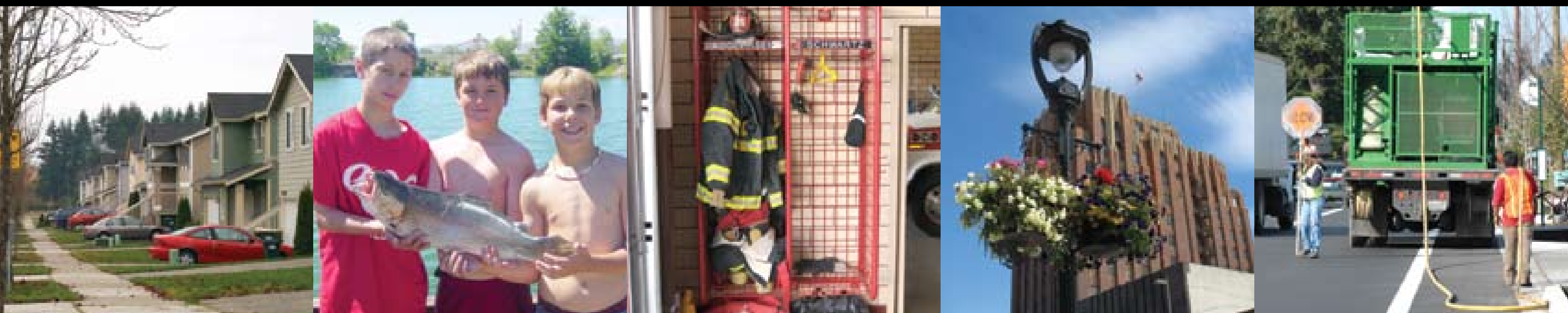
State of the Cities

2009 Full Report

ASSOCIATION OF WASHINGTON CITIES

Assessing the health of Washington's communities



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State of the Cities Report 2009

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.

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Acknowledgement

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

2008-2009 AWC Board of Directors

Special thanks to:

A special thank you is extended to the cities and towns that completed the surveys and participated in the focus groups. Appreciation is also extended to the AWC Board and staff who participated in this project.

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Executive Summary

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

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.

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.

"Cities have been operating with reduced revenues for years since Initiatives 695 and 747, and now cities have minimal required reserves, they are selling property and some are on the verge of bankruptcy."

~Karen Rogers, Councilmember, Port Angeles

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.

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.

> 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*

Essential service providers

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, cities 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.

> Our 2009 budget only increased by one-half of a percent. We've cut all possible expenditures, including salary increases.
>
> *~Glenn Johnson, Mayor, Pullman*

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.

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.

City infrastructure systems: Cracks in the foundation

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.

> “Our road fund can no longer fully fund the larger truck routes.”
>
> *~Pete Lewis, Mayor, Auburn*

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 lifecycle 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.

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.

> "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*

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.

As the economic, social and cultural hubs of the state, cities turn statewide priorities into statewide results. Cities play a vital role in the state's plan to foster a prosperous economy, a clean environment and healthy communities.

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.

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 smallest, most vulnerable communities. 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.

- **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.

Chapter 1

State of the Cities Research Projects

Chapter 1

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.

In 2005, AWC released its first State of the Cities report on cities' fiscal needs and challenges at that time. Four years later, we are releasing this updated report, presenting a comprehensive analysis of conditions that impacted our cities between reports and a look at what cities envision happening in the near future. Once again, the primary question is *what implications do Washington cities and towns' recent fiscal trends have for statewide public policy?*

In this report, the word "cities" refers to all 281 cities and towns in Washington.

Report methodology

Cluster analysis

The adequacy of funding for local services varies widely amongst cities, depending on the business activity in each community and other economic conditions. It is important to consider this diversity when examining the fiscal condition of Washington cities.

