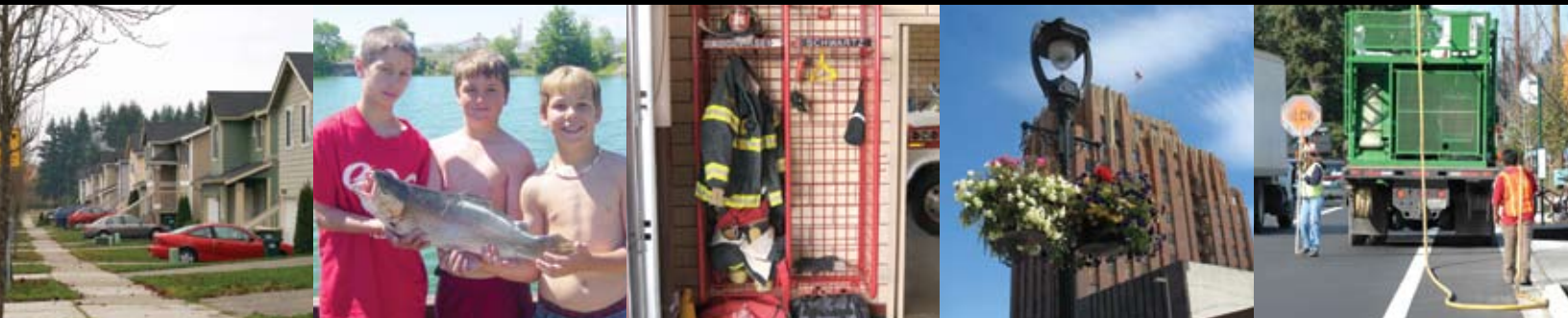


State of the Cities

2009 Executive Summary



Assessing the health of Washington's communities



Introduction

Throughout the last decade, many of Washington's cities and towns have stretched revenues to meet the most basic, critical services.

As we end 2008, we face an unprecedented economic downturn. The housing bubble has burst; the stock market has plummeted; the state's deficit has ballooned; fuel costs are volatile; infrastructure materials are skyrocketing; and the headlines of job losses continue.

These economic trends and statistics are more than words and numbers on a page—they represent harsh realities on daily lives of our citizens and the communities in which we live. But that's where we will find the solutions in the months and years ahead—right here in the backyards of our cities and towns across Washington.

Yes, times are tough. But that's when our communities come together in common purpose and tap the ingenuity and resourcefulness that make our cities and state great. Healthy cities are where we make the investment in our future—the local staging grounds for managing growth, protecting our environment, and strengthening public health and safety.

We know what works. On behalf of the citizens of Washington, it's time to further strengthen the partnership between cities and the state, and make the investments needed for their future.

Karen Rogers
President, AWC Board of Directors

State of the Cities Research Projects

State of the Cities is an ongoing research project designed to reflect the fiscal condition of cities in Washington State. The Association of Washington Cities (AWC) releases a comprehensive State of the Cities report every four years at the beginning of each gubernatorial term. Interim reports, presenting an in-depth look at a specific topic, are released annually between full reports.

This report presents a comprehensive analysis of the conditions that impact our 281 cities today, over the last four years, and what cities envision happening in the near future.

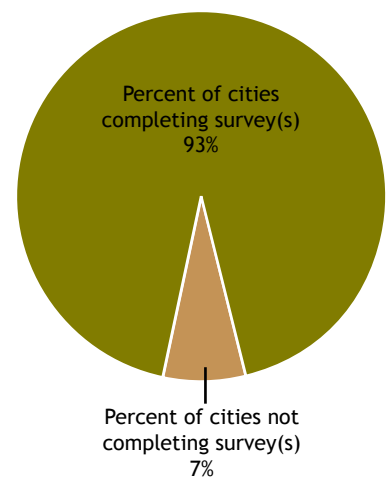
For the complete AWC State of the Cities research, go to www.awcnet.org/stateofthecities.

The Association of Washington Cities (AWC) Inc. is a private, non-profit membership organization that exists to create and maintain livable cities and towns throughout the state. AWC serves its members through advocacy, education and training, technical assistance, risk management and insurance services.

I am startlingly concerned about the sustainability of our budget for 2010 and beyond. Without revenues keeping pace with the cost pressures we face as a personnel-based service provider, we will be facing cuts in staffing every year moving forward to live within our means.

-Eric Swansen, City Manager, Sunnyside

This report reflects the views of city officials in Washington's cities and towns. Collectively, 93 percent of cities took one, two or three surveys used for this report.



State of the Cities report findings: Cities nearing the breaking point

Our town has few revenue sources outside of property taxes. Since the city's property tax is held at a 1% increase, Sultan has been forced to cut park and street maintenance in order to maintain public safety and other mandatory services.

