person from sales tax***	**Rev/person from property tax***
Skagit County	$69	$162
Anacortes	$190	$252
Burlington	$771	$277
Mount Vernon	$171	$214
Sedro-Woolley	$106	$169

Source: County and City budget documents, U.S. Census population estimates
*Average per year, for as many years as budget data allowed
Note #1: Skagit County "per person" assumptions are for the entire County, rather than population in the unincorporated area, as the County collects revenues County-wide.
Note #2: Finance directors of each municipality reviewed this table and provided data.
Note #3: Burlington City Finance Director notes that recent sales tax receipts have been much lower, and are currently closer to $713 per person.

Findings associated with Exhibit 5 above:

- **Burlington** is the major retail center in Skagit County, and receives by far the most sales tax revenues per resident. The large retail corridor adjacent to Interstate 5 attracts shopping dollars from across

Skagit County, as well as from outside the County. City staff reported shoppers from as far away as British Columbia.

The large retail presence means that the City's daytime population swells from about 9,000 to as many as 60,000, which creates the necessity for additional city services, such as police, in addition to creating impacts on the transportation system and congestion.

- **Mount Vernon**, the largest municipality in Skagit County, has sales tax and property tax revenues that are close to the same on a per person basis. The City has the capability (as do all cities and towns in Washington) to increase property taxes to the existing base by 1% per year, but has not chosen to do so for eight straight years, from 2005 to 2010.
- **Sedro-Woolley**, of the four major municipalities in Skagit County, has the lowest per-person revenues. Per person sales tax revenues are the lowest of the major cities, and per person property taxes are low despite having higher levy rates than Anacortes and Burlington. Despite the rising costs of governance, Sedro-Woolley declined the optional increase in property taxes for the third year in a row for the 2011 budget because of the financial climate of the community.
- **Anacortes** collects nearly the same revenue per person for property tax as Burlington (the highest of the four municipalities), and also collects the second highest revenue per person for sales tax.

4.3 COMMON CHALLENGES: OPERATING COSTS AND REVENUE RESTRICTIONS

In Sections 4.1, we described the increase in operating costs among municipalities in Skagit County. This rise in operating costs is not a challenge in and of itself. Rising costs become challenging, however, when they are not accompanied by sufficient accompanying increases in revenues.

In this section, we more specifically describe the factors that are causing increases in operating costs. We also describe how major revenue sources – property and sales tax – may prove insufficient in covering municipality costs. Maintaining and increasing the collections of property taxes and sales tax represent the largest challenges municipalities face when addressing future growth. Certain policies can induce development (to drive property taxes) and retail growth (to drive sales tax), but the laws governing these taxes limit their natural growth and leave municipalities with little control over how much they collect.

4.3.1 INCREASING OPERATING COSTS

Personnel costs incurred by local governments in Washington increased more rapidly than population, FTE, and inflation. This phenomenon has also been experienced by private sector employers, and is driven by national economic forces.

Personnel costs in Washington's local governments grew by 4.7% per year from 2004-2008, while population grew by 1.4% per year during the same period.

Budget data show increases across Skagit County. In Anacortes and in Mount Vernon, for example, personnel expenditures grew 5.4% and 6.3% per year, respectively. Mount Vernon's Firemen's Pension grew at 48.9% per year between 2001 and 2010.

FTE in Washington's local governments grew by 1.7% per year from 2005-2009.

Average annual inflation rate was 2.4% from 2005-2010.

[See Appendix 1 for details.]

Operating costs, more than any other municipal costs, are rising in municipalities across the State of Washington.[8] In particular, for personnel costs (including salaries, wages, benefits, and pension contributions), inflation will probably continue to increase over the 50-year period the *Envision* model projects. In this section, we describe trends in these costs for different municipalities in Skagit County and point out, when possible, how they relate to each other and overall trends in the state and in the economy.

Both public and private sector employers across the country are struggling to keep up with rising personnel costs of wages, pensions, and benefits. Of the jurisdictions that ECO interviewed, Mount Vernon stated that rising personnel costs, now and in the future, were its primary concern regarding expenses. Specifically, public safety (police and fire) costs have climbed to 25% of the total budget and 52% of governmental operating fund budgets for 2012. A study completed in 2009 found that nearly half of the of the Washington municipal officials were less able to meet financial needs in 2008 than they were in 2004.[9] The evidence provided by the *Envision* model suggests that over the next 50 years, virtually every local government will be forced to reexamine operating costs, and specifically, the structure of their personnel costs. Appendix 1 provides a detailed review of operating cost expenditures across Washington State and, as the data are available, in Skagit County.

4.3.2 REVENUE RESTRICTIONS

So far, we have discussed some of the costs municipalities must bear and how these costs likely will increase into the future. Here, we discuss two of the largest revenue sources for municipalities – property taxes and sales taxes - and how laws regulating the flexibility of decision makers to change tax rates likely will create future challenges in balancing budgets.

[8] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

[9] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

Property Tax Limit

Two Washington State statutes limit property tax revenues for taxing districts: 1) The aggregate levy rate of taxing districts may not exceed $5.90 per thousand dollars of assessed value; and 2) the total tax levied on a property cannot exceed 1% of the true and fair market value. If either of these limits is reached, levies are reduced by a process called prorationing (compression). During this process, levies from junior districts are reduced or eliminated until the limits are met; if the limits are still not met, senior districts' rates are reduced. Voter approval is required to raise these limits.

For example, assume a jurisdiction receives $10 million in property taxes in one year. In the next year, the maximum allowable property tax the jurisdiction can levy is one percent higher, or $10.1 million. Jurisdictions calculate their levy rates based on this restriction and based on the assumption that there is no new construction or improvements of existing properties. Jurisdictions may receive more than 101% of the previous year's property tax revenues if there is new development and/or improvements of existing properties within their district boundaries. Over half of the Washington municipal officials interviewed by researchers think Initiative 747 has had a major impact on their budgets, and another third believe it has had a moderate impact.[10]

Property Tax Revenue (2005-2009)

Skagit County general fund increased 7.2% per year.

Municipal general funds increased 6.6% per year.

Total revenues increased 7.2% per year.

Without new, taxable development, property tax revenues are capped at 1% per year.

Many of Skagit County's taxing jurisdictions have lowered their levy rates, relative to historical levels, to comply with this regulation. As a result, these jurisdictions have collected less revenue from property taxes than they would have, had they continued their pre-restriction trends. In 2007, revenues from property taxes for municipalities across the state were about $137 million less than they would have been without Initiative 747.[11] Recently, falling assessed values have actually caused levy rates to rise in order to achieve levy amounts. Overall, taxing jurisdictions in Skagit County have not experienced major constraints from the restriction on property tax collections

Average Sales Tax Revenue

Anacortes's revenue dropped 1.2% per year (2005-2010)

Burlington's revenue dropped 2.4% per year (2005-2010).

Mount Vernon's revenue rose .7% per year (2005-2010).

Revenues from sales tax are volatile and difficult to forecast.

[Details in Appendix 1.]

[10] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

[11] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

because of property taxes collected from new developments and from improvements on existing properties. If, however, in the future, development and improvements decline, these jurisdictions could see their annual increase in property tax revenues decline, and move ever closer to the one percent restriction.

Sales Tax Volatility

Revenue derived from property taxes throughout Washington State has been limited by regulations. Revenue from sales taxes has, so far, proved more or less sufficient for Skagit County and its municipalities to cover the costs that reduced property taxes cannot. Sales taxes are a challenging revenue source in regard to the budget process, however, because they can swing wildly from year to year. Collections are directly tied to consumer spending, which can rise or fall dramatically with the larger economic situation.

Sales taxes can be a powerful revenue source for cities and towns with a strong base of taxable sales. Dense retail development can have positive fiscal impacts to a city or town because they require less in terms of infrastructure and other services when compared to the amount of sales tax they generate. However, a large reliance on sales tax can leave a jurisdiction even more vulnerable to economic downturns than cities or towns with more diverse revenue bases.

An additional area of exposure to revenue risk is in home sales. In Washington, the sale of a new piece of property results in collection of sales tax, and every subsequent sale results in real estate excise tax. An unexpected drop in the real estate market can dramatically slow the purchases of property and leave a jurisdiction unable to fulfill its budget requirements. Further, once a home is built, the city or town must continue to provide services to it indefinitely. Several interviewees commented that the one-time bump in revenues from sales tax is not sufficient to overcome the cap on revenues for that property, and that this tension has become much more evident in the current declining real estate market where fewer transactions occur.

Revenues from sales taxes differ from revenues from property taxes in that they are more difficult to project and plan for. While changes in the value of homes and the rate of new development may follow trends in historical data, changes in general commerce may not. The mobility of commerce makes it difficult to pin down to a specific municipality. If, for example, a large retailer closes in one municipality and opens a new store nearby, revenues derived from sales taxes would shift from one municipality to the other. Similarly, if all consumer spending declines (as it

has over the past several years due to the economic downturn) total revenues from sales taxes, in municipalities across the state, will decrease.

4.4 GOOD NEWS: CAPITAL COSTS

Capital costs (or capital outlays) include expenditures on fixed assets and durable goods, with a life expectancy greater than one-year, or expenditures intended to extend an existing asset's useful life, and/or improve its efficiency, capacity, or usability. Capital outlay can include relatively small objects like furniture, machinery and equipment, as well as much larger projects, like land, buildings, and infrastructure (e.g., streets, pipes, and water treatment plants, etc.).

Capital Costs
Capital outlays vary from year to year, but have more flexibility in planning and other sources of revenue to support them.

Capital projects can begin early or late depending on budget availability.

Impact fees and new property taxes from new developments contribute to new infrastructure.

State-run low-interest loan programs subsidize county- and municipal-level capital projects.

[Details in Appendix 1.]

As with most government expenditures, capital outlays are influenced by population and employment growth. As cities and towns grow, adding more homes and businesses, they need infrastructure to accommodate that growth. This includes more roads to support the flow of commerce, pipes to provide water and sewerage to homes, and fire and police stations to keep new neighborhoods safe. Municipal departments with increased workloads will need additional office space, furniture, and vehicle fleets to support increased staffing levels. Interviews with local and county officials and the research conducted for this analysis suggest that they have instruments for increasing revenues to account for the capital costs new developments require. These instruments include **impact fees, property taxes,** and **low-interest loans**.