As in the 2005 study, analysis about the fiscal conditions of Washington's 281 cities was done by dividing cities into clusters based on similar economic characteristics. After separating cities into two groups based on 2000 U.S. Census defined metro areas and non-metro areas, cities were initially divided based on the results of a statistical analysis known as a hierarchical cluster analysis. For the purpose of this report, the original cluster analysis was validated through discriminant analyses. The results confirmed the original cluster formation and indicate the cluster structure holds up over time. Using current city-level data, these analyses also identified cities that moved from one cluster to another based on changing fiscal conditions.[1]

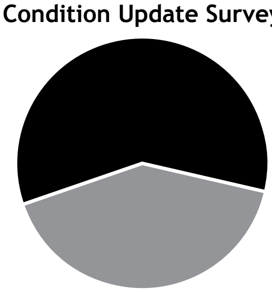
[1] A complete list of cities by cluster can be found in Appendix A.

State of the Cities surveys completed

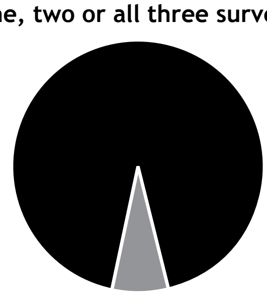
69% of cities completed Survey I Part I

84% of cities completed Survey I Part II

59% of cities completed Fiscal Condition Update Survey



Collectively, 93% of cities took one, two or all three surveys



These cluster analyses used variables such as:

- Population size;
- Population growth over a ten year period;
- Property assessed value per capital; and
- Sales tax revenue per capita.

No two cities are the same and categorizing these diverse entities can be difficult. However, the clustering of cities based on financial characteristics offers a tool to view basic differences in resources and needs. Although variance exists between the cities within each cluster, it is clear that within the context of the larger city family there are more similarities than differences.

More information about the cluster methodology can be found on AWC's website, www.awcnet.org.

Survey and focus group research

Several online surveys were sent to city officials in order to obtain views of their city's fiscal environment.[2] In May 2008, city officials were asked to complete two parts of one survey:

- Part I was completed primarily by chief administrative officials (mayors or city managers/administrators); and
- Part II was completed primarily by finance directors or clerk-treasurers.

Part I was completed by officials at 194 cities, representing 69 percent of cities and 73 percent of the state's population living in cities. Part II was completed by officials at 236 cities, representing 84 percent of cities and 89 percent of the incorporated population.

A follow-up survey was sent to city finance directors or clerk-treasurers in October to capture actions cities were planning to take in an effort to balance the 2009 budget. One hundred and sixty-seven cities responded to this survey, representing 59 percent of cities and 68 percent of city residents.

Collectively, 262 cities completed one, two or all three surveys; representing 93 percent of cities and 99 percent of Washington's incorporated population.

A number of small focus groups were also held, during which city officials were asked to discuss city economic and community trends. Thirty-six city officials representing 33 cities participated in these groups. The city officials included mayors, councilmembers, city managers, finance directors and other city staff.

[2] A list of cities that participated in the surveys or in a focus group can be found in Appendix B.

Finally, data from other AWC research projects are used in this report.

- Tax and User Fee Survey, 2008
- Salary and Benefit Survey, 2008
- *Washington's Invisible Backbone: Infrastructure Systems in Washington's Cities and Towns*, State of the Cities, 2008
- *Strong Cities, Strong State: Economic Development in Washington's Cities and Towns*, State of the Cities, 2007

More information about the surveys, a list of respondents and AWC reports is available on AWC's website, www.awcnet.org.

Characteristics of Washington's city clusters

State of the Cities identified 14 different city clusters, each with their own name and number. Clusters one through six contain cities located in non-metro areas as defined by the 2000 U.S. Census. Clusters seven through 14 include cities located in metro areas. Characteristics of the 14 clusters are explained below.

Although cities are divided by metro and non-metro areas, clusters can have similarities. For example, the Largest Cities cluster has many of the same characteristics as the Regional Centers cluster. Conversely, some clusters are unique to metro or non-metro areas, such as the Tourism Hubs cluster or the High Income Residential cluster.

Additional characteristics of each city cluster can be found on AWC's website, www.awcnet.org.