-Deborah Knight, City Administrator, Sultan

Both the local community and national economic trends impact city fiscal conditions, creating budget pressures for cities on the revenue and the expenditure side of the equation. Cities are facing:

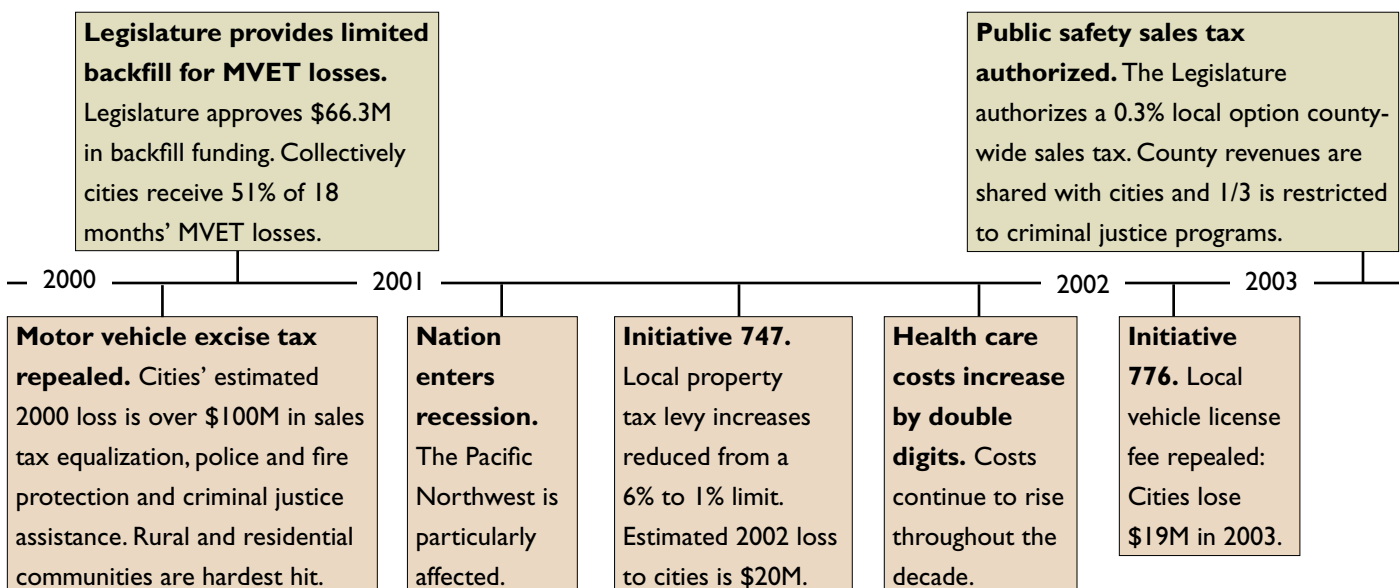
- The worst economic turmoil the country has seen since the great depression;
- The burst of a nation-wide housing bubble; and
- Sky-rocketing infrastructure material costs, health insurance costs and volatile energy prices.

The State of the Cities research identified two distinct, but very interconnected struggles for Washington's cities:

- Operating budget revenues are not sufficient for many cities to support the level of services required to meet federal and state mandates, citizen expectations, and community priorities.
- City infrastructure systems are crumbling. These aging systems are inadequate to meet current needs of businesses and residents, or sustain and attract growth.

As cities enter a new fiscal year, city officials report that conditions are worsening. Sixty-three percent of city officials indicate their city will be less likely to meet fiscal needs in 2009 than in 2008, and 66 percent report their city will be less likely to meet fiscal needs in the next four years.

City fiscal ups and downs since 2000



How will cities respond to this budget shortfall?