Impact Fees

Skagit County and its jurisdictions have a way of dealing with capital outlays associated with new development, described in Skagit County Code Ch. 14.30 – Public Facilities Impact Fee. All new developments in jurisdictions within Skagit County that impose impact fees must pay a fee, based on the size of the development and other factors. According to the code, the revenue generated by these fees must "be used for public facility improvements of the district that will reasonably benefit the new

development."[12] In other words, jurisdictions collect revenue from new developments to pay for future capital-based projects in the community that are necessary due to development expansions. In some cases, the County acts as the fee collector, even though the County itself does not impose any fees other than for parks.

Property taxes from new development

Revenues from property taxes collected by the County and by municipalities also support capital outlays. As discussed earlier, Initiative 747 limits the annual increase in revenue generated from property taxes among existing properties. New developments, however, allow taxing districts to increase their revenues from property taxes above the one percent threshold mandated by Initiative 747 in the first year in which they are assessed.

Public Works Board – Low-interest Loans

The Public Works Board (PWB), operating within the Washington State Department of Commerce, is tasked with providing low-interest loans to help local governments finance infrastructure projects. PWB administers the Public Works Trust Fund (PWTF), which has four loan programs:

- The **Construction Loan Program** helps local governments address infrastructure needs for water, sewer, stormwater, roads, bridges, and solid waste/recycling systems.
- The **Pre-Construction Loan Program** helps accelerate a project's readiness to proceed and provides funding for design, engineering, environmental review, permits, and bid development.
- The **Planning Loan Program** provides funds to update comprehensive plans for water, sewer, stormwater, roads, bridges and solid waste-recycling.
- The **Emergency Loan Program** addresses unforeseen and unavoidable infrastructure emergencies.[13]

Funding for these programs comes from a variety of sources including: Solid Waste Collection Tax (18%), Real Estate Excise Tax (17%), Public Utilities Tax (8%), as well as Grant Repayment, Loan Repayment, and

[12] http://www.codepublishing.com/wa/skagitcounty/html/SkagitCounty14/SkagitCounty1430.html#14.30

[13] www.pwb.wa.gov

Interest Earnings (57%).[14] Skagit County's local governments have access to these low interest loans for capital projects.

4.5 SUMMARY: BASELINE ISSUES AND CHALLENGES

This section highlights the key findings from this baseline analysis, and begins to tie them to discussion of the Envision scenarios. A brief summary of key findings:

- Fiscal motivation appears to be for most new development to be located inside UGAs, for both counties and municipalities, **provided that revenues associated with growth can keep pace with costs associated with growth.**

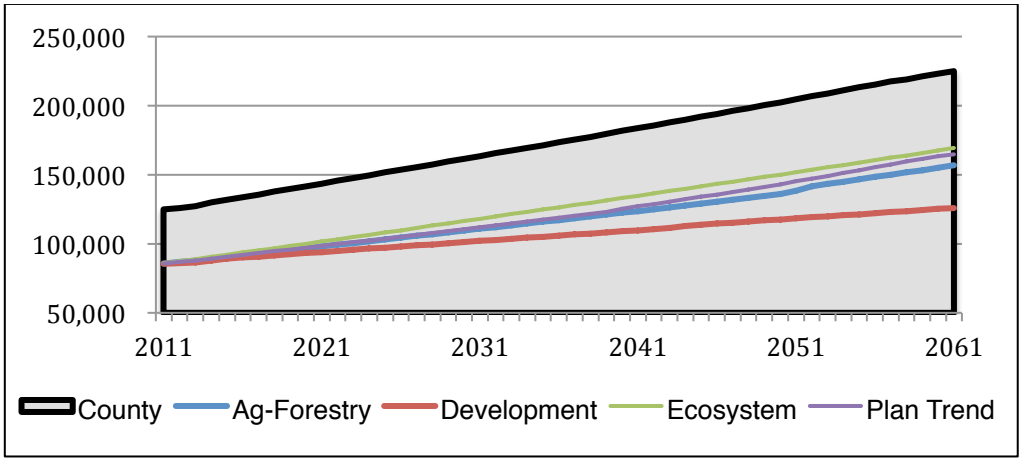
- While many of the capital costs associated with new development are covered through impact fees, general ongoing municipal costs (operating and maintenance costs) are growing out of pace with statutory limits on property taxes. The volatility of sales tax makes it a less-than reliable gap filler, especially given that jurisdictions need to maintain a mix of land uses (both residential and commercial) within their boundaries.

- Nonetheless, the growing gap between costs and revenues places increasing pressure on sales tax to fill the gap, or the need for additional revenue sources.

Exhibit 6 and Exhibit 7 illustrate this issue, using the four *Envision* scenarios and rough estimates of future property and sales tax revenues compared to local government expenditures. Exhibit 6 shows population levels across the four *Envision* scenarios; at the County level, the population is the same in all four scenarios (the dark black line at the top of the graph). Where the scenarios differ is in the distribution of that population across municipalities (the colored lines show the aggregated population inside of urban growth areas in each of the four scenarios). The Ag-Forestry, Ecosystem, and Plan Trend scenarios all have similar populations, at the municipal level. The Development scenario has a slightly lower municipal population, because more of the population is distributed to unincorporated Skagit County.

[14] ibid

Exhibit 6. County and Municipal Population Under *Envision* Scenarios



Source: ECO analysis of Envision results, 2011.
Note: The black line shows total population in the County, which does not vary by scenario. The colored lines show the population inside the combined municipalities in each scenario.

Exhibit 7 projects the revenues and the costs that would accrue to the County from population and development that locates in unincorporated Skagit County in the Plan Trend scenario. The assumptions:

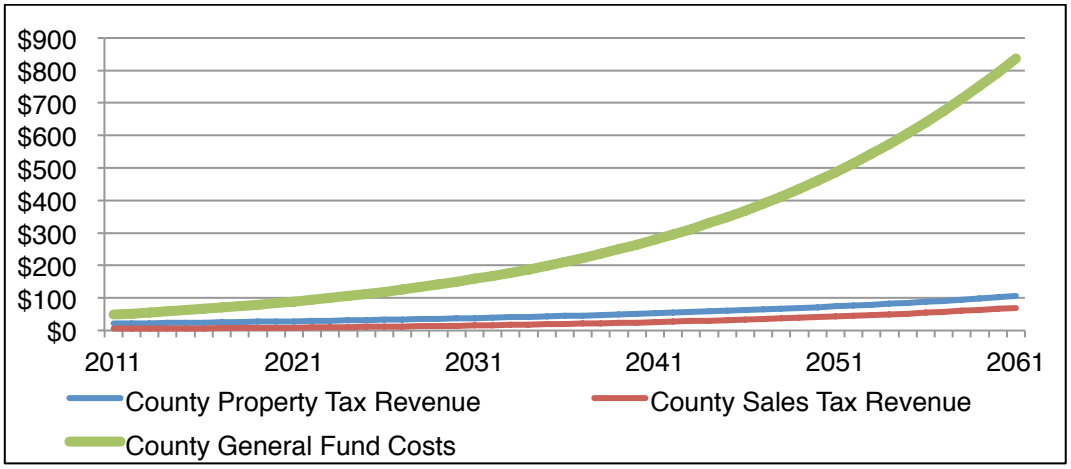
- As described in previous sections, regulations restrict the annual increase in revenues derived from property taxes. With the exception of new home construction values, the County's revenues from property taxes are limited to relatively linear growth. Here, we account for the new homes associated with the population growth projected in the County (but outside of its municipalities) in the *Envision* scenarios. We projected the County's property tax revenues by applying the average home price in Skagit County (assuming an annual appreciation of 4.2%[15]), the County's tax levy, and regulatory restrictions to annual changes in the number of dwellings in the County from Envision.
- Revenues derived from sales tax are volatile. In our model, we assume that growth in sales tax revenues is related to growth in population. The more people that live in the County, the higher the sales tax revenues generated in the County. Assuming sales tax revenues grow along with population and projected inflation, they will follow a relatively linear path, similar to property tax revenues. We projected the County's sales tax revenues by calculating current sales tax revenues per person and applying that to population

[15] 4.2% is the nominal interest rate on a 30 year treasury bond, and essentially equates to an assumption that an investment in a property keeps pace with treasury investments over 30 years. While this is a fairly conservative assumption over 30 years, real estate markets are cyclical and in any given 2 to 5 year period, appreciation might be significantly lower.

increases projected by Envision (assuming increases in sales tax revenues from new construction derived in the property tax revenue projection and an average annual increase in home prices of 4.2%).

- Evidence suggests that municipal and county-level costs are increasing. Rapidly increasing operating costs associated with personnel (salaries, wages, benefits, and pensions) and inflation likely will cause exponential increases in overall costs incurred by municipalities and counties across Washington. Our projections assume that the per capita expenditures remain roughly the same, and applying that to population increases projected by Envision (assuming per capita costs increase at a rate of 4.6%[16] per year).

Exhibit 7. County General Fund Expenditures and Revenues (in millions of nominal dollars); Plan trend scenario



Source: ECONorthwest analysis of *Envision* growth scenarios, using the assumptions and methods described in the text above.

Exhibit 7, while a rough estimate based on assumptions about a likely future that does not account for policy changes, real estate and economic cycles, and a host of other factors that influence tax rates and expenditures over time, nonetheless illustrates clearly the problem that local governments in Washington State face. Costs are growing out of proportion to revenues.

It is important to note that the County has other revenue sources that help to fill the gap between costs and revenues (impact fees and charges that are attributable to new development); especially in the early years of this projection, there may not actually be a "gap" as shown in Exhibit 7. But even if the projections in the table are off as much as $50 - $100M, the fiscal

[16] 2002-2007 average annual increase in operation costs in Skagit County.

situation for the County is still very challenging in 2031, and worse in 2041, without an intervention of policy change or significantly increased revenues from some source. Sales tax and fees are the most likely options, given caps on property tax. The magnitude of difference between costs and revenues is such that changes in growth management policy alone are not likely to overcome the difference.

In short: if new growth requires more and higher cost personnel and other services, but cannot generate sufficient revenues to support that growth (as Exhibit 7 suggests), then the fiscal motivation to attract new development (particularly residential development) inside of UGAs is significantly muted and competition for sources such as impact fees and sales tax is exacerbated.

Section 5 Fiscal Implications of Density

All future growth scenarios developed for the *Envision* model project at least some increase in density in the County's municipalities, and many suggest a more complex mix of uses that increases the physical proximity of commercial, industrial, and residential uses. This section discusses and evaluates the fiscal implications of that increased density. It asks and begins to answer these questions: "How does increasing density change the cost of providing services and infrastructure to the citizens of the County? How does increasing density affect the revenues that accrue to the County's local governments to provide that service and infrastructure?"