Regional Centers – Cluster 1

These big cities in Washington's more rural areas offer the greatest economic opportunities to their residents and neighboring communities. As they work to enhance their communities' economic conditions and meet the service needs of their residents and local employers, these cities are entering a time of budget uncertainty. Nearly all are less able to meet needs in 2008 than four years ago and all report they will be less able to meet needs in 2009 and in the next four years (2012). Some of the problems these communities need to address include environmental quality and crime.

Rural Commercial Centers – Cluster 2

These cities have enough commercial activity to set them apart from most of their neighbors. However, they still struggle to provide ample economic opportunities for residents. Nearly all cities in this cluster identified this as one of the most important issues to address in the next four years. Nearly all these cities have delayed or reduced spending on capital development projects to balance the budget.

Tourism Hubs – Cluster 3

Proximity to mountains, rivers and the ocean defines these cities and attracts people from near and far. These tourist-based economies provide some additional resources, but service levels can also be more demanding at times. These smaller cities have fought to sustain a variety of services over the past few years including police, streets, parks, planning and business recruitment. The lack of affordable housing is a key community condition that will need to be addressed in the future.

Light Industrial/Natural Resources Hubs – Cluster 4

These rural communities peppered throughout the state rely on their natural resources—agriculture, forestry, fishing, hunting—and/or manufacturing. Unlike many other communities throughout the state, these cities experienced very little population growth over the past ten years. In some cases, cities lost population. These cities lack employment opportunities as well as amenities for residents, including high speed telecommunications, for example.

Small Residential – Cluster 5

Varying in character from quaint towns to small cities, these communities are shaped by their natural environment. Primary employers are retailers, but most residents travel elsewhere for their livelihood in agriculture, timber, manufacturing and a variety of other industries. Many of these cities have been sustaining services by dipping into reserves, and all receive support from the City-County Assistance Account, a state assistance account for low tax-base cities.

Rural Communities – Cluster 6

These small communities have a strong rural character, with top employers in agriculture, forestry, fishing and hunting industries. Many of the cities in this cluster are Washington's smallest cities and towns with the lowest population growth of the last ten years. Many decreased the city workforce over the past four years and delayed or reduced spending on capital development projects. All of these cities receive assistance from the City-County Assistance Account.

Urban Outskirts – Cluster 7

Many of these communities display a rural character, but their close proximity to urban centers makes them unique. Most of these cities' residents access jobs in nearby urban centers. Compared to other metro-area cities, these communities have little revenue capacity and recognize that the vitality of their downtowns and retail corridors is a key community condition that must be addressed in the future.

Residential – Cluster 8

These suburban communities are prominent neighbors of the large urban centers and experienced a good deal of growth over the past decade. While property values in these cities can be relatively high, the sales tax base is low. These communities relied heavily on the housing boom of recent years. As growth continues to slow, many of these cities will be less able to meet residential and commercial service needs in coming years.

High Income Residential – Cluster 9

These cities are distinctly residential, with neighborhoods that include the homes of some of the state's wealthiest residents. These residents are primarily highly-educated professionals, who typically work in neighboring large cities. These communities have some of the highest assessed values in the state, though business activity is relatively low.

Mixed Resources – Cluster 10

Characteristics in these communities vary. Most cities experienced high population growth in recent years, putting pressure on traffic congestion and the availability of affordable housing. These communities struggle to improve a variety of services including streets, police, human services and business recruitment. Many of these communities will be less able to meet their communities' needs in coming years.

Small Commercial Centers – Cluster 11

Most of these cities are located far enough from the nearest major freeway and/or urban centers to retain a small town feel. For a variety of reasons, they also generate a significant amount of retail activity among residents and visitors. Most these communities lack access to recreational and cultural opportunities, and some services such as health care.

Medium Commercial Centers – Cluster 12

Moderate retail and manufacturing activity defines most of this group, similar to the large commercial centers. However, per capita sales tax and property assessed values are lower than their larger commercial center counterparts. Many have delayed or reduced spending on capital development projects in recent years and some decreased their workforce.