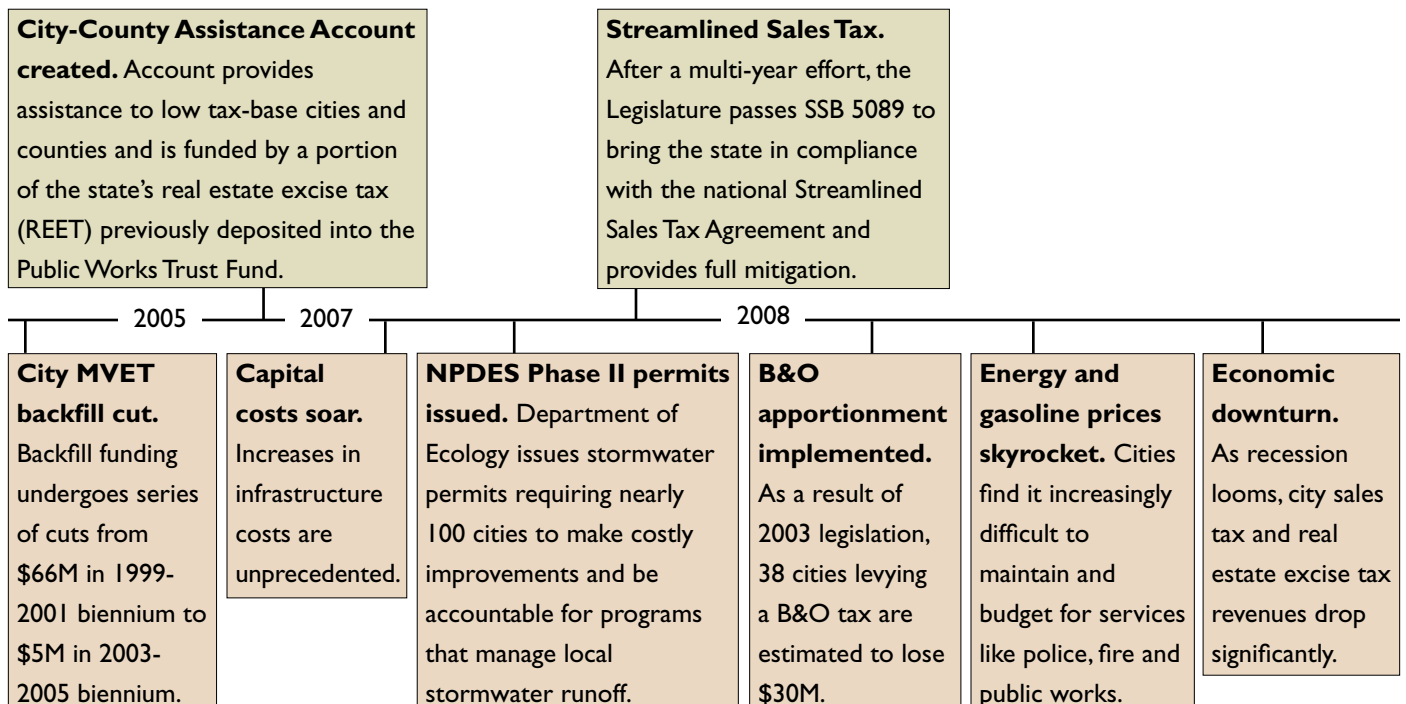
They will reduce infrastructure spending. Forty-six percent of city officials report their city is likely to reduce infrastructure spending in 2009, with 26 percent saying a significant decrease is likely. Directing fewer resources towards one of our state’s most valuable assets means cracks will grow in this vital foundation.

They will reduce their scope of services and their workforce. Thirty percent of city officials report they will likely reduce their city’s scope of services and the workforce. Fewer police officers may be on the street, planning departments may reduce hours, or pools may close.

They will continue to seek innovative ways to do more with less. In times of budget shortfalls, cities pull in, reexamine priorities and work with citizens and staff to “make it work.” At some point, however, working with less resources, simply delivers less results.

Mandates and tax restrictions have created \$1 million in lost capacity for the city. This totals 17 percent of our tax-supported programs and there has been no comparable reduction in expectations. We have been buying time, but time is running out. This condition is simply not sustainable.

-Dave O’Leary, City Administrator, Shelton



An unsustainable tug-of-war

City revenues are uncertain: City revenues don't keep pace with expenditures. Since the early part of this decade, important revenue sources such as the property tax and the motor vehicle excise tax were capped or eliminated. Coupled with increases in expenditures, many cities have struggled with basic service delivery. Others were able to maintain services in light of rising expenditures simply because unprecedented growth provided short-term revenues. However, those days are over.

As the housing market continues to slump, real estate excise tax yields and other revenues associated with home sales and construction are declining. As the national economy teeters on recession, people are spending more cautiously. Washingtonians are purchasing less—especially large items—and sales tax revenues reflect this.

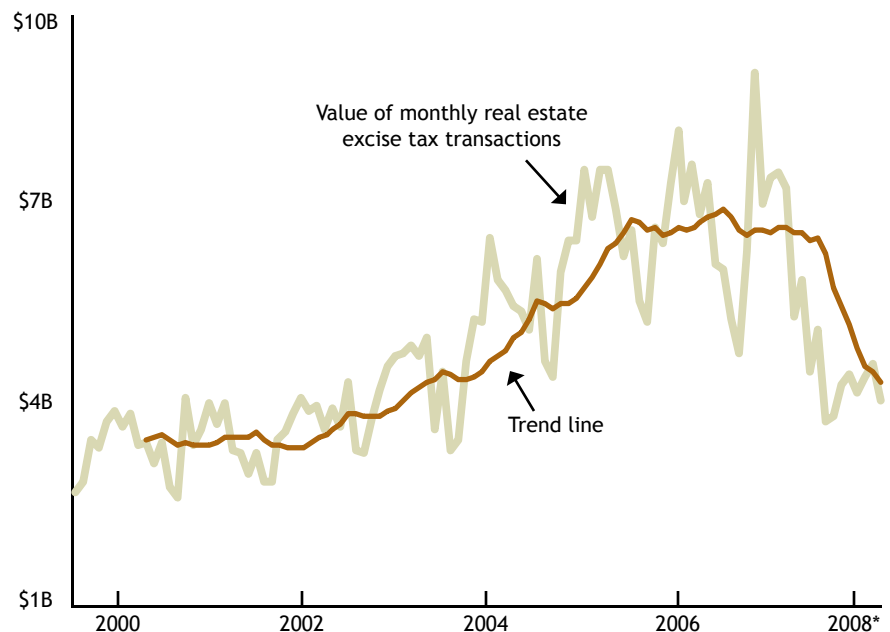
Even with 12 percent population growth, we've had to reduce 12 staff positions, and could lose up to ten in the next biennium.