To address the fiscal implications of compact development specific to Skagit County, we take three steps:

- We discuss the findings of relevant literature looking at the fiscal impacts of compact and sprawling development in other regions. This literature has focused primarily on the *costs* of different development patterns.
- We describe three sample areas in Mount Vernon: one is a purely residential community, one a commercial area, and the other a mixed-use area. We use these areas to show how different types of development have different *revenue* structures for the County and its municipalities in their current configuration.
- We discuss two different indicators projected by the Envision model as they relate to the County's municipalities; we consider residential density (the number of dwellings per residential acre in each municipality's UGA) and commercial density (commercial acres per capita in each municipality's UGA).

Literature Review: Cost of Compact vs. Sprawling Development

Over the past several decades, many researchers have looked at the fiscal implications of compact development in many regions. Exhibit 8 summarizes some of these analyses, most of which have focused on the cost of the development from a local government perspective. Overall, nearly all the research suggests that compact development provides a more favorable cost structure than does sprawling development. Many of these studies agree that compact development decreases capital costs, energy costs, transportation costs, and operations costs typically incurred by municipalities.

The logic behind this finding is simple: more compact development means fewer miles of road, pipe, and transmission wires; better opportunity for alternative forms of transportation (bicycles, transit, and pedestrian access) that reduce maintenance costs on all transportation systems; and improved access to and use of parks, libraries, schools, and other facilities that reduce the total number of facilities that are needed. Economists refer to this efficiency as an *economy of scale.*

Few of these studies evaluated the *revenue* side of the equation to better understand how sales and/or property tax collections and fees vary depending on the density of the development. Further, there are many criticisms of the methodologies and data interpretations contained in these studies, and suggestions for improvements in methodologies for fiscal impact studies that would lead to more accurate results.[17] Nonetheless, the implication is that, all other things being equal, more compact development is a more favorable pattern from a fiscal perspective over the long-run.

Exhibit 8. Review of Literature Describing Fiscal Impacts of Compact vs. Sprawling Development

Citation: Transportation Research Board. 2002. *Cost of Sprawl Revisited.* **Study Details**: Defines "sprawl" and synthesizes literature on impacts and costs of sprawl. **Is Compact Less Expensive?** Yes.	**Study Type**: Community classification study of national development patterns. **Major Findings**: Denser development produces fewer impacts to land, transportation, and natural systems and lower costs, overall.
Citation: American Farmland Trust. 2002, 1992, 1986. *Cost of Service Analyses* **Study Details**: Various cost of service analyses focused on development on farm land and urban development. **Is Compact Less Expensive?** Yes.	**Study Type**: Change in Land Use Study **Major Findings**: Denser patterns are preferable because they cost less and also save farmland. One study estimates off-site capital costs to be around $3,500 to $5,000 per household in 1986 dollars, with denser patterns leading to lower cost.
Citation: Real Estate Research Corporation. 1974. *Costs of Sprawl.* **Study Details**: Comprehensive study examining the impact of urban form on cost in six hypothetical communities. **Is Compact Less Expensive?** Yes.	**Study Type**: Prototype study of change in development patterns. **Major Findings**: Low-density development results in higher cost in energy and infrastructure capital / operating cost.
Citation: James Duncan Associates. 1989. *The Search for Efficient Urban Growth Patterns*. **Study Details**: Detailed study of differences in cost of providing services to five local	**Study Type**: Comparative community study of differences in development patterns. **Major Findings**: Public capital and operating costs for close-in, compact development lower than they were for

[17] For a thorough review of these criticisms and suggestions, see Juntunen (2011) *Fiscal Impacts of Alternative Development Types*, Urban Public Finance and Governance, Oxford Press.

governments in Florida **Is Compact Less Expensive?** Yes.	fringe, scattered, linear, and satellite development.
Citation: Kotchen, M. and S. Schulte. 2009. "A Meta-Analysis of Cost of Community Service Studies." *International Regional Science Review*. 32(3): 376-399. **Study Details**: Quantitative meta-analysis of 125 cost of community service studies. **Is Compact Less Expensive?** No.	**Study Type**: Change in Land Use Study **Major Findings**: For residential development: "Although many planning decisions tend to focus on density and factors that affect home values, the results here suggest that these planning dimensions may have relatively little effect on the balance of expenditures and revenues…"
Citation: Center for Urban Policy Research. 2000. *The Costs and Benefits of Alternative Growth Patterns: The Impact Assessment of the New Jersey State Plan.* **Study Details**: Comprehensive, state-level analysis of New Jersey. Examines road, water/sewer, and school costs. **Is Compact Less Expensive?** Yes.	**Study Type**: Community classification study of regional land use study. **Major Findings**: New Jersey's compact growth plan reveals savings as much as $2.3 billion in capital costs for local road and water and sewer infrastructure over the next 20 years and as much as $160 million per year in reduced fiscal deficits statewide for municipalities and school districts.
Citation: Ladd, H. 1992. "Population Growth, Density, and the Costs of Providing Public Services." *Urban Studies*. 29(2): 273-295. **Study Details**: Econometric analysis to examine 1985 government expenditure data from 247 large counties. **Is Compact Less Expensive?** Sometimes.	**Study Type**: Econometric study of national land use patterns. **Major Findings**: Except within a range of very low densities, public service costs for increase with higher densities. She finds a U-shaped relationship between the rate of growth and growth in local government per capita spending. According to regression analysis, spending decreases as density increases to around 1,750 persons per square mile, then begins to increase along with further density increase. This implies that there are diseconomies of scale as well as economies of scale.
Citation: Carruthers, J. and G. Ulfarsson. 2008. "Does 'Smart Growth' Matter to Public Finance?" *Urban Studies*. 45(9):1791-1823. **Study Details**: Econometric analysis of Census of Government data for twelve categories (including capital facilities, roadways, sewerage, trash collection, police, fire, parks, and education) used to model expenditures from 283 metropolitan counties nationwide. **Is Compact Less Expensive?** Yes.	**Study Type**: Econometric study or national development patterns. **Major Findings**: Per capita cost declines with density and increases with spatial extent. Low-density, spatially extensive development is more expensive to support. Compact development results in the largest savings for (in order): roadways, parks, education, and police protection.

In Washington State, this equation that correlates costs and revenues to density is complicated by the State's budgeting system. Each municipality sets its budget each year, and then works backward to determine the

amount that must be levied on each property to achieve that amount. This methodology, in effect, decouples property value increases from tax collection rates. If property values increase but the total city budget does not, the effect for the individual property owner is a lower total tax rate, and the municipality does not capture the benefit of increased value. This means that, while increased density might still lead to greater efficiencies on the cost side of the equation, the effect on revenues is muted.

However, in Washington State, local real estate and fiscal experts still find economies of scale that lead to a better cost to revenue ratio for cities simply because they are larger. "…Most small cities in Washington State have the opportunity to become more efficient simply by becoming larger. While it is difficult to quantify overall efficiencies, we firmly believe that a city of 6000 residents has significant efficiency advantages over a city of 3,000; a city of 12,000 has significant efficiency advantages over a city of 6000; and a city of 24,000 residents has significant advantages over a city of 12,000."[18]

The weight of the literature and research suggests that, even in Washington State, growth is most beneficial when it is focused (1) in areas where infrastructure capacity already exists to accommodate the new population or commercial activity, and (2) in denser development patterns where public services can be provided in an efficient matter.

[18] BERK Associates, Fiscal Assessment of Growth Alternatives, Whatcom County Washington, 2009.

5.1 COMPACT DEVELOPMENT IN SKAGIT COUNTY

The literature review above suggests that compact development is, on the whole, more efficient for local governments nationally. In this section, we focus on the revenue side of the equation, which is sometimes ignored in fiscal evaluations of compact development. All of the *Envision* scenarios assume some increase in urban density, and at least some of the scenarios suggest a future for the County's municipalities that has a greater mix of uses and a greater number of households inside the urban growth areas. This affects the sales and property tax revenue structure for all municipalities in the County.

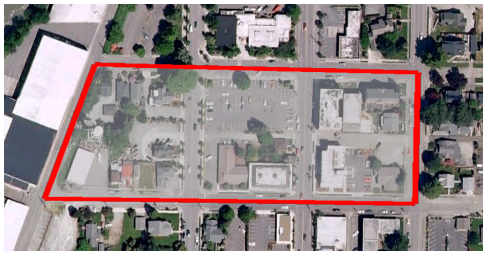
Here, we look at three different sample areas in Mount Vernon to show how different types of development have different revenue structures for the City and the County in their current configuration. We randomly selected three different four-acre areas in Mount Vernon that show different densities and mixes of uses. The first sample is in a residential area, the second is in a commercial area, and the third is in a mixed-use area. Exhibit 9 provides aerial photographs of the three sample areas we look at in this section. The figure also contains descriptions of the development in each area.

Exhibit 9. Case Study of Three Sample Areas in Mount Vernon

Residential Sample Area (4 acres)	
Number of Parcels	16
Municipal Property Taxes (2011)	$6,146
County Property Taxes	$3,655
Total Property Taxes (2011)	**$31,435**
Total Sales Taxes (2011)	**$0**[2]
Land-use Types	16 Households
Number of Bedrooms	13 3-bedroom 3 4-bedroom
Average Square Footage	1,182 sf
Revenue per Square Foot	$1.66/sf
Residential Density (dwellings/acre)	4.0

Commercial Sample Area (27.3 acres, results estimates for 4 acres for comparison)[1]	
Number of Parcels	1
Municipal Property Taxes (2011)	$6,468
County Property Taxes (2011)	$3,789
Total Property Taxes (2011)	**$38,993**
Municipal Sales Taxes (2011)	$203,995
County Sales Taxes (2011)	$83,998
Total Sales Taxes (2011)	**$1,967,949**[19]
Land-use Types	1 Retail Trade
Residential Density (dwellings/acre)	0.0

Mixed-Use Sample Area (4 acres)	
Number of Parcels	25
Municipal Property Taxes (2011)	$8,095
County Property Taxes (2011)	$4,640
Total Property Taxes (2011)	**$49,659**
Municipal Sales Taxes (2011)	$47,689
County Sales Taxes (2011)	$19,637
Total Sales Taxes (2011)	**$460,058**[20]
Land-use Types	7 Prof. Services; 7 Residential Bldg; 6 Misc. Serv; 2 Gov. Serv; 2 Public Assem; 1 Retail Trade
Number of Dwellings	56+
Residential Density (dwellings/acre)	14



Some additional details and data about the sample areas in Exhibit 9:

[19] Approximate sales tax revenue for the Commercial Sample Area was calculated based on average size and average sales per square foot for a *discount department store*. The figure chosen for "average sales per square foot" is on the lower end of a range that can be as high as $429/square foot. Source: Urban Land Institute. *Dollars and Sense of Shopping Centers/The Score 2008*. "Detailed Tenant Information Tables for U.S. Super Community/Community Shopping Centers." p. 200.

