

APPENDIX B: FISCAL STRATEGIES

3. Spokane County Fiscal Story (October 23, 2008)

2007-2009 CTED Collaborative Planning Grant: Fiscal Issues for Spokane County Metro Urban Growth Area

Spokane County's Fiscal Story

Spokane County and the metro cities of Spokane, Spokane Valley, Liberty Lake, Airway Heights, and Millwood are now engaged in a collaborative planning process that focuses on the Metro Urban Growth Area. This collaboration is intended to benefit all Spokane County residents and set up all jurisdictions for long-term success:

- *Cities will have mechanisms to influence issues of land use, permitting, and infrastructure impacts associated with development in the unincorporated urban growth area.*
- *The County will have a clear service delivery/revenue structure that allows fiscal sustainability.*

With these goals in mind, the collaborating jurisdictions received a grant from the Washington Department of Community, Trade, and Economic Development (CTED).

A Rare Opportunity

The goal of the collaborative planning process is to identify solutions that will set all jurisdictions up for long-term success. By pursuing this goal, Spokane County and the metro cities have recognized that many of the challenges that they face can best be tackled by working together and by taking a big picture, collaborative approach. Moreover, they have recognized that, in order for Spokane County to achieve its best future, *all* levels of governments in the county must be healthy and strong.

Clearly, there are daily instances across Washington State when counties, cities, and other local jurisdictions are collaborating to solve problems. Just as clear, however, are instances where it seems the prevailing

attitude is one of parochialism among jurisdictions, an attitude of us-versus-them.

1. Looking to the future, the fundamental challenge Spokane County faces is one of fiscal sustainability. How can County government provide services and live up to its obligations as an agent of the state in the face of eroding General Fund revenues?
2. If the County is to be set up for success, a necessary first step is to recognize and articulate the fiscal challenge the County faces.

This folio provides baseline information about the underpinnings of Spokane County's fiscal challenges. The goal is to inform discussions as the process moves forward. The folio was prepared by Berk & Associates, a consulting firm that specializes in finance and economics, and the fiscal consultant for the collaborative effort.

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Among Washington's counties, Spokane County is in an enviable position. It is a county with substantial population, and of substantial means. At the same time, the County government, and the Metro area city governments are cohesive enough and few enough in number that big picture, truly collaborative solutions are within their grasp.

If the collaborating jurisdictions can take advantage of this rare opportunity—if they are successful in resolving tricky issues of land use coordination in urban growth areas and beginning to address the deep-seated fiscal challenges that counties face—they can lead the way for other counties and cities in Washington State.

Spokane County's Fiscal Challenge

- Strict limits on taxing authority
- Heavy reliance on property taxes
- A long list of state-mandated service obligations
- Complex relationships with its constituencies

Changing Fiscal Landscape

Over the past ten years, a combination of statewide initiatives and legislative actions have altered the landscape for local governments. The most sweeping changes have revolved around voters' decisions to end the Motor Vehicle Excise Tax and create strict limits on the growth of property taxes.

Across Washington State, the effect of these actions has varied by jurisdiction. Cities and local service providers like fire and library districts face one set of challenges, while Washington's counties face another.

Cities and Special Districts Response

If one were to ask a city manager or a fire chief about the altered landscape, they would probably say three things:

1. There is *always* a tension between local governments' *desire* to provide high levels of public services and the *reality* that taxpayers' dollars face many competing demands;
2. Recent shifts in tax structure have made it more difficult to make ends meet—to balance that tension; and
3. Difficulties notwithstanding, most cities and special service districts across the state have found that they *do* have the tools to adapt to the shifting tax structure. The solutions (from tapping unused taxing authority, to securing voter-approved "levy-lid-lifts") may not be easy, but they are out there.

Counties Are Different

Washington's counties are different from cities and special service districts in fundamental ways:

1. Counties face strict limits on their taxing authority;
2. Counties are heavily reliant on property taxes (which are now eroding);
3. Counties face a long list of regional service obligations that are mandated by the state;
4. Counties have a complex set of relationships with multiple constituencies:
 - Counties collect *regional taxes* and provide *regional services* for all constituents in the county;
 - They collect *local taxes* and provide *local services* to unincorporated areas;
 - And, through contracts, they provide services for other jurisdictions in exchange for payments.