~Bob Hammond, City Manager, Kennewick

Those programs dependent on general fund funding have been the most difficult to sustain, especially discretionary programs such as parks, recreation, community services and internal administrative support.

~Betsy Williams, Assistant City Manager, Vancouver

The value and number of statewide real estate excise tax transactions have fallen sharply, impacting city revenues as well as important funds like the City-County Assistance Account and the Public Works Trust Fund



Source: Department of Revenue

*Through August 2008

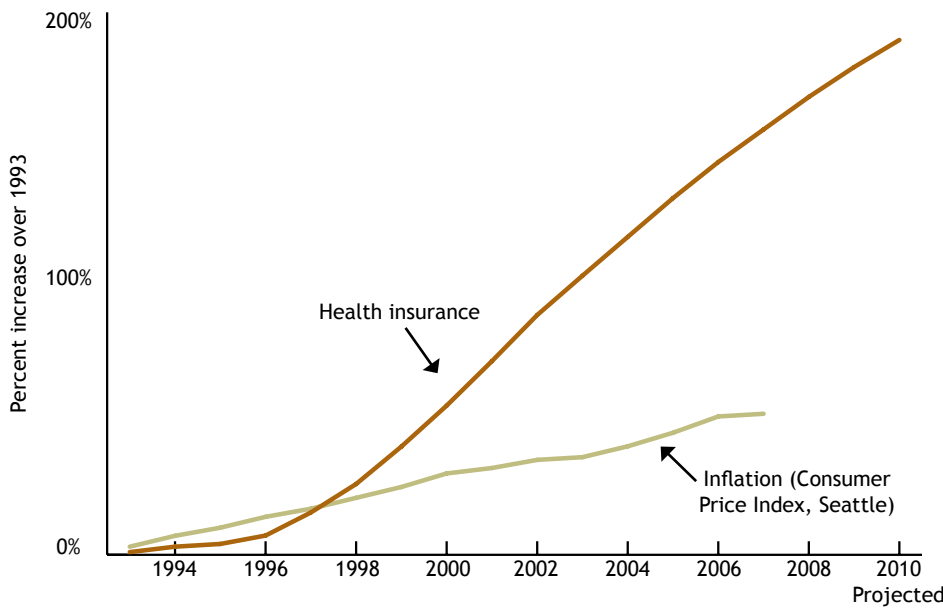
City expenses are growing: Citizens and businesses face rapid inflation in certain expenditure areas, and so do governments. Cities identify these items as negative budget impacts:

- Infrastructure needs—with cost increases in materials like asphalt and steel, this is the most frequently-cited negative budget influence;
- Public safety needs—consuming, on average, close to 50 percent of the city operating budget, increases in public safety personnel and capital costs create a hardship;
- Personnel costs—people are behind nearly every city service, but personnel costs are increasing faster than revenues; and
- Inflation—volatile fuel and energy costs negatively impact cities, particularly public safety and public works departments.

With the increase in costs, there's an urgency to start infrastructure projects now. Don't wait.

