



# Association of Washington Cities Elected Officials Essentials Workshop An Introduction to Municipal Finance

December 9, 2023

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## Agenda

### Local taxing power in Washington State

- Property taxes
  - Brief history of property taxes
  - Constitutional requirements/limitations
  - Budget based property tax structure
  - Statutory limitations
- Excise taxes

### Other sources of revenue

#### Debt financing

- What is a bond and common types
- Legal framework

### Questions



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## Local Taxing Power in Washington State

### Overview

- Local governments in Washington do not have inherent taxing authority
- Ability to impose taxes and fees must derive from the State Constitution or Statutes adopted by the State Legislature
- Two main types of taxes
  - Property taxes
  - Excise taxes
    - All taxes except property taxes – broad category
    - Sales tax and B&O tax are significant in Washington
- Washington has evolved to become less dependent on property taxes (and ever more dependent on excise taxes, including sales taxes and B&O taxes)
  - In 1970 property taxes accounted for 86.5% of local tax revenues; by 2007 that percentage had declined to 57.8% . *DOR Washington Tax History*
  - Today heavily dependent on excise taxes – sales taxes and B&O taxes

## Understanding “funds” and legal restrictions

Three main types, but funds structure depends on your city's accounting structure

- Governmental (taxes, GO debt service, street fund)
- Proprietary (utilities, fees)
- Fiduciary (investment Trust, pension)

## Local Taxing Power in Washington State

### Brief History

- State Constitution, many amendments
- Statutory limitations, initiatives (Referendum 47 (lesser of inflation or 106%), I-722 (102%), I-747(101%))
  - 2007 Legislature “reinstated” the I-747 one percent property tax limit factor adopted by the voters

## Constitutional Requirements

### Property taxation (Article VII, §1)

- Uniformity within classes of property
  - Must be uniform within the territory of the particular taxing district (e.g. each county, city, port)
  - Real estate is one class
  - Legislature may grant exemptions by general laws
- Property “shall mean, and include everything, whether tangible or intangible, subject to ownership”

### Purpose

- All property taxes only for public purposes
- State property taxes for the support of the common schools

### State taxes must be paid into State treasury

**Fees, excise taxes, special assessments are not property taxes**

## Constitutional Limitations

**Assessed on true and fair value of property (Article VII, §2)**

**1% limitation (aka the \$10 limit)**

Aggregate limitation on all levies by state and taxing districts

- Excludes property taxes by ports and public utility districts

Prorationing

**Excess property taxes, outside 1% limitation**

Supermajority approval plus minimum voter turnout requirement

- One-year levies for any lawful purpose
- To pay unlimited tax general obligation bonds for capital purposes (other than replacement of equipment)

## Budget-based property tax levies

### Rates and Amounts

Washington taxing districts set property taxes through the budget process based on a budgeted dollar amount. This amount is subsequently converted into a levy rate per thousand of assessed value. There are legal limitations on both amount and rate.

- **Levy amount**
  - Taxing district sets total amount to be collected through annual budget process
  - Subject to a number of limitations
  - Levy amount is certified to County Assessors by November 30 each year
- **Assessed value (AV)**
  - Taxable property within the taxing district
- **Levy rate**
  - County Assessors divide the levy amount by the AV to determine levy rate
  - Rate per thousand of AV
  - Subject to a number of limitations
- **Overlapping taxing districts**

## \$5.90 limit

### **\$5.90 limit is an aggregate limit on the total levy rate of local taxing districts**

Excludes the State levy

Applies to counties, cities and junior taxing districts

- Does not apply to ports and public utility districts
- Does not apply to excess levies