Large Commercial Centers – Cluster 13

They range in population from small to large, but all the cities in this cluster are strong retail centers. Located in the Puget Sound area, large department stores, malls and vehicle dealerships are major features in these cities. Jails, streets and human services are among the services most difficult for these cities to sustain. Many of these cities will be less able to meet service needs in future years.

Largest Cities – Cluster 14

These large and denser cities are the state's major population centers. Drawing people and business activity from the region and beyond requires these cities to provide high levels of services. Community conditions that present a problem for these cities include the lack of available affordable housing, access to social services, abundance of homelessness, and traffic congestion.

Key economic indicators in Washington city clusters

Non-Metro Area Cities
Regional Centers – Cluster 1 Size – Largest in non-metro areas Property value – Moderate Commercial activity – Moderate Growth – Moderate Geography – East and west *Examples: Pullman, Centralia*
Rural Commercial Centers – Cluster 2 Size – Small Property value – Moderate Commercial activity – High Growth – Moderate Geography – Mostly east *Examples: Omak, Shelton*
Tourism Hubs – Cluster 3 Size – Small Property value – High Commercial activity – High Growth – Moderate Geography – East and west *Examples: Ocean Shores, Winthrop*
Natural Resources/Light Industrial Hubs – Cluster 4 Size – Small Property value – Moderate Commercial activity – Moderate Growth – Low Geography – East and west *Examples: Pateros, Forks*
Small Residential – Cluster 5 Size – Small Property value – Low Commercial activity – Low Growth – Moderate Geography – Mostly east *Examples: Entiat, White Salmon*
Rural Communities – Cluster 6 Size – Small Property value – Low Commercial activity – Low Growth – Low Geography – East and west *Examples: Bridgeport, Pe Ell*

Metro Area Cities
Largest Cities – Cluster 14 Size – Largest Property value – Moderate Commercial activity – Moderate Growth – Low to moderate Geography – Mostly west *Examples: Tacoma, Spokane*
Major Commercial Centers – Cluster 13 Size – Large Property value – High Commercial activity – High Growth – Low to moderate Geography – All west *Examples: Tukwila, Lynnwood*
Medium Commercial Centers – Cluster 12 Size – Large Property value – Moderate Commercial activity – Moderate Growth – Low to moderate Geography – East and west *Examples: Pasco, Lacey*
Small Commercial Centers – Cluster 11 Size – Small Property value – Moderate to high Commercial activity – High Growth – High Geography – Mostly west *Examples: Yelm, Union Gap*
Mixed Resources – Cluster 10 Size – Medium Property value – High Commercial activity – High Growth – High Geography – All west *Examples: Arlington, Issaquah*
High Income Residential – Cluster 9 Size – Small Property value – Highest Commercial activity – Moderate Growth – Low Geography – All west *Examples: Hunts Point, Medina*
Residential – Cluster 8 Size – Medium Property value – High Commercial activity – Moderate Growth – High Geography – Mostly west *Examples: Normandy Park, Camas*
Urban Outskirts – Cluster 7 Size – Small Property value – Moderate Commercial activity – Moderate Growth – Moderate Geography – East and west *Examples: Eatonville, Zillah*

Chapter 2

City Fiscal Conditions: Nearing the Breaking Point

Chapter 2

City Fiscal Conditions: Nearing the Breaking Point

Washington cities are more than particular points on a map. And they are more than service providers or revenue generators. Cities are places where people live, work and play. Cities are where families are raised, progress occurs and history is made.

Whether small rural towns or large urban metropolises, cities 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, cities are the hub of creative energy and innovation. These communities are the bedrock of entrepreneurial activity and quality of life.

Washington's 281 cities provide a wide array of services for residents, the business community and visitors. However, each of these services is only possible with sufficient funding. Absent adequate monetary resources, city services begin to slowly—or sometimes rapidly—deteriorate.

The State of the Cities research points to two distinct but very interconnected struggles for Washington's cities.

First, 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. The competition for resources within the operating budget is fierce and services are seldom funded to a level that meets performance benchmarks.