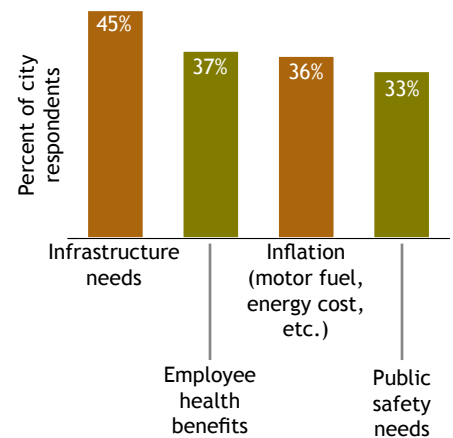
-Craig George, Mayor, Dayton

Increases in health care costs are far greater than increases in inflation

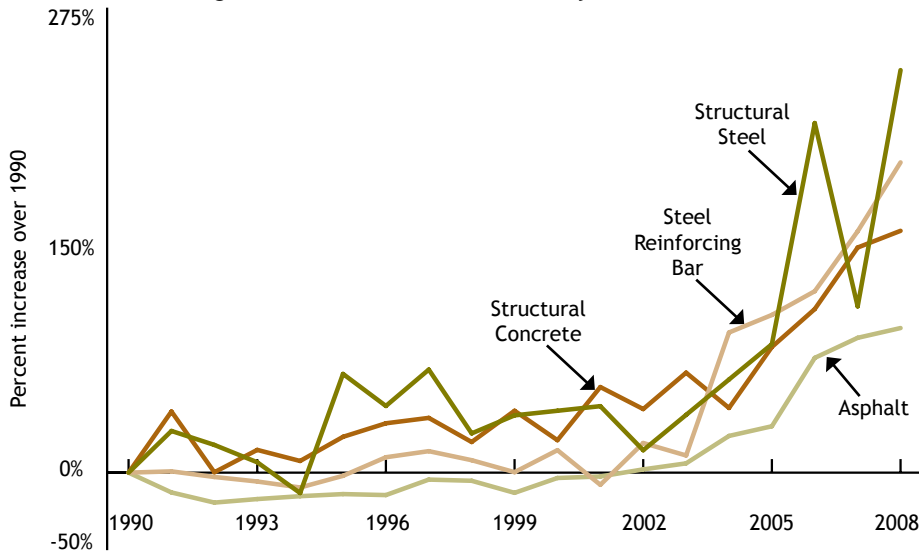


Source: AWC Employee Benefit Trust

When asked about the three most negative budget impacts of the last four years, cities point to infrastructure needs, employee health benefits, inflation and public safety needs



Bid prices show steady cost increases for materials critical to building our most basic infrastructure systems



Source: Department of Transportation

Essential service providers

Public safety is difficult to sustain in general. The rising costs of personnel, equipment, third-party agreements and overhead far exceed the city's revenue increases. Call volume, complexity or nature of calls, state and federal mandates and the liability of providing services also contribute to the challenges in providing sound public safety.

~Pat Reay, City Administrator, College Place

We are ignoring the maintenance and obligation to maintain 100 miles of streets. If the city increased its street fund by \$1 million a year, it would still take more than 100 years to repair and replace them.

~ David Timmons, City Manager, Port Townsend

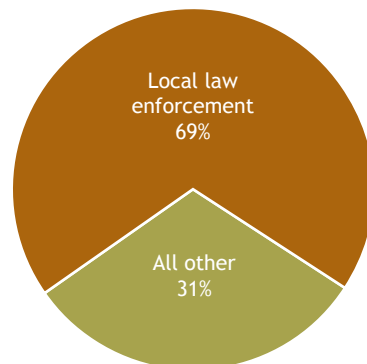
Whether small, rural towns or large, urban metropolises, Washington's 281 cities and towns are home to 62 percent of the state's population. From coastline communities that boast international ports to inland communities that are home to cutting-edge industries, and from quaint-residential towns to tourist villas are the bedrock of entrepreneurial activity and quality of life.

City government offers specific services that are defined by state and federal laws and a reflection of their citizens' demands. These essential services include:

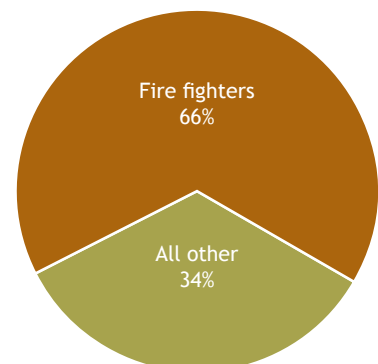
- **Public safety and security**—protecting residents and businesses through employment of 69 percent of the state's local law enforcement and 66 percent of fire personnel.
- **Streets**—constructing and maintaining streets over which one-quarter of all the state's traffic is carried.
- **Water, sewer and stormwater**—providing dependable utility services for millions of urban residents and businesses.
- **Parks, libraries and recreation activities**—enhancing cities with quality of life opportunities that keep communities healthy and engaged.
- **Permitting and licensing**—ensuring public safety and shaping livable and vibrant communities.

In recent years cities have struggled to maintain essential and citizen-demanded services. As cities enter the 2009 fiscal year, many face budget shortfalls and critical services are in jeopardy. The implications of this financial crisis will be felt across Washington State. Erosion of services threatens our economic vitality, public health and safety, and quality of life.

Of all local law enforcement employees, 69% work for cities



Of all local fire employees, 66% work for cities



Growing cities

Cities are home to more than four million residents—and the numbers are rising year after year. Whether it's because these communities offer more services, are closer to job centers or provide greater cultural amenities, people are choosing to live in Washington's cities.

Growth carries positive and negative fiscal implications.

- On the positive side, it provides a city with one-time revenues such as sales tax and real estate excise tax generated from new construction. It expands the tax base creating greater new revenue potential (although the one percent cap on property tax revenues creates challenges).
- On the negative side, growth increases service demands and these demands are ongoing. Unfortunately, many of the revenues associated with growth are not.

One-time revenues are not enough to keep cities on pace with the constant service requirements generated by growth such as:

- Expanding streets and utilities;
- Maintaining sufficient public safety services;
- Creating additional parks and open spaces;
- Building new facilities such as libraries and fire stations;
- Planning for affordable housing and a growing workforce; and
- Managing the impact of growth on the environment.

Building a foundation for growth

The Growth Management Act (GMA), passed in 1990, clearly mandates that cities plan for and accommodate future growth. The GMA directs growth to take place where infrastructure exists; it requires that city infrastructure systems provide a foundation for growth. But maintaining and building a solid foundation is expensive.