[20] Approximate sales tax revenue for the Mixed-Use Sample Area were calculated based on average size and average sales per square foot for a *drugstore/pharmacy*. . Source: Urban Land Institute. *Dollars and Sense of Shopping Centers/The Score 2008*. "Detailed Tenant Information Tables for U.S. Neighborhood Shopping Centers." p. 290.

- The Residential Sample Area has 16 parcels, each of which has one single-family home on it, with a residential density of 4 dwelling units per acre. Property taxes collected from this area total $31,435 in 2011 (about $7,900 per acre). About 19% of that revenue ($6,146) went to Mount Vernon's general fund and another 12% ($3,789) went to the County. The remaining 69% was distributed to jurisdictions ranging from local parks districts to the State general fund.

  The Residential Sample Area does not generate any sales tax revenue as it is made up solely of residential housing.

- The Commercial Sample Area is one four-acre portion of a single retail trade parcel that covers about 27.3 acres. Property taxes collected from this particular area total about $266,000 in 2011 (about $9,748 per acre). About 17% of the property tax revenue ($44,147) went to Mount Vernon's general fund and another 10% ($25,862) went to the County. Total sales tax collected for the area was nearly $2 million. On a per acre basis the City collected $51,000 and the County $21,000.

- The Mixed-use Sample Area has 25 parcels: thirteen provide professional or miscellaneous services, and seven are residential buildings (some of which are multi-unit and some of which are single-family or duplexes). The residential density in the area is 14.0 dwelling units per acre. The value of property taxes collected from this area is $49,659 in 2011 (about $12,400 per acre). About 16% of the property tax revenue ($8,095) went to Mount Vernon's general fund and another 9% ($4,640) went to the County. The total amount of sales tax collected by the City and County was $48,000 and $20,000, respectively, or $12,000 and $5,000 on a per acre basis.

5.1.1 FINDINGS REGARDING PROPERTY TAXES AND DENSITY

In general, property taxes are a more stable form of revenue than sales tax, because they do not fluctuate as greatly with economic cycles. Property taxes in Mount Vernon, for example, grew from $5.2M in 2005 to $6.9M in 2010, at a relatively stable pace. In that same time period, sales tax grew from $4.8M in 2005 to $5.7M in 2008, and then back to $4.7M in 2010.[21] This volatility in sales tax makes it difficult to maintain appropriate levels of staffing and provide consistent services. Property taxes are also geographically distinct and remain within a municipality regardless of new developments (e.g., commercial developments) that spawn competition among neighboring communities.

[21] Alicia Huschka, Finance Director, City of Mount Vernon, Washington.

The higher-density, mixed-use sample area generated more property taxes than either of the lower density, single-use sample areas. This additional revenue flows to both the County and the City of Mount Vernon, as well as to the tax districts that serve it.[22] While this analysis looks only at these sample areas, this finding likely is applicable to other similar areas: higher-density use areas have more development in them to tax. A recent study examining the property tax implications of density in Florida found that property tax revenues were highest in dense, mixed-use communities and decreased along with decreasing density. The study found that sprawling commercial development generated only slightly higher property tax revenues than did sprawling residential development, and stated that the costs associated with the commercial developments likely outweighed those of residential development.[23]

However, these property tax findings have two important caveats. First, because Washington State municipalities annually set a total budget, and work backward to a levy amount for each individual property, increased density increases the *potential* for future revenue generation, but may not immediately increase revenues. The real beneficiaries of higher density are the property owners in the municipality. The municipality will still get the same amount of total revenue, but if it is distributed over a greater number of properties, each property owner will pay less. And, if greater density is more cost efficient, the municipalities' budget will (theoretically and, as suggested in the literature for many communities, practically) need to increase by smaller amounts for each new residential unit to accommodate growth.

The second caveat relates to the cost side of the fiscal equation. Residential development, by definition, houses the people that generate the majority of the demand for municipal services (both hard infrastructure and social services). In theory, if the municipalities each set a budget and work backward to a rate on an individual property, each household covers its own costs. In practice, and especially given the limits on allowable growth in property taxes, this may not continue to be true in the future, and the costs imposed by each new household, no matter how densely their homes are constructed, may outstrip the revenues associated with their property taxes.

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[22] Other taxing districts receiving revenues from these properties include the Port District, School District 320, a Hospital District, a Conservation Futures Fund, a State Levy, and a medic services district.

[23] Katz, P. 2010. "Sarasota's Smart Growth Dividend." *American Planning Association*. December: 26-29.

5.1.2 FINDINGS REGARDING SALES TAX AND DENSITY

Every community needs a mix of residential and commercial uses. The findings for sales tax are marked. The residential sample area, of course, generated no sales tax. Both the mixed-use and the commercial only areas generated large sums of sales tax revenue for both the municipality and the County, but the commercial only area significantly outperformed the mixed-use area. And, in both areas, the revenue associated with sales tax was significantly greater than the revenue associated with property taxes. As described in earlier sections of this report, given statutory caps on the growth of property tax revenue, sales tax is an increasingly important source of revenues for municipalities in Washington State. These findings emphasize the motivation for local jurisdictions to encourage as much retail development as possible.

However, when considering retail sales tax revenues, it is important not to ignore the cost side of the equation. Our interviews suggested that regionally-serving retail is beneficial overall from a revenue perspective. But, significant costs to the system are also incurred. Regionally-serving retail increases the number of trips on local roads, arterials, and freeway systems, and requires police and public safety services capable of serving a day-time population that grows significantly with the influx of shoppers. The costs associated with these impacts are significantly reduced when the retail is locally-serving, and especially if it is in a walkable mixed-use neighborhood that brings residents closer to their daily needs. Given the magnitude of the difference in sales tax revenues between the Commercial Sample Area and the Mixed-use Sample Area, it seems unlikely that these cost differences would level the playing field between the two land use types. However, accounting for systems costs would certainly bring the two Sample Areas closer to equality in terms of their net revenues generated.

5.2 DENSITY IN THE *ENVISION* SCENARIOS

All four scenarios in the *Envision* model project some degree of increased densities in the future. The increased density and changes in mix of uses projected in the *Envision* model will mean more locally-serving and smaller scale retail in many parts of Skagit County's municipalities, and may mean increased density on large-format retail sites. From a fiscal perspective, this means greater revenue generation potential[24] from both

[24] Again, actual revenue generation may not increase, because of limits on property taxes and because of Washington's levy-based taxation system. However, the *potential* for increased revenue generation exists.

sales tax and property tax. It also means the potential for greater revenue generation from existing properties currently inside the UGA.

Assuming that national patterns that show reduced costs for serving increased density hold true in Skagit County, we would expect to see a long-term pattern that reduces overall costs on a per-person basis for service provision and increases property and sales tax revenue on a per-person basis in all scenarios. We'd expect higher density scenarios to have a relationship that is closer to one-to-one on per-person costs to per-person revenues.

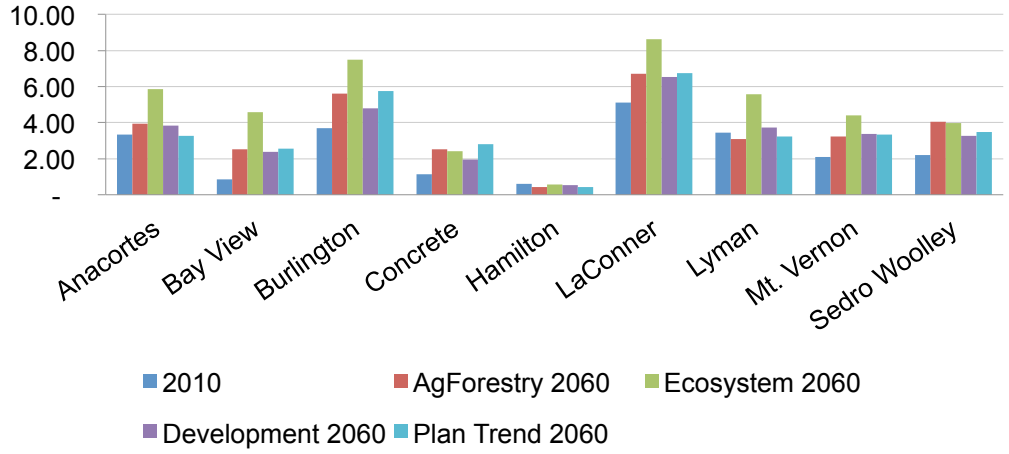
In this section, we discuss two different indicators projected by the Envision model as they relate to the County's nine main municipalities: Anacortes, Bay View, Burlington, Concrete, Hamilton, LaConner, Lyman, Mount Vernon, and Sedro Woolley. First, we look at residential density (the number of dwellings per residential acre in each municipality's UGA); then we look at commercial density (commercial acres per capita in each municipality's UGA).

Scenario Analysis: Residential Density

Exhibit 10 summarizes trends in residential density in the nine municipalities analyzed in Skagit County. The first column shows the number of dwellings per residential acre within the UGA in 2010. The UGA is used as opposed to city or town limits to account for expansion of those current boundaries into the UGA over the next fifty years. The following four columns show the number of dwellings per residential acre in each municipality in 2060 under each of the four *Envision* scenarios. Exhibit 11 summarizes trends in residential density within the city limits of the municipalities analyzed in Skagit County.