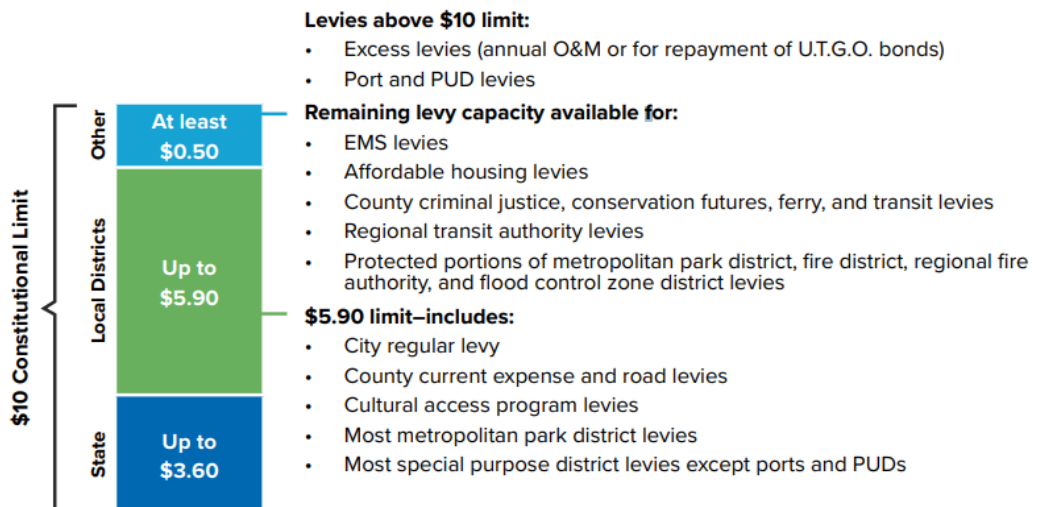
List of specific exclusions including, among others:

- Conservation futures levies under RCW 84.34.230
- EMS levies under RCW 84.52.069
- Affordable housing levies under RCW 84.52.105

Prorating (aka cram down)

- Specific sequence; WAC outlines; different sequence than for the 1% limit
- Certain junior taxing districts may protect a portion of their levy from prorating

The chart below demonstrates both the \$10 constitutional and \$5.90 local government limits.



## Maximum rates per thousand

**With certain exceptions, taxing districts have specific statutory maximum levy rates for regular property taxes**

“Regular” property taxes (compare to excess property taxes)

Most councilmanic or nonvoted

General maximum rate per thousand by type of taxing district

“Special” regular levies

- Affordable housing
- EMS levies
- Conservation futures levies

Because of the effect of the 101% limit on the total annual amount of property taxes (next slide), rates per thousand tend to decline; taxing districts commonly levy well below their maximum levy rates.

“Levy lid lift” allows taxing district to bump back up to their maximum regular property tax levy rate, with simple majority voter approval



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## 101% Limitation

- Eyman 102% and then 101% initiatives passed, both ruled unconstitutional, Legislature enacted 101% limitation
- 101% limit (aka the 1% limit, but that is very confusing, given the 1% constitutional limit). RCW 84.55.010
- Applies to regular properties (subject to 1%/\$5.90 limits), includes port/PUD
- “Limit factor” limits annual increases in the total dollar amount of regular property taxes to, basically, 101%
- Highest of the three most recent years plus an additional amount for
  - New construction/improvements
  - AV increases due to construction of certain wind turbine, solar, biomass, geothermal facilities
  - *Note exemptions*



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## Levy Lid Lifts

**“Lift” the 101% cap on *regular property taxes* with a “levy lid lift,” to restore levy up to maximum statutory rate per thousand**

Simple majority voter approval

Single year v. multi-year (up to 6 years, added in 2003)

- Single year also known as “one-year,” “one-bump,” “basic,” or “original” lifts
- Confusing because single year lifts usually last for a number of years or can even be permanent
- Distinction between single and multi-year is based on the number of bumps (one/single or more)

Temporary v. permanent

Limited purpose or any purpose

- If purpose is payment of debt service then limited to no more than 9 years (25 in Thurston County)

Specify whether the base year is to be used for future calculations



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## What is a Bond?

Structured to allow sale/placement with a wide array of investors

- Public sale to investors by an underwriter selected via RFP or a competitive sale
- Private placement with a bank (bank loan)

Secured by a pledge of tax or other revenues

Benefit of bond financing

- Receive project funding up front
- Intergenerational equity
- Time value of cash

Must be authorized by State law

- Requires city council approval
- Approval may be delegated within certain parameters

May be issued as tax-exempt

- Interest paid to investor holding tax-exempt municipal bonds may be excludable from federal income taxation
- Subject to ongoing federal tax law requirements

Subject to securities laws



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# What is a Bond?