Counties' Structural Challenge

Given this combination of factors, counties have found themselves with:

- A long list of service obligations that are non-negotiable;
- Structural erosion in their most important revenue source;
- Few statutory options for securing new revenue streams.

As they look to the future, Washington's counties face a fundamental, structural challenge—a challenge that will become increasingly unmanageable over time.

Spokane County is no exception.

Spokane County's Three Roles:

- Regional Services for All County Residents
- Local Services for Unincorporated Areas
- Contracted Services to Other Local Jurisdictions

What Do Counties Do?

Cities and service providers like fire and library districts typically provide local services. They collect taxes from a single pool of constituents, and they use those revenues to provide services to those same constituents.

Clearly, many cities provide services and amenities that benefit the broader region. In most instances, they do so in an elective manner. For example, the City of Spokane spends locally-generated tax dollars for operation of Riverfront Park—a facility that benefits the entire region.

In contrast to cities and special districts, counties are statutorily required to be a provider of both *local* and *regional* services. Counties collect local taxes in unincorporated areas and they provide local services like police protection, animal control, and parks services. Counties also collect regional taxes from all county residents and provide regional services to city and unincorporated residents alike.

As so-called "agents-of-the-state," counties bear sole responsibility for providing a range of regional services. The most costly of these include:

- Juvenile Detention, Courts, and Probation;
- Superior Courts; and
- Felony Prosecution, Defense, Incarceration.

In 2006, Spokane County's tax-supported obligations for these three regional services alone exceeded \$45 million. This means that, by themselves, these three categories of regional services used up most of the regional taxes the County collected (roughly \$56 million in 2006).

In addition to these big-ticket items, there are other regional services for which the County bears sole responsibility, including functions like the County Assessor and the County Medical Examiner.

Counties' three roles, and the fact that they have different relationships with different constituencies, make it challenging for constituents, and even policy makers, to understand how all the pieces fit together.

Where Do Counties Get Their Revenue?

In addition to being different from cities in what they do, Washington's counties have different revenue streams available with which to do it.

From a revenue perspective, counties across Washington State are much more restricted in their taxing authority than are cities. Cities generate their general operating revenues from a variety of sources, with the vast majority of their revenues coming from three key sources: property taxes, local sales taxes, and taxes on utilities and other businesses (Exhibit 1). This balance among three major sources is sometimes referred to as the three-legged stool.

Unlike cities, Washington's counties have no statutory authority to levy business or utility taxes, and they have authority to levy local sales taxes only in unincorporated areas—areas which often tend to have relatively low levels of retail sales activity. This leaves counties in a position of being heavily reliant on regional property taxes as their principal source of general operating revenues (Exhibit 2). This, in turn, makes counties particularly vulnerable to Washington's strict limit of one percent on property tax growth.

Exhibit 1: All Washington Cities:
Sources of Tax-Related Revenues (2005)

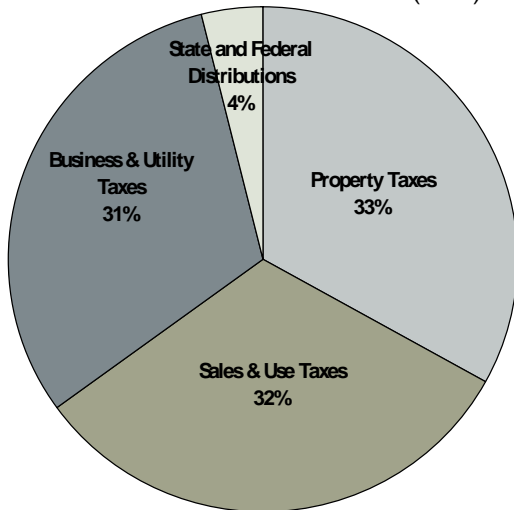
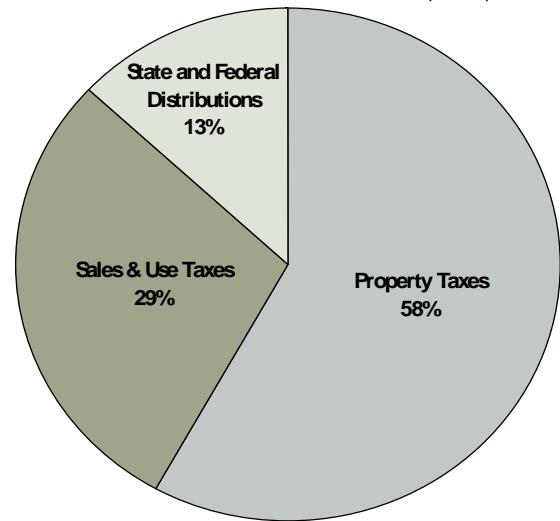