Exhibit 10. Residential Density Now and Under each *Envision* Scenario (Dwellings per Gross Residential Acre in Urban Growth Area)

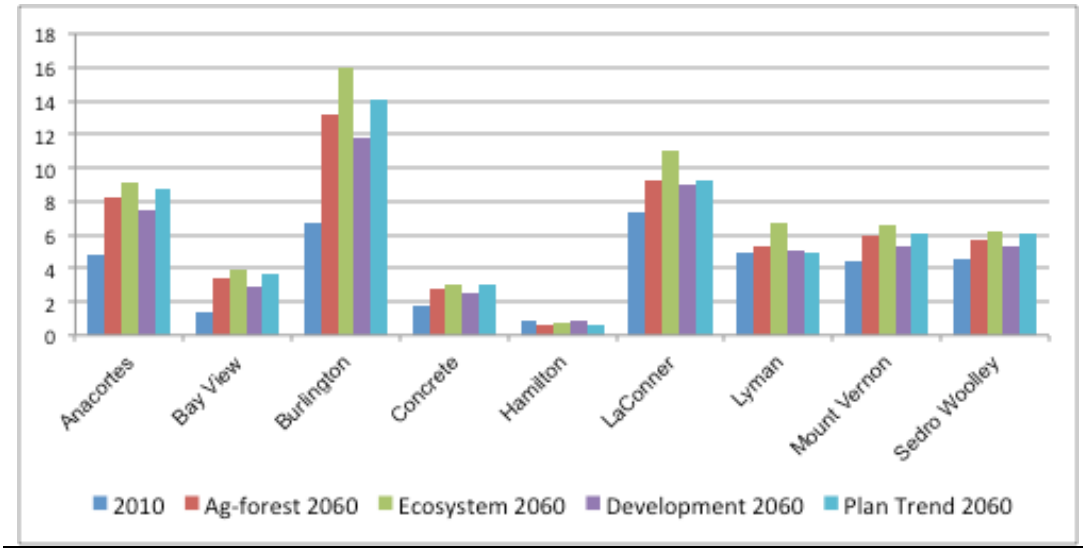
	2010	Ag-forest 2060	Ecosystem 2060	Development 2060	Plan Trend 2060
Anacortes	3.34	3.94	5.86	3.83	3.28
Bay View	0.87	2.51	4.57	2.36	2.56
Burlington	3.67	5.59	7.47	4.78	5.75
Concrete	1.12	2.53	2.41	1.96	2.80
Hamilton	0.59	0.42	0.56	0.54	0.42
LaConner	5.13	6.71	8.61	6.54	6.74
Lyman	3.43	3.09	5.58	3.74	3.21
Mount Vernon	2.11	3.23	4.39	3.36	3.32
Sedro Woolley	2.19	4.03	3.97	3.28	3.50



Source: *Envision* model results, Skagit County, 2011

Exhibit 11. Residential Density Now and Under each *Envision* Scenario (Dwellings per Gross Residential Acre in Cities Only)

	2010	Ag-forest 2060	Ecosystem 2060	Development 2060	Plan Trend 2060
Anacortes	4.82	8.25	9.13	7.46	8.72
Bay View	1.31	3.35	3.94	2.92	3.62
Burlington	6.70	13.23	16.00	11.79	14.07
Concrete	1.77	2.76	2.98	2.49	2.96
Hamilton	0.83	0.58	0.79	0.87	0.58
LaConner	7.34	9.18	11.05	8.97	9.27
Lyman	4.87	5.35	6.71	5.02	4.93
Mount Vernon	4.46	5.89	6.52	5.26	6.09
Sedro Woolley	4.53	5.74	6.16	5.29	6.04



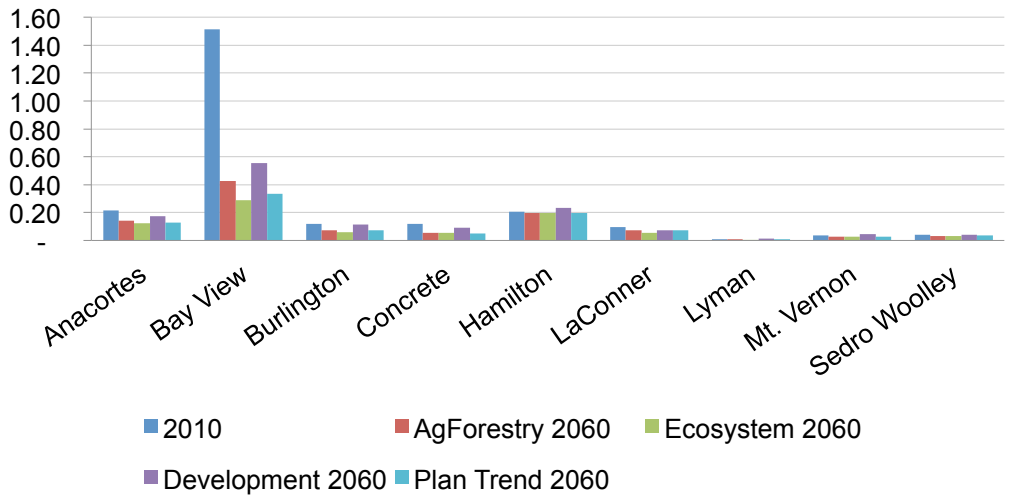
Source: *Envision* model results, Skagit County, 2011

Scenario Analysis: Commercial/Industrial Density

Exhibit 12 summarizes trends in commercial/industrial density in the nine municipalities we analyzed in Skagit County. The first column shows the commercial/industrial acres per capita within the urban growth boundary in 2010. The following four columns show the commercial/industrial acres per capita in each municipality in 2060 under each of the four *Envision* scenarios.

Exhibit 12. Commercial/Industrial Density Now and Under each *Envision* Scenario (Commercial/Industrial Acres per Person in Urban Growth Boundary)

	2010	Ag-forest 2060	Ecosystem 2060	Development 2060	Plan Trend 2060
Anacortes	0.21	0.14	0.12	0.17	0.13
Bay View	1.51	0.42	0.29	0.56	0.33
Burlington	0.12	0.07	0.06	0.11	0.07
Concrete	0.12	0.05	0.06	0.09	0.05
Hamilton	0.21	0.20	0.20	0.23	0.20
LaConner	0.09	0.07	0.06	0.07	0.07
Lyman	0.01	0.01	0.01	0.01	0.01
Mount Vernon	0.04	0.03	0.03	0.04	0.03
Sedro Woolley	0.04	0.03	0.03	0.04	0.04



Source: *Envision* model results, Skagit County 2011

Some descriptive findings associated with these tables:

- Residential density ranged from about 0.6 – 5.1 dwellings per residential acre in 2010 in the nine municipalities we analyzed. The average residential density among these nine municipalities in 2010 (not weighting for differences in population size) was about 2.5 dwelling units per residential acre.
- In nearly all cases, residential density is higher in 2060, under any of the scenarios, than it was in 2010. The total range of residential

density across all four scenarios is about 0.4 – 8.6 dwellings per residential acre in 2060. In general, residential density is highest under the Ecosystem scenario (about 0.6 – 8.6 dwellings per residential acre in 2060 depending on the municipality). The other three scenarios have similar residential densities ranging from about 0.4 – 0.5 dwellings per residential acre in 2060 on the low side to about 6.5 – 6.7 on the high side.

- The residential densities in Skagit County's municipalities are relatively low in all scenarios - both now and in 2060. To add context to the discussion, the residential density of a typical single-family area in Seattle is about 10 dwellings per residential acre. Some townhouse developments in Seattle have residential densities in the range of 14–41 dwellings per residential acre, and residential tower condos may range up to 89–220 dwellings per residential acre.[25] Even the municipality with the highest projected residential density (La Conner under the Ecosystem scenario, about 8.6 dwellings per residential acre in 2060) has a much lower projected residential density than a typical single-family area in Seattle under current conditions.
- Commercial/industrial density ranged from about 0.0 – 1.5 in 2010 in the nine municipalities we analyzed. The average commercial/industrial density among these nine municipalities in 2010 was about 0.13. In 2010, the commercial / industrial density is highest in Anacortes and Burlington. While the ratio drops in Anacortes and Burlington, and hold roughly steady in Mount Vernon and Sedro Wooley, they are still projected higher in these communities in the future. In general, commercial/industrial density is projected to be lower in 2060 than it was in 2010, across all municipalities and scenarios.
- The decreasing per capita commercial density projected in these scenarios suggests decreasing reliance on regionally-serving retail, and decreasing access to sales tax generated by these types of uses. In the future, revenue streams may be more stable and predictable as a result of decreased reliance on volatile sales tax as a source, but they will also be more constrained.

[25] Vehige, D. 2009. "Understanding Housing Density." GGLO. February 18, 2009.

5.3 MARKET CHALLENGES TO ACHIEVING DENSITY

Market feasibility is a key question that planners and decision-makers should consider when developing policies about growth. Simply enacting zoning to support higher density uses won't change the development patterns on the ground unless they are in line with market dynamics. These dynamics are measured through a combination of (1) development pro formas that account for construction and land costs, achievable rents, financing costs, and other variables; and (2) underwriting and banking practices that provide access to capital. If rents and achievable sales prices are not high enough to support the cost of new high-density construction, new development of that type will not occur.

Rents and sales prices are largely a function of consumer demand for the housing type. Prior to the most recent recession, many communities nationally were seeing an increase in demand for higher density, walkable, urban housing types.[26] However, the cost of producing this type of housing in the neighborhoods that have the amenity to support it is often high, relative to the cost of creating lower density housing types in other locations. This situation, coupled with the ongoing effects of the most recent recession, reduces the motivation for developers to pursue compact housing forms.

There is almost certainly a feasibility gap for new higher density mixed-use products in the Skagit Valley in the current market. There are very few markets in the United States where new development of this type is currently market feasible, given the current constraints in the lending market, costs associated with building this type of development, and demand for it. While this situation will probably change nationally as the economy improves, it is likely that the market for these types of uses will remain soft in Skagit County for some time.

If the County and others enact policies that constrain growth within very tight boundaries, and they want to see increased density that the private market will not produce on its own:

(1) *Either* the policies may have the effect of slowing total growth in the County in the longer-run, *or, to avoid this situation*;
(2) The County and its jurisdictional partners will need to enact other policies that encourage and support the higher density development

[26] For instance, see: A.C. Nelson, "Leadership in a New Era," Journal of the American Planning Association, Vol. 72, Issue 4, 2006, pp. 393-407. Christopher B. Leinberger, The Option of Urbanism: Investing in a New American Dream, Island Press, 2009. National Association of Realtors, "The 2011 Community Preference Survey: What Americans are looking for when deciding where to live," March 2011.

it wants to see. These types of policies and programs are suggested in the next section of this memorandum.

The market constraints may be short-term (in the first 10 years of plan implementation). In the longer-run, it is possible that demand for higher-density mixed-use products would be strong enough to support new development.

Section 6 Key Findings and Implications

This section summarizes key findings from the analysis, and applies them to the assessment of the four scenarios in the *Envision* model. The *Envision* model projects future growth patterns in Skagit County under four different scenarios: Ag-forest, Ecosystem, Development, and Plan Trend.

This section begins by summarizing key findings from earlier parts of this report, and then discusses the implications of these findings for the County and the municipality as the consider their growth management options.