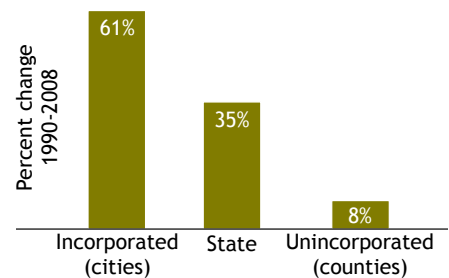
Cities report that inadequate infrastructure systems are a barrier to economic development.

- One in three cities report lack of street capacity is a barrier to economic development;
- One in four cities report lack of sewer capacity is a barrier to economic development; and
- One in five cities report lack of drinking water capacity is a barrier to economic development.

Our city has nearly doubled in population over the past four years, which has impacted our ability to maintain certain levels of service.

~Justin Clary, City Manager, Ridgefield

City population has grown far more than unincorporated areas or the state as a whole



City infrastructure systems: Cracks in the foundation

Infrastructure is the foundation for which everything else is possible in our community. Therefore, we have an unrelenting commitment to provide sound, basic infrastructure for our residents.

~Michael Echanove, Mayor, Palouse

Our road fund can no longer fully fund the larger truck routes.

~Pete Lewis, Mayor, Auburn

Washington's cities provide residents, businesses and visitors with a network of fundamental public capital facilities and systems that are collectively known as infrastructure. This catch-all phrase encompasses:

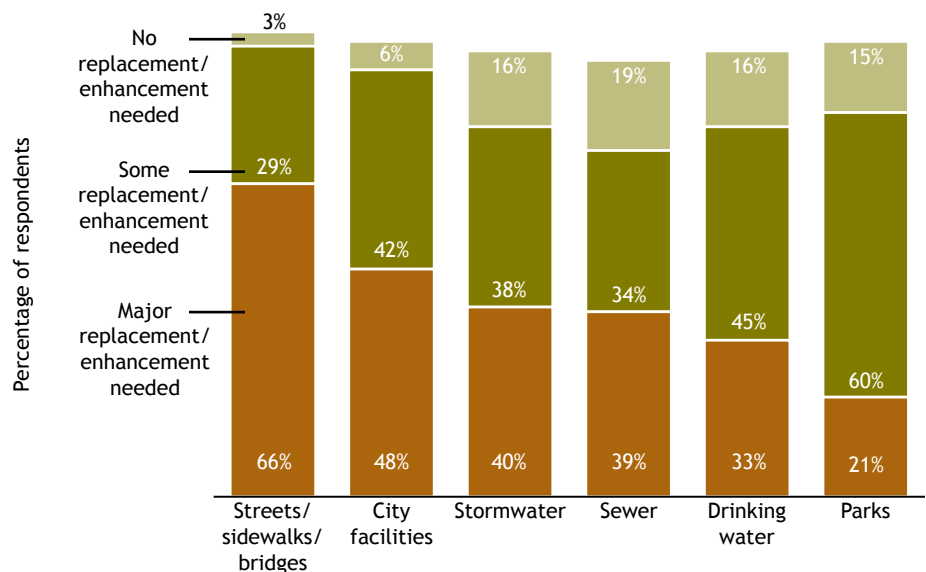
- Streets, sidewalks and bridges;
- Drinking water and sewage treatment facilities;
- Stormwater management;
- Municipal buildings like city halls, community centers and fire stations;
- Parks, open spaces and recreation centers; and
- Police cars and fire engines.

These infrastructure systems keep cities economically vibrant, clean, safe and livable. They are often unique to government, providing services that are large in scale and critical to the production and delivery of private and public goods and services.

Yet, many city infrastructure systems are inadequate.

- Aging, deteriorating systems are nearing the end of their useful life;
- Systems lack the capacity needed to accommodate new growth;
- Soaring infrastructure costs create new hurdles that capital replacement reserves could not have anticipated; and
- Unfunded federal and state mandates require costly system improvements.

Many city infrastructure systems must be replaced or enhanced to meet current demand



All systems need investment

Nearly every component of cities' infrastructure systems needs attention. System maintenance and replacement varies from city to city. Some systems are at or near the end of the life cycle while others have recently been replaced. But the statewide trends are very clear.

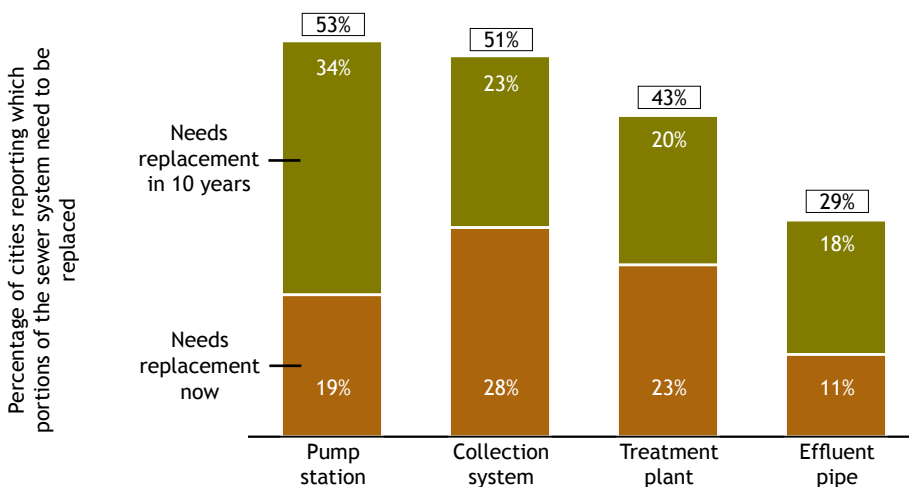
Overwhelmingly, city officials report that streets suffer more than any infrastructure system.