Exhibit 2: All Washington Counties:
Sources of Tax-Related Revenues (2005)



Source: CTED Report on County Financial Health (December 2007)

In terms of its mix of revenues, Spokane County is in a better fiscal position than the average county in Washington. As Exhibits 3 and 4 show, Spokane's Metro Area cities have a mix of revenues that is generally similar to cities statewide (dominated by revenue mixes for the City of Spokane). For Spokane County, however, rather than getting 58% of its revenues from its regional property tax like the average Washington county, Spokane County generated less than 50% of General Fund revenues from property taxes in 2005. Still, Spokane County is heavily reliant on property tax—more reliant than any metro area city.

Exhibit 3: Spokane Metro-Area Cities
Tax-Related General Fund Revenues (2006)

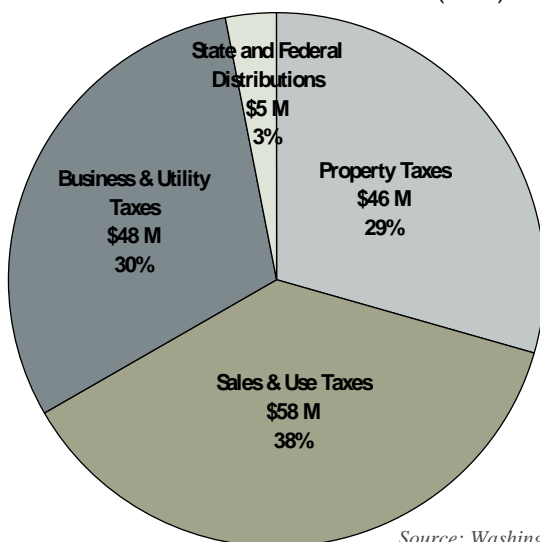
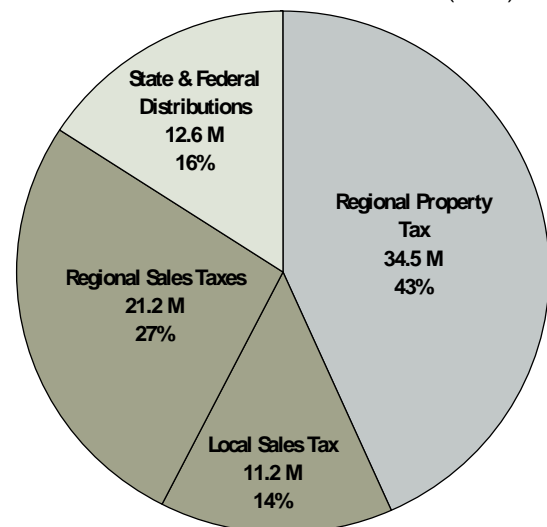


Exhibit 4: Spokane County
Tax-Related General Fund Revenues (2005)