6.1 KEY FINDINGS SUMMARY

Although the intent of the project was to describe the impact of the growth scenarios upon the fiscal situation, ECO found that the implications of the scenarios upon the fiscal situation were relatively small, and that the issues that will matter most to the future fiscal health of the County and its municipalities change only slightly with changes in density. This was true for a variety of reasons:

- **The scenarios were fairly similar.** The main driver of fiscal impacts, both positive and negative, is population. In each of the four scenarios, the total population of Skagit County remained the same; the only difference was the location of the growth. For most services, and within a reasonable geography, the level of services a population demands will remain similar, regardless of how the population is distributed. The exceptions are those that are physically geographic in nature, such as roads, sewers, and water infrastructure, and those that require movement over distance, police and fire services.
- **Many of the scenario-based costs are covered by revenue sources that scale appropriately.** The costs that rely the most on growth scenarios are infrastructure capital and maintenance costs. Municipal and county staff expressed that these costs have traditionally been covered sufficiently by impact fees and the other designated sources, but our research suggests that this may not be the case in the future.
- **Potential funding shortfalls in personnel and operating costs would occur regardless of scenario.** The costs expected to grow the most rapidly are generally personnel-based. With the exception of police and fire, the demand for government personnel will not change in accordance with the location of the new population. More

staffing is not required in areas like city or town councils, planning, libraries, and municipal courts because the city or town has a lower density. Police and fire are perhaps the only services to suffer greatly from development sprawl.

- **In all scenarios, the 1% cap on property taxes leads to greater pressure on sales tax and other revenue sources to cover increased costs.** Municipal competition for commercial uses that generate sales tax, as well as pressure on utility and other fees, will increase as the property tax limitations begin to pinch municipal and County resources. This situation limits total resources in the future in all scenarios. Different scenarios change the flow of the revenue (to County or to municipalities) at the margins, but no change in growth pattern can overcome the overall shortfall.

In short, taxation policy and external economic factors will have a greater impact on fiscal issues than the range of growth management policies considered through the *Envision* analysis, and those impacts are not likely to be favorable. Many in Washington have suggested the state-wide tax reform will be necessary to overcome some of these challenges.

However, we did find some small differences among the scenarios that the County and its municipalities should consider when setting growth management policy. In general, our findings support a conclusion that, from a fiscal perspective, and especially in the longer-run, higher density development with a more diverse mix of uses is more fiscally advantageous than lower-density (sometimes called "sprawling") development patterns for the municipalities inside of Skagit County. To a certain extent, all of the four scenarios will increase density. The "ecosystem" scenario has the highest residential density. Of the four scenarios, the "development" scenario appears to be the least beneficial from a fiscal perspective. It requires the County to provide services, without the benefit of a tax structure designed for urban services. It also reduces the amount of growth that occurs in more cost-efficient locations (i.e., where much of the infrastructure already exists inside of municipal boundaries), and reduces the number of households and businesses from which the municipalities can capture revenues.

More specifically:

- Higher-density development appears to lead to cost savings in the long-run, based on a review of state and national literature, as local governments achieve greater economies of scale and development occurs in locations with the infrastructure in place to support it. Higher-density development will lead to greater revenue generation potential for local governments from both sales tax and property taxes when measured per-acre as a municipal-wide average.

- The *Envision* model projects a decreased proportion of commercial property relative to population. If this projection is true, it suggests that, in the future, revenue streams may be more stable and predictable, because they will have decreased reliance on volatile sales tax as a source along with a corresponding increase in reliance on more stable property taxes. But this decreased reliance on sales tax means: (1) more competition among municipalities for regionally-service retail; and (2) more pressure on other revenues streams, such as fees and surcharges.
- The fiscal implications for the County government are less clear. The County provides some services (such as some social services) equally to all County residents, whether they are inside a municipal urban growth area or not. Other services (such as road maintenance) vary, and costs to the County for those services are higher for areas outside of a municipality. The County receives a greater portion of the total sales tax and property tax revenue for properties located outside of municipal boundaries.
- In most scenarios, there may be market-based challenges to achieving the density that *Envision* projects. Higher-density developments are often more costly to develop, and in communities where this type of development are not common, the first few buildings can be challenging. Some public-sector support of location-efficient higher-density projects may be warranted in the short-run to achieve longer-term fiscal benefits.

6.2 RECOMMENDATIONS

In Skagit County, as in all communities, growth management decisions must account for many considerations, ranging from preservation of open space and resource lands to support of residential units that can house a diversity of income ranges. Fiscal considerations are just one of these considerations, but an increasingly important one for most local governments.

Recommendations regarding the fiscal implications of increasing density:

Develop programs to support high-quality infill and mixed use development

The findings in this memorandum that generally support higher density development from a fiscal perspective rely on one important assumption: that there is sufficient demand for higher density and mixed-use residential

land uses to support their development in the open market. It is likely that our analysis will find that short- to mid-term demand is insufficient to support much new development. This is a common challenge among many jurisdictions across the country. Choosing to ignore the market variables may mean that new development occurs at a slower pace than has been projected. Instead, if the County opts for higher-density scenarios, it should consider programs and policies that can incent this type of development in the market. There are two general categories of programs and policies that the County and its municipal partners can consider:

1. **Land use policies:** Assure that zoning and building codes allow sufficient density, and are flexible enough to not present a barrier to infill and redevelopment of existing sites. Code language around lot subdivision, accessory dwelling units, parking, height and floor area ratios, and allowable mixes of uses are especially important to evaluate. In many communities, for example, requirements for parking ratios for residential units increase the cost of developing new residential units such that they become infeasible. Allowing for lower parking ratios, or allowing developers to count on-street parking can help to achieve policy goals around increased density. We recommend including developers and property owners in the process of reviewing zoning and development code, so that this perspective can be considered.
2. **Development support for selected development types:** Below are some ideas on the types of programs that can help to encourage high-quality mixed use development, and infill housing that matches the neighborhood character:
    a. **Public acquisition of key development sites.** A local government can write down the cost of the land to support development that meets certain public-sector goals for higher-quality development (such as environmental standards, inclusion of public art, or pushing density beyond what the development pro forma might independently support). Well-located and executed development can catalyze redevelopment of adjacent sites, and help to "prove the market" so that future developments can more easily access financing.
    b. **Waivers of impact fees.** Again, waivers would typically be given only in exchange for a development meeting a particular set of public-sector goals.
    c. **Pre-development studies**. Local governments can contract with design firms and market analysts to provide direct support to developers and property owners who are interested in redeveloping their properties. This reduces development costs and also provides an opportunity to encourage community-

supported design options. This is a common program provided by many urban renewal agencies in Oregon State.

d. **Gap financing**. Some municipalities have programs in place that provide low-interest loans to developers working on developments that meet certain public goals. These loans can the increase financial feasibility of more compact development types.
e. **Improvements to public spaces**. Higher-density development is generally most successful when it is adjacent to high-quality urban spaces with adequate and attractive access for multiple modes of transportation, and with inviting and well-designed streetscapes.

Consider revenue sharing

As property tax sources become more constrained relative to costs, there will be more pressure on sales tax sources to fill the gap. From a market perspective, the best location for regionally-serving retail, which brings sales tax dollars into the County from other places and can be a critical bolster to locally-produced sales tax and property tax, will probably remain near major freeway interchanges along I-5. This means that not all jurisdictions will have access to this increasingly important revenue source. One option for addressing this is to enact a system for sharing sales tax or other revenues.

Revenue sharing is a term used to describe a situation in which multiple taxing jurisdictions distribute their overall tax revenues among themselves. Revenue sharing has two main objectives:

- Promote orderly development at the regional level.
- Improve equity in the distribution of fiscal resources.[27]

To account for the increased costs associated with providing regionally-serving retail establishments (such as police, fire, and transportation networks), revenue sharing should apply only to *net* revenues from sales tax. This will eliminate any potential disincentive associated with attracting and retaining these establishments within a municipal boundary. Within the Washington State context, a public development authority might provide the necessary organizational structure to allow for revenue sharing.

[27] Hinze, S. and K. Baker. 2005. *Minnesota's Fiscal Disparities Program: Twin Cities Metropolitan Area and Iron Range*. Minnesota House Research Department. January.

In 2005, the Minnesota House Research Department published a report that included a list of beneficial characteristics typically associated with revenue-sharing programs.[28]

- Revenue sharing distributes fiscal benefits associated with business development attracted by regional facilities (e.g., shopping centers and airports).
- Revenue sharing can reduce the need for communities with low tax bases to raise their tax rates, which would otherwise make them unattractive to potential homeowners and business developers.
- Revenue sharing can reduce competition among neighboring communities for commercial and industrial development. Competition for this type of development has, historically, incentivized communities to offer tax concessions and special services to would-be developers and has spawned urban sprawl.
- Revenue sharing can increase the equitable distribution of revenues between communities with low commercial/industrial densities and those with high commercial/industrial densities, balancing some of the tax volatility issues discussed earlier.
- Revenue sharing can provide incentive for communities to support initiatives for projects with low tax yields (e.g., parks) which may provide large public benefit at the regional level despite not generating large tax revenues for the community.
- Revenue sharing assists communities with older buildings and infrastructure by providing potential sources for financing urban redevelopment.

To summarize, revenue sharing could provide many benefits to municipalities in Skagit County. The County's municipalities rely on sales tax revenues to varying degrees. Along the same lines, some municipalities have attracted more commercial/industrial development than others. In good years, these municipalities collect high revenues from sales tax collection. In bad years, they do not. Revenue sharing would allow municipalities without large commercial/industrial developments to benefit from the high revenues generated from sales tax collections elsewhere during good years. During bad years, municipalities heavily reliant on sales tax revenues could buffer the impact of unexpected reductions in revenue collections by benefiting from property tax collection elsewhere.

[28] Hinze, S. and K. Baker. 2005. *Minnesota's Fiscal Disparities Program: Twin Cities Metropolitan Area and Iron Range*. Minnesota House Research Department. January.

Minneapolis-St. Paul Metropolitan Area, Minnesota[1]
Seven counties participate in the Twin Cities Fiscal Disparities Program and have been sharing revenues from commercial/industrial property taxes since the early 1970s. The counties pool 40% of the increase in commercial/industrial property value. They tax this pooled value using a weighted average of the local property tax rates of all participating jurisdictions and distribute revenues based on property tax capacity.

Portland Metropolitan Area, Oregon[2]
The three counties in Portland, Oregon's metropolitan area collect revenues from a region-wide property tax as well as from fees on regional services (e.g., waste disposal) to fund the Metro Council. The Metro Council, created in 1992, funds several types of region-wide programs and projects such as capital projects, park and green space operation, solid waste disposal facilities, and the Oregon zoo.

Allegheny County, Pennsylvania[3]
The Allegheny Regional Asset District levies a 1% sales tax across Allegheny County. Half of the revenue generated from this tax levy is directed to regional cultural facilities. A quarter of the revenue is directed to the County. The remaining quarter is directed to municipalities and is based on property values and tax revenues at the municipal level relative to property values and tax revenues at the county level. This system redistributes revenues to distressed communities.