Must be authorized by State law

RCW 39.44.200(1); RCW 39.46.020(1)

- "Bond" means any agreement, which may or may not be represented by a physical instrument, including notes, warrants, or certificates of indebtedness, that evidences an indebtedness of the state or a local government or a fund thereof, where the state or local government agrees to pay a specified amount of money, with or without interest, at a designated time or times.

RCW 39.44.210

- "Type of bond" includes: (a) General obligation bonds, including councilmanic and voter-approved bonds; (b) revenue bonds; (c) local improvement district bonds; (d) special assessment bonds such as those issued by irrigation districts and diking districts; and (e) other classes of bonds.

RCW 39.46.020(4)

- "Obligation" means an agreement that evidences an indebtedness of the state or a local government or a fund thereof, other than a bond, and includes, but is not limited to, conditional sales contracts, lease obligations, and promissory notes.
- RCW 35.42.200 (for example).

# Common Financing Methods

Public bond market

Bank financing (private placement)

Seller/vendor/equipment financing

Local Option Capital Asset Lending ("LOCAL") State borrowing program

State

- Public Works Trust Fund, State Revolving Fund, Clean Renewable Energy Bond

Federal

- USDA Rural Development
- US EPA (Water Infrastructure Finance and Innovation Act (WIFIA) loans
- US DOT (Transportation Infrastructure Finance and Innovation Act (TIFIA) loans



# Common Types of Debt

Unlimited tax general obligation (UTGO)	Limited Tax General Obligation (LTGO)
<ul style="list-style-type: none"> <li>▪ Consumes UTGO debt capacity (2.5% for general purposes)</li> <li>▪ Only for capital purposes, not the replacement of equipment</li> <li>▪ Supermajority (60%) voter approval</li> <li>▪ Validation requirement</li> <li>▪ Paid from excess property tax levy</li> <li>▪ Outside of statutory or constitutional limits on regular property taxes</li> <li>▪ Levy set at rate required to pay debt service</li> </ul>	<ul style="list-style-type: none"> <li>▪ Councilmanic, non-voter approved</li> <li>▪ Consumes LTGO debt capacity (within the allowable 2.5% for general purposes, up to 1.5% can be issued without voter approval)</li> <li>▪ Any municipal purpose (generally)</li> <li>▪ Pledge to levy regular (nonvoted) taxes as necessary to pay debt service within legal limits:</li> <li>▪ Statutory rate per thousand (e.g. \$3.60/\$1,000 AV for cities)</li> <li>▪ Aggregate rate limit (\$5.90/\$1,000 AV – subject to prorating)</li> <li>▪ 101% limit on increases in dollar amount of levy</li> <li>▪ Paid from general fund or other legally available revenues</li> </ul>

# Common Types of Debt

Revenue Bonds	Assessment Bonds
<ul style="list-style-type: none"> <li>▪ Payable from generating assets (user fees, rates, water, sewer, storm)</li> <li>▪ Revenue bonds are <b>not</b> subject to constitutional or statutory debt limitations – special fund doctrine</li> <li>▪ An issuer’s capacity to issue additional bonds secured by enterprise revenues is typically limited by covenants established in the bond resolution</li> <li>▪ Additional bonds test (ABT) requires an issuer to demonstrate a minimum level of debt service coverage (e.g., 1.25x or 1.50x), including the proposed new debt</li> <li>▪ May require a debt service reserve fund</li> </ul>	<ul style="list-style-type: none"> <li>▪ Infrastructure with special benefit to property owners</li> <li>▪ Payable from charges imposed against properties in a designated local improvement district or utility local improvement district in respect of special benefits received by those properties from the construction of nearby or adjacent public improvements, separate and apart from the general benefit accruing to the public at large</li> <li>▪ Special assessments are determined according to the value of the benefit received – value capture financing</li> <li>▪ Process for creating district, setting the assessment roll, finalizing the assessment roll, and issuing debt payable from assessment is highly statutory</li> </ul>

## Legal Framework – State Law

Legal authority to issue bonds derives from State law

- Specific statutory authority
- City's charter or code may contain additional requirements

Decision-making tree:

- Does the city have constitutional and statutory authority to issue debt of the type proposed?
- Does the debt first require voter approval? (e.g. UTGO bonds)
- Does the city have legal debt capacity to issue the debt? (e.g. UTGO and LTGO bonds)
- What is the statutory process for issuing the debt? (e.g. formation of LID/ULID and confirmation of assessment roll)
- Are any third party approvals or guarantees needed?
- Does the city have the legal authority to undertake the project to be financed? Are there any doubts?
- What is the city's approval process for the authorizing legislation? (e.g. ordinance approving the bonds or delegating authority to approve the bonds within specified parameters)

## Legal Framework - Federal Tax Law

Internal Revenue Code and regulations govern

- How Tax-Exempt Bond Proceeds Can be Spent
- Use of Financed Facility/Assets
  - Limits private business use at the bond financed facility
  - Limits the ability of the issuer to sell or lease the bond financed facility
- The Investment and Arbitrage of Bond Proceeds
- Records Retention

Set expectations at closing with key documents

- Tax Certificate and Form 8038-G

Monitor for changes

- Post-Issuance Compliance Policy
- Private activity tracking

# Federal Securities Laws

## Overview

Although municipal bond issuers are exempt from the SEC's registration and filing requirements that apply to corporate issuers, all issuers (including municipalities) are subject to the antifraud requirements that apply when issuers speak to the market

- Antifraud Requirements
  - Rule 10(b)(5)
  - Section 17
- Application of Antifraud Requirements
  - 2020 SEC Staff Legal Bulletin
- Primary and Secondary Market Disclosure

# Municipal Bonds; Antifraud Laws

## Rule 10b-5

Rule 10b-5, promulgated under Section 10(b) of the Securities Exchange Act of 1934, prohibits fraud in connection with the purchase and sale of securities. Among other provisions, it makes unlawful:

- any untrue statement of a material fact or
- omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,
  - in connection with the purchase or sale of any security.

SEC must show “scienter” or an intent to defraud.

- Note: recklessness is sufficient to establish intent
  - Highly unreasonable conduct that is an extreme departure from the standards of ordinary care

## Municipal Bonds; Antifraud Laws

### Section 17(a)

Section 17(a) of the Securities Act of 1933 prohibits fraud in the offer and sale of securities. Section 17(a) makes it unlawful for any person in the offer or sale of any securities...directly or indirectly:

- To employ any device, scheme, or artifice to defraud, or
- To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Based on SEC settlements: negligence is sufficient to establish a Sec. 17(a) violation.

- no finding of scienter (intent) is required
  - “knew or should have known” standard for establishing negligence
  - Failure by an actor to conform conduct to the standard of a reasonable person under like circumstances



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## Materially Accurate and Complete

### Materiality

Whether a statement or omission can give rise to a securities law violation depends on whether the statement or omission is *material*.

The definition of “material” has been established by case law

- There is a substantial likelihood
- That a reasonable bond investor
- Would consider it important in making an investment decision
  - There must be a substantial likelihood that a fact *"would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."*



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## Speaking to the Market: 2020 SEC Staff Legal Bulletin (Feb. 7, 2020)

### A caution regarding the scope of the antifraud requirements

The SEC Office of Municipal Security (OMS) released a Staff Legal Bulletin summarizing existing law regarding the application of the antifraud requirements to public statements by issuers and borrowers.

- Rule 10b-5 under Section 10(b) of the Securities Exchange Act
  - Applies to secondary market disclosures
  - Prohibits making any untrue statement of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading
- Any public statement (at least by officials who may be viewed as having knowledge regarding the financial condition and operation of an issuer) may be reasonably expected to reach investors and therefore be subject to the antifraud requirements.

## Questions?

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### Resources

- MRSC, *Revenue Guide for Washington Cities* (<https://mrsc.org/getmedia/d3f7f211-fc63-4b7a-b362-cb17993d5fe5/Revenue-Guide-For-Washington-Cities-And-Towns.pdf?ext=.pdf>)
- National Association of Bond Lawyers, *The Bond Basics* (<https://www.nabl.org/wp-content/uploads/2023/03/NABL-Bond-Basics.pdf>)
- EMMA system (<https://emma.msrb.org/Home/Index>)