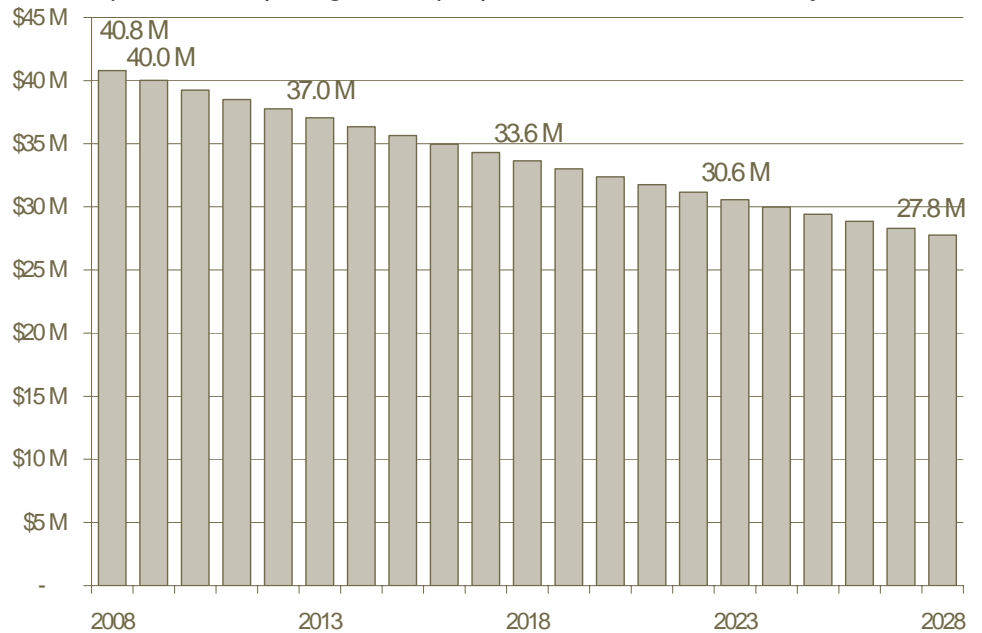
Source: Washington State Auditors Office and Berk & Associates

Impacts of the 1% Property Tax Limit

The reason counties' reliance on property taxes matters so much is because of the one percent property tax limit. This restriction limits the total amount of taxes most jurisdictions can collect by an increase of only one percent per year, excluding the impact of new construction. However, a jurisdiction can go above the one percent limit, if a majority of its voters approve a so-called "levy lid lift."

When one talks about the impact of the one percent limit, the conversation quickly gets complicated. Rather than trying to describe how all the pieces fit together, Exhibit 5 offers an illustration of how the limit stands to impact Spokane County in coming years. The bottom line is that, in terms of purchasing power, the County's most important regional revenue source can be expected to erode, significantly, in coming years.

Exhibit 5: An Illustration of Property Tax Erosion in Spokane County
Spokane County's Regional Property Tax Revenues in Inflation-Adjusted Dollars



Note: Assumes 1% growth limit, 2% growth in countywide property values from new construction, and annual cost-of-service (inflation) increases of 5%. This 5% cost-inflation reflects the combination of core inflation (equal to, perhaps, 4%) and increased demand for county services resulting from increased population (1%).

Putting the Pieces Together: Why Are Counties in Such a Tough Position?

Looking at cities across Washington State, responses to the new property tax limits have varied. Some cities have seen very strong retail sales tax growth over the past seven years and some of those have simply allowed sales tax growth to offset erosion in property taxes. Other cities have responded to property tax erosion by tapping previously unused taxing authority (e.g. enacting or increasing utility taxes). Other cities, still, have sought voter-approved levy lid lifts to forestall the effects of the one percent property tax limit. And finally, some cities have chosen, through their political processes, to reduce levels of services.

On the other side of the spectrum, most special service districts like fire and library districts have been able to quickly adapt to the one percent limit. As providers of a focused set of high-profile services, many fire and library districts have been successful in getting voters to approve

property tax levy lid lifts, thereby immunizing themselves against the effects of the one percent limits.

Counties, on the other hand, have found themselves in the worst of both worlds. Counties are highly dependent on property taxes, so they can't count on growth in other revenue sources to bail them out. Counties do not have statutory authority to levy new taxes. And, unlike special service districts, counties have a much more complex relationship with their constituencies.

In order for a county to secure a levy lid lift, they have to win majority approval from voters across the entire county. Voters who live in cities see their city as the primary provider of government services, and many are not even clear on what services the County provides. This makes voter-approval of a regional property tax lid lift an uphill battle.

Next Steps

Again, the goal of this folio is to inform the discussion among the collaborating jurisdictions, to articulate in broad terms the challenge Spokane County faces. The next steps in the process to further the goal of long-term fiscal sustainability for Spokane County will be to:

1. Develop a high level articulation of Spokane County's approach to service delivery (*What do we mean when we say the County is a regional service provider to all residents and a local service provider to unincorporated areas?*), and
2. Develop an overview of potential solutions that may be available to the County's fiscal challenges.

With these products in hand, the goal is for the collaborating jurisdictions to have a strategy for moving forward by the Spring of 2009.