- Ninety-five percent of city officials indicate that enhancement or replacement is needed for their city's streets simply to meet current demand, with 66 percent indicating major replacement or enhancement is needed;
- More than half of city officials report that streets have been one of the most difficult services to sustain during the last four years; and
- Of the nearly 700 city-owned bridges that are federally reported, one in four is functionally obsolete, and approximately one in ten is structurally deficient or weight restricted.

City officials are also concerned about their utility systems and other capital assets.

- Nearly 60 percent of cities need to replace a portion of their water distribution systems in the next ten years;
- Seventy-three percent of city officials report their sewer systems need replacement/enhancement to meet current demands;
- Ninety-three percent of the cities required to obtain the National Pollutant Discharge Elimination System (NPDES) Phase II permit need to replace or enhance their stormwater system;
- City officials report that in times of budget pressures parks and recreation services are often the first to be cut, but parks and open space are critical to accommodate increasing density; and
- Almost half of cities (48 percent) report that capital facilities—fire stations, city halls, etc.—need major replacement or enhancement to meet current needs.

In the near future many cities will need to update sewer systems



Source: State of the Cities, 2008

The sewer is an ongoing project for which we have received some funding, but far from enough to meet all requirements.

-Lorna Pearce, Clerk-Treasurer, Coulee City

It will take 25 years to get through our list of projects. Covington is committed to high-quality and high-functioning stormwater management systems. However, we can only satisfy immediate expectations with capital funding help.

-Glenn Akramoff, Public Works Director, Covington

Strong cities, strong state

Cities are the state's long-term partners in creating and maintaining a strong Washington. Businesses choose to locate in cities and they are where the majority of the state's population lives.

Enhancing a city-state partnership

Cities view the state as an invaluable partner. More than half of cities say their relations with the state improved over the past four years.

The state provides some:

- Financial assistance to low-tax base cities;
- Infrastructure assistance; and
- Public safety assistance.

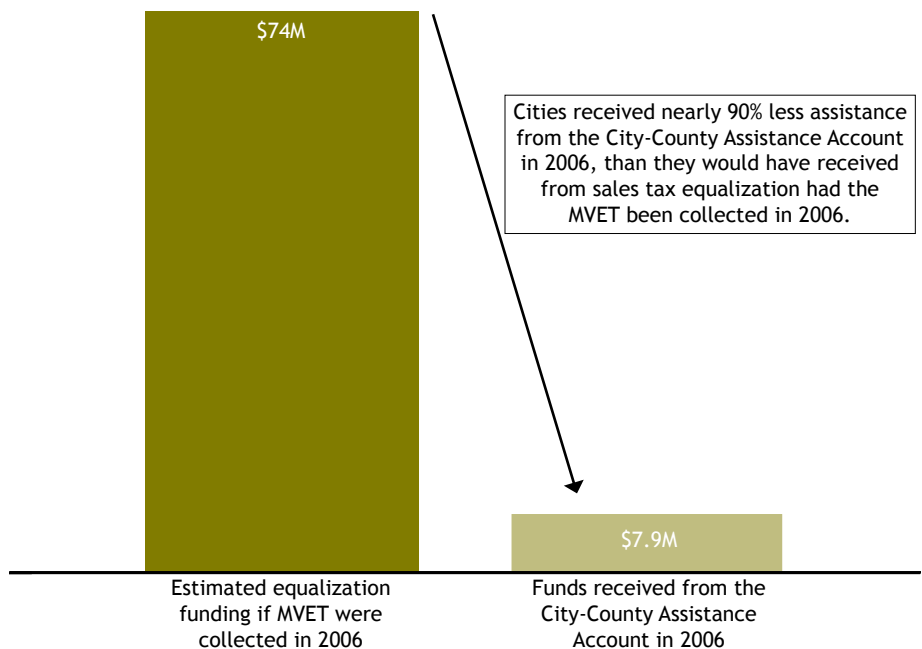
However, state financial assistance has not kept pace with the times. In the last decade, the intergovernmental revenues cities received from the state as a proportion of city operating budget revenues declined by nearly half. In addition, state unfunded mandates place additional financial pressures on cities to meet certain service standards.

When cities meet service expectations, businesses, residents, and the whole state prosper. But when essential services are lacking, communities decline and so does the state's economic vitality. It is possible some cities that are truly struggling may close their doors and disincorporate. This would create an even greater service burden for counties, as they struggle with their own fiscal problems.