Montgomery County, Ohio[4]
In 1989, Montgomery County increased the sales tax rate by 0.5%. The County distributes 70% of these revenues to local governments through a grant process with an emphasis on economic development. The County prioritizes programs and projects that promote multi-community collaboration, and encourages bringing new business to the County rather than redistributing businesses within the County.

1 Hinze, S. and K. Baker. 2005. *Minnesota's Fiscal Disparities Program: Twin Cities Metropolitan Area and Iron Range*. Minnesota House Research Department. January.

2 Jensen, B. and J. Turner. 2000. "Act 77: Revenue Sharing in Allegheny County." *Government Financial Review*. December: 17-21.

3 Montgomery County ED/GE Program. 2011. Retrieved on June 13, 2011 from http://www.mcohio.org/services/ed/edge.html.

4 Metro Finances and Funding. 2011. Retrieved on June 13, 2011 from http://www.oregonmetro.gov/index.cfm/go/ by.web/id=24271.

Appendix 1: Details on Operating Cost Increases

INCREASING OPERATING COSTS

Operating costs, more than any other municipal costs, are rising in municipalities across the State of Washington.[29] In particular, personnel costs (including salaries, wages, benefits, and pension contributions), inflation will probably continue to increase over the 50-year period the *Envision* model projects. In this section, we describe trends in these costs for different municipalities in Skagit County and point out, when possible, how they relate to each other and overall trends in the state and in the economy.

Jurisdictions across the country are struggling to keep up with rising personnel costs of wages, pensions, and benefits. While none of the jurisdictions that ECO interviewed expressed concern over rising personnel costs over the next few years, a study completed in 2009 found that nearly half of the of the Washington municipal officials were less able to meet financial needs in 2008 than they were in 2004.[30] The evidence provided by the *Envision* model suggests that over the next 50 years, virtually every local government will be forced to reexamine operating costs, and specifically, the structure of their personnel costs.

- Personnel costs in Washington's local governments grew by 4.7% per year from 2004-2008.
- FTE in Washington's local governments grew by 1.7% per year from 2005-2009.
- Average annual inflation rate was 2.4% from 2005-2010.
- **Personnel costs incurred by local governments in Washington increased more rapidly than population, FTE, and inflation.**

[See Appendix 2 for details.]

As a whole, local governments across the State of Washington have experienced a rise in expenditures on salaries, wages, and benefits. Exhibit 13 shows annual expenditures by local governments in Washington on these personnel costs. The average annual change in expenditures on personnel costs was about 4.7% from 2004 to 2008. The average annual change in Washington's population, however, was only 1.4% over that

[29] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

[30] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

same period, suggesting that increases in these costs aren't proportionally tied to increased demand for services.[31]

Exhibit 13. Annual Expenditures on Salaries, Wages, and Benefits by Local Governments Across Washington (in Millions)

Expenditure Category	2004	2005	2006	2007	2008	Mean Annual Change
Benefits	$137.9	$140.2	$148.2	$158.8	$176.2	6.4%
Salaries and Wages	$10,671.5	$10,975.6	$11,428.2	$11,846.0	$12,787.7	4.6%
Total	**$10,809.5**	**$11,115.8**	**$11,576.3**	**$12,004.9**	**$12,963.9**	**4.7%**

Source: U.S. Census Bureau. State & Local Government Finance

Similarly, many municipalities in Skagit County are experiencing higher personnel costs. Exhibit 14 summarizes results from Anacortes and Mount Vernon. In Anacortes, these expenditures on personnel costs increased by 5.4% per year from 2007 to 2010, while the city's average annual population increased by less than 1% per year from 2000 to 2010. In Mount Vernon, the expenditures on personnel costs increased by 6.3% per year from 2005 to 2010 while the city's average annual population increased by about 2.4% per year.

Exhibit 14. Annual Expenditures on Salaries, Wages, and Benefits (in Millions)

Municipality	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	Average Annual Change
Anacortes			$15.4	$16.5	$18.3	$18.1	5.4%
Mount Vernon	$15.4	$16.1	$17.4	$22.8	$24.3	$19.8	6.3%

Source: Anacortes Annual Budget 2007, 2008, 2009, 2010; Mount Vernon Annual Budget, 2005, 2006, 2007, 2008, 2009, 2010.

Personnel costs are determined by the number of employees and their compensation (wages and benefits). Exhibit 15 shows the change in number of FTE employees employed by local governments across the State of Washington and their average annual salaries. The number of FTE employees increased, on average, 1.7% per year from 2005 to 2009. The average annual salary of these employees increased, on average, 4.0% per year over the same period. Overall, average annual salaries for all

[31] U.S. Census Bureau. 2011. Quickfacts, Washington. Retrieved on July 25, 2011 from http://quickfacts.census.gov/qfd/states/53000.html.

employees throughout the State of Washington grew, on average, 3.6% per year over the same period. In 2009, the average local government employee earned $62,734, while the average worker in the state earned about $47,770.

Exhibit 15. Annual Local Government FTE Employees and Average Annual Salaries

	2005	2006	2007	2008	2009	Average Annual Change
FTE Employees	117,282	116,943	119,970	122,541	235,109	1.7%
Average Annual Salary Local Gov't Employees	$46,768	$48,081	$50,386	$53,044	$62,734	4.0%
Average Annual Salary All WA	$41,460	$42,910	$44,710	$46,430	$47,770	3.6%

Source: U.S. Census Bureau. Government Employment & Payroll and U.S. Bureau of Labor Statistics. Occupational and Employment Statistics.

In addition to the salaries and benefits described above, many local government employees participate in pension programs. Few municipalities in Skagit County report pension expenditures as a line item in their budget reports. Mount Vernon reported annual expenditures on the Firemen's Pension. Exhibit 16 shows that those expenditures increased, on average, 48.9%, per year from 2005 to 2010. Unfortunately, there are too few data to further describe trends in pension expenditures by local governments in Skagit County. About 70% of Washington municipal officials interviewed by researchers indicated that costs associated with pensions have impacted their budgets over the past several years.[32] In particular, economic declines associated with the recession have caused pension funds to decrease and have increased the need for municipal contributions.

Exhibit 16. Annual Expenditures on Pensions (in Thousands)

Municipality	FY 05	FY 04	FY 07	FY 08	FY 09	FY 10	Average Annual Change
Mount Vernon	27.5	51.5	51.5	69.3	162.7	143.0	48.9%

Source: Mount Vernon Annual Budget, 2005, 2006, 2007, 2008, 2009, 2010.

[32] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

Thus far, we have reported our data regarding personnel expenses in nominal dollars. To better understand these data, we must compare their annual changes against changes in the consumer price index (CPI), which we use to describe trends in inflation. Exhibit 17 shows the percent change in CPI, per year, since 2005. The average annual change in CPI was 2.4% from 2005 to 2010. These data suggest that annual expenditures on personnel costs are increasing more rapidly than inflation.

Exhibit 17. Average Annual Change in CPI

	2005	2006	2007	2008	2009	2010	Average Annual Change
Average Annual Change in CPI	3.4%	2.5%	4.1%	0.1%	2.7%	1.5%	2.4%

Source: U.S. Bureau of Labor Statistics. Consumer Price Index

REVENUE RESTRICTIONS

So far, we have discussed some of the costs municipalities must bear and how these costs likely will increase into the future. Here, we discuss two of the largest revenue sources for municipalities – property taxes and sales taxes - and how laws regulating the flexibility of decision makers to change tax rates likely will create future challenges in balancing budgets.

PROPERTY TAX LIMIT

The State of Washington limits increases in property taxes by individual taxing districts to 1% per year for all existing property, as described by Initiative 747. For example, assume a jurisdiction receives $10 million in property taxes in one year. In the next year, the maximum allowable property tax the jurisdiction can levy is one percent higher, or $10.1 million. Jurisdictions calculate their levy rates based on this restriction and based on the assumption that there is no new construction or improvements of existing properties. Jurisdictions may receive more than 101% of the previous year's property tax revenues if there is new development and/or improvements of existing properties within their

Property Tax Revenue (2005-2009)

- Skagit County general fund increased 7.2% per year.
- Municipal general funds increased 6.6% per year.
- Total revenues increased 7.2% per year.
- **Without new, taxable development, property tax revenues are capped at 1% per year.**

district boundaries. Over half of the Washington municipal officials interviewed by researchers think Initiative 747 has had a major impact on their budgets, and another third believe it has had a moderate impact.[33]

Exhibit 18 shows a breakdown of the annual revenue generated from property taxes within Skagit County from 2005 to 2009. Overall, revenues derived from property taxes collected in Skagit County increased by about 7.2% per year over that period. In 2009, the value of property taxes collected from the area was about $161 million. Property taxes collected by municipalities in Skagit County increased by about 5.9% per year and made up about 10% of the total in 2009, property taxes collected by the county increased by about 6.3% per year and made up about 23% of the total in 2009, and property taxes collected by the state increased by about 4.6% per year and made up about 21% of the total in 2009.

Exhibit 18. Annual Property Tax Revenues Generated in Skagit County (in Millions)

Municipality	2005	2006	2007	2008	2009	Average Annual Change
State Total	$27.6	$29.1	$30.4	$32.4	$33.0	4.6%
County General Fund	$15.9	$17.6	$18.5	$19.6	$21.0	7.2%
County Total	$29.1	$30.5	$33.8	$35.9	$37.1	6.3%
Municipality General Fund	$11.8	$12.9	$13.8	$14.6	$15.2	6.6%
Municipality Total	$13.0	$14.1	$15.0	$15.8	$16.4	5.9%
Other Assessments	$52.2	$62.0	$66.0	$69.3	$74.3	9.4%
Total	$121.9	$135.7	$145.2	$153.5	$160.8	7.2%

Source: Skagit County Assessor Office. 2011. *Information on Property Tax Procedures.* Retrieved on June 2, 2011, from: http://www.skagitcounty.net/Common/asp/default.asp? d=Assessor&c=General&p=reportsmain.htm.

As shown in Exhibit 18, property tax revenues, at all levels, increased by an average of more than one percent (the limit on increases in property tax revenues described above). The additional property tax revenues are largely attributable to: (1) new development and improvements to existing properties (neither of which are included when calculating the tax levy for the regulation), and (2) local voting efforts that approve increases of greater than one percent.