Harrah wouldn't be here if it weren't for the City-County Assistance Account. However, this fund isn't stable; we'll be hurting with the downturn in real estate excise taxes.

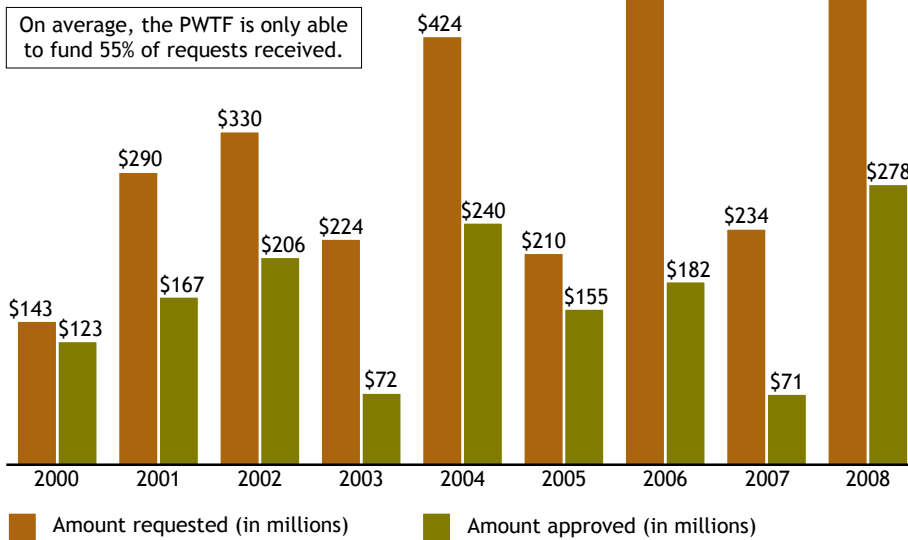
-Barbara Harrer, Mayor, Harrah

With the repeal of the MVET, low tax base cities lost important assistance from sales tax equalization



Source: Joint Legislative Audit and Review Committee

The Public Works Trust Fund is only able to fund a portion of the loan requests received



Note: Graph represents all PWTf applicants, not just cities

Source: Public Works Board

City and state governments share a common goal in creating opportunities for a vibrant economy. A critical element in fostering economic vitality is an efficient and effective infrastructure, a responsibility that should be shared by both cities and states.

~Al French, Councilmember, Spokane

Recommendations for strong cities, a strong state

Cities need continued state investment and new tools to emerge from this budget crisis.

Recommendations for state action:

- **Allocate additional state assistance for city infrastructure systems.** Eighty-nine percent of cities indicate that enhanced state funding for local infrastructure projects would be very helpful. Aging infrastructure systems, unable to accommodate Washington’s growing population, need an immediate infusion of financial resources.
- **Provide additional state assistance for low tax-base cities.** The approximately 170 low tax-base cities that receive assistance from the City-County Assistance Account were the most hard-hit after the repeal of the motor vehicle excise tax. These cities include some of Washington’s most vulnerable communities, but this account is funded by a portion of the real estate excise tax, a volatile funding source. A “floor” should be established on this account, so these already-distressed cities have at least one dependable funding source.
- **Allow greater fiscal flexibility with existing resources to help cities meet current needs.** Many local government revenue sources are restricted to specific purposes, even when voter-approved. Cities need greater fiscal flexibility with these revenues to best meet needs identified by their communities.

We are still trying to dig out of the deep hole we entered in the early part of the decade, with initiative cuts and the economic downturn.

~Donald Hanson, Councilmember, Vader

The constantly changing emphasis on state oversight and increased litigation on open meetings and public records have greatly complicated these areas and have had a major impact on both our ability to comply with regulations and the staff hours required for compliance.

-Randy Lewis, City Administrator, Westport

- **Provide cities with the proper tools to manage growth.** Since the state adopted the Growth Management Act in 1990, GMA-planning cities often plan for growth and services within their city boundaries and to some extent, within their urban growth area. To manage this growth and plan for smoother governance transitioning, cities and counties need expanded tools to facilitate annexation and planning within designated urban growth areas.
- **Convene a workgroup to study local government fiscal conditions.** Local governments have struggled for years to provide essential services with inadequate resources. It is now time for the legislature to convene a workgroup to address statewide service responsibilities and county and city governments' fiscal capacity to deliver both mandated and citizen-desired services.

Action items for cities:

- **Work with citizens and the business community to prioritize services.** Cities are the most local form of government. City officials should work even closer with constituents to determine service level expectations and uncover unexplored revenue and cost-cutting options.
- **Invest in economic development.** City officials should work closely with their business community, educational institutions and regional economic development councils to implement strategies that attract and retain good jobs for residents, and expand their tax base.
- **Be good stewards of infrastructure systems.** Maintaining existing infrastructure systems is always the most cost effective way to ensure adequacy and longevity. City councils should fully consider future costs when setting annual utility rates and establish reserves to fund upgrades or unexpected emergencies.

www.awcnet.org



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