[33] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

Many of Skagit County's taxing jurisdictions have lowered their levy rates, relative to historical levels, to comply with this regulation. As a result, these jurisdictions have collected less revenue from property taxes than they would have, had they continued their pre-restriction trends. In 2007, revenues from property taxes for municipalities across the state were about $137 million less than they would have been without Initiative 747.[34] Overall, taxing jurisdictions in Skagit County have not suffered from the restriction on property tax collections because of property taxes collected from new developments and from improvements on existing properties. If, however, in the future, development and improvements decline, these jurisdictions could see their annual increase in property tax revenues decline, and move ever closer to the one percent restriction.

SALES TAX VOLATILITY

Revenue derived from property taxes in throughout Washington has been limited by regulations. Revenue from sales taxes has, so far, proved more or less sufficient for Skagit County and its municipalities to cover the costs that reduced property taxes cannot. Sales taxes are a challenging revenue source in regard to the budget process, however, because they can swing wildly from year to year. Collections are directly tied to consumer spending, which can rise or fall dramatically with the larger economic situation.

Average Sales Tax Revenue

- Anacortes's revenue dropped 1.2% per year (2005-2010)
- Burlington's revenue dropped 2.4% per year (2005-2010).
- Mount Vernon's revenue rose .7% per year (2005-2010).
- **Revenues from sales tax are volatile and difficult to forecast.**

Sales taxes can be a powerful revenue source for cities and towns with a strong base of taxable sales. Dense retail development can have overwhelmingly positive fiscal impacts to a municipality because they require less in terms of infrastructure and other services when compared to the amount of sales tax they generate. However, a large reliance on sales tax can leave a jurisdiction even more vulnerable to economic downturns than municipalities with more diverse revenue bases.

Exhibit 19 shows the revenue generated from sales taxes in Anacortes, Burlington, and Mount Vernon over the past few years. From 2005 to 2010, revenues from sales taxes in Anacortes have dropped, on average, 1.2% per

[34] Association of Washington Cities. 2009. *State of the Cities Report 2009.*

year; in Burlington, revenues dropped by 2.4% per year from 2005 to 2010; in Mount Vernon, revenues increased by .7% per year from 2005 to 2010.

Exhibit 19. Annual Sales Tax Revenues Generated in Skagit County (in Millions)

Municipality	2005	2006	2007	2008	2009	2010	Average Annual Change
Anacortes	$3.7	$3.9	$4.2	$3.9	$3.1	$3.3	-1.2%
Burlington	$6.7	$7.4	$7.6	$6.9	$6.1	$5.9	-2.4%
Mount Vernon	$4.8	$6.0	$6.2	$5.7	$5.1	$4.7	.7%

Source: Steve Hoglund, Finance Director, City of Anacortes; Greg Thramer, Finance Director, City of Burlington; Alicia Huschka, Finance Director, Mount Vernon, actual revenue collected in 2005-2010.

An additional area of exposure to revenue risk is in home sales. In Washington, the sale of a new piece of property results in collection of sales tax, and every subsequent sale results in real estate excise tax. An unexpected drop in the real estate market can dramatically slow the purchases of property and leave a jurisdiction unable to fulfill its budget requirements.

Revenues from sales taxes differ from revenues from property taxes in that they are more difficult to project and plan for. While changes in the value of homes and the rate of new development may follow trends in historical data, changes in general commerce may not. The mobility of commerce makes it difficult to pin down to a specific municipality. If, for example, a large retailer closes in one municipality and opens a new store in nearby, revenues derived from sales taxes would shift from one municipality to the other. Similarly, if all consumer spending declines (as it has over the past several years due to the economic downturn) total revenues from sales taxes, in municipalities across the state, will decrease (as they have).

GOOD NEWS: CAPITAL COSTS

Capital costs (or capital outlay) include expenditures on fixed assets and durable goods, with a life expectancy greater than one-year, or expenditures intended to extend an existing asset's useful life, and/or improve its efficiency, capacity, or usability. Capital outlay can include relatively small objects like furniture, machinery and equipment, as well as much larger projects, like land, buildings, and infrastructure (e.g., streets, pipes, and water treatment plants, etc.).

Capital Costs

- Capital outlays vary from year to year, but have more flexibility in planning and other sources of revenue to support them..
- Capital projects can begin early or late depending on budget availability.
- Impact fees and new property taxes from new developments contribute to new infrastructure.
- State-run low-interest loan programs subsidize county- and municipal-level capital projects.

Expenditures for capital outlay tend to vary more from year to year compared to operating expenditures. This variability is less apparent when looking at a pooled dataset of statewide expenditures by all Washington cities and towns (shown in Exhibit 20), and becomes more apparent when looking at individual municipalities' budgets (shown in Exhibit 21). Some small municipalities may spend millions of dollars in one year for a new library, or fire station, and then make no capital outlays in the following year. This variability is one contributing factor making capital outlays difficult to forecast.

Exhibit 20. Annual Capital Outlays in Washington by State and Local Governments (in Millions)

	1992	1996	2000	2004	2005	2006	2007	2008	Average Annual Change since 2004
State	$7.6	$1.6	$1.8	$2.6	$2.5	$2.3	$3.0	$3.1	6.1%
Local	$10.8	$3.5	$4.2	$6.0	$6.5	$6.2	$5.5	$7.8	8.8%

Source: U.S. Census Bureau. State and Local Government Finance 1992, 1996, 2000, 2004, 2005, 2006, 2007, 2008.

Exhibit 21. Annual Capital Outlays in Anacortes and Mount Vernon (in Millions)

	2005	2006	2007	2008	2009	2010	Average Annual Change
Anacortes	-	-	$2.8	$1.8	$11.5	$6.6	157.0%
Mount Vernon	$6.7	$6.5	$8.2	$8.0	$6.7	$6.1	-1.0%

Source: Anacortes Annual Budget 2007, 2008, 2009, 2010; Mount Vernon Annual Budget, 2005, 2006, 2007, 2008, 2009, 2010.

Additionally, capital projects often do not have the same sense of urgency as operating expenditures. Employee salaries need to be paid to keep them showing up to work. The utility bills need to be paid to keep the lights on. If municipalities delay making these expenditures, work will grind to a halt. But, replacing an aging bridge? That can happen this year,

or the next, or the next, making it easier to delay capital outlays until (1) they pose a critical problem, (2) they are a high political priority, and (3) sufficient funds are available.

As with most government expenditures, capital outlays are influenced by population and employment. As cities and towns grow, adding more homes and businesses, they need infrastructure to accommodate that growth. More roads to support the flow of commerce, pipes to provide water and sewerage to homes, and fire and police stations to keep new neighborhoods safe. City and town departments with increased workloads will need additional office space, furniture, and vehicle fleets to support increased staffing levels. Interviews with local and county officials suggest that they have instruments for increasing revenues to account for the capital costs new developments require. These instruments include impact fees, property taxes, and low-interest loans.

Impact Fees

Skagit County has a way of dealing with capital outlays associated with new development, described in Skagit County Code Ch. 14.30 – Public Facilities Impact Fee. All new developments within Skagit County impact fee jurisdictions must pay a fee, based on the size of the development and other factors. According to the code, the revenue generated by these fees must "be used for public facility improvements of the district that will reasonably benefit the new development."[35] In other words, jurisdictions collect revenue from new developments to pay for future capital-based projects in the community that are necessary due to development expansions. In some cases, the County acts as the fee collector, even though the County itself does not impose any fees.

Property Taxes

Revenues from property taxes collected by the County and by municipalities also support capital outlays. As discussed earlier, Initiative 747 limits the annual increase in revenue generated from property taxes among existing properties. New developments, however, allow taxing districts to increase their revenues from property taxes above the one percent threshold mandated by Initiative 747. Interviews with local and County officials, however, indicate that many Skagit County jurisdictions are not using their bonding capacity and are not taxing the full one percent increase they are allowed.

[35] http://www.codepublishing.com/wa/skagitcounty/html/SkagitCounty14/SkagitCounty1430.html#14.30

Public Works Board – Low-interest Loans

The Public Works Board (PWB), operating within the Washington State Department of Commerce, is tasked with providing low-interest loans to help local governments finance infrastructure projects. PWB administers the Public Works Trust Fund (PWTF), which has four loan programs:

- The **Construction Loan Program** helps local governments address infrastructure needs for water, sewer, stormwater, roads, bridges, and solid waste/recycling systems.
- The **Pre-Construction Loan Program** helps accelerate a project's readiness to proceed and provides funding for design, engineering, environmental review, permits, and bid development.
- The **Planning Loan Program** provides funds to update comprehensive plans for water, sewer, stormwater, roads, bridges and solid waste-recycling.
- The **Emergency Loan Program** addresses unforeseen and unavoidable infrastructure emergencies.[36]

Funding for these programs comes from a variety of sources including: Solid Waste Collection Tax (18%), Real Estate Excise Tax (17%), Public Utilities Tax (8%), as well as Grant Repayment, Loan Repayment, and Interest Earnings (57%).[37] Skagit County's local governments have access to these low interest loans for capital projects. Exhibit 22 provides additional details about these four programs.

[36] www.pwb.wa.gov

[37] ibid

Exhibit 22. Characteristics of PWTF Loan Programs

Loan Terms	Non-Distressed	Distressed	Severely Distressed
Construction Program			
Required Local Match Funding	5, 10, or 15%	0%	0%
Interest Rate	0.5, 1, or 2%	0.5%	0.25%
Loan Cap per Biennium	$10 million	$10 million	$10 million
Length of Loan	20 years	30 years	30 years
Planning Program			
Required Local Match Funding	0%	0%	0%
Interest Rate	0%	0%	0%
Loan Cap per Biennium	$100,000	$100,000	$100,000
Length of Loan	6 years	6 years	6 years
Pre-Construction Program			
Required Local Match Funding	5, 10, or 15%	0%	0%
Interest Rate	0.5, 1, or 2%	0.5%	0.25%
Loan Cap per Biennium	$1 million	$1 million	$1 million
Length of Loan	3, 5, or 20 years	5 or 30 years	5 or 30 years
Emergency Program			
Required Local Match Funding	0%	0%	0%
Interest Rate	3%	0.5–3%	0.5–3%
Loan Cap per Biennium	$500,000	$0.5–$1 Million	$0.5–$1 Million
Length of Loan	20 years or life of project	20 years or life of project	20 years or life of project

Source: Public Works Board. 2011. Retrieved on June 8, 2011 from: www.pwb.wa.gov.

In addition to these four programs, PWB administers several other programs including:

- Water System Acquisition and Rehabilitation Program
- Direct Appropriation Grants
- Small Communities Jobs Grants
- Urban Vitality Grants
- Drinking Water State Revolving Fund, American Reinvestment and Recovery Act forgivable loans.