Second, city infrastructure systems are crumbling. These aging systems are inadequate to meet current needs of businesses and residents, state and federal mandates, and sustain and attract growth. As these systems continue to deteriorate, they become an environmental, safety and public health concern. The backlog of maintenance and capital improvements puts our cities in danger of losing economic development opportunities to other communities across the country and around the world.

> "Even with 12 percent population growth, we've had to reduce 12 staff positions, and could lose up to ten more in the next biennium."
>
> *~Bob Hammond, City Manager, Kennewick*

Cuts in a Down Economy

As the national and local economies face economic disarray, important city revenues are declining. This economic turmoil looms over cities as they plan for 2009. Many cities will cut staff positions and reduce service levels. For example:

- Kennewick reduced its staff by seven FTE. The city also increased stormwater utility fees and utility taxes to pay for LEOFF 1 medical cost obligations.
- Port Angeles cut five FTE in police administration, parks and general government, and another nine FTE will be cut with the planned pool closure by the end of March 2009.
- Gig Harbor eliminated five positions including a community services officer that was cut to part time. The 2009 budget is 28 percent less than the 2008 budget.
- Olympia's preliminary budget plans to cut more than 21 positions, which will reduce services in virtually every department. The capital budget will also decrease by nearly $1 million.

This mirrors cities' actions nationwide. A fall 2008 International Public Management Association for Human Resources survey indicates more than half of public agencies are no longer hiring for vacant positions and one-quarter expect to layoff employees in the next year.

Struggling fiscal conditions

Washington's cities are at a breaking point.

Forty-seven percent of city officials indicate they are less able to meet financial needs in 2008 than four years ago. Over the same time period, city officials worked hard to balance the budget:

- Forty-four percent of cities increased reliance on ending cash balances and reserves—with 18 percent reporting a significant increase;
- One out of six cities decreased their workforce; and
- Nearly one-half of cities (45 percent) report increasing taxes to preserve public safety services.

The worst is yet to come

As cities enter a new fiscal year, the situation is worsening. In the wake of a near recession and revenue caps, many cities are faced with budget shortfalls. Sixty-three percent of city officials report they will be less likely to meet needs in 2009 than in 2008, and 66 percent report they will be less likely to meet needs in the next four years.

Percent of cities within each cluster indicating they are less able to meet financial needs in 2009 than 2008

40%-59%	60%-79%	80%+
Tourism Hubs (Cluster 3)	Rural Commercial Centers (Cluster 2)	Regional Centers (Cluster 1)
Light Industrial/Natural Resources Hubs (Cluster 4)	Small Residential (Cluster 5)	Residential Communities (Cluster 8)
Rural Communities (Cluster 6)	Mixed Resources (Cluster 10)	High Income Residential (Cluster 9)
Urban Outskirts (Cluster 7)	Small Commercial Centers (Cluster 11)	
Largest Cities (Cluster 14)	Medium Commercial Centers (Cluster 12)	
	Major Commercial Centers (Cluster 13)	

Percent of cities within each cluster indicating they are less able to meet financial needs in four years (2012)

40%-59%	60%-79%	80%+
Light Industrial/Natural Resources Hubs (Cluster 4) Rural Communities (Cluster 6) Largest Cities (Cluster 14)	Rural Commercial Centers (Cluster 2) Tourism Hubs (Cluster 3) Small Residential (Cluster 5) Urban Outskirts (Cluster 7) Residential Communities (Cluster 8) Mixed Resources (Cluster 10) Small Commercial Centers (Cluster 11) Medium Commercial Centers (Cluster 12) Major Commercial Centers (Cluster 13)	Regional Centers (Cluster 1) High Income Residential (Cluster 9)

How will cities respond to this budget shortfall?

They will reduce infrastructure spending. Forty-six percent of city officials report they are 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 the scope of services and the size of the workforce. There may be fewer officers 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.

"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

Unintended Consequences Abound With Service Cuts

Deciding which services to cut is always difficult when budgets are tight. Cutting too much of one service can sometimes produce unintended consequences.

Yakima Valley cities recognize the downside of cutting parks and recreation services during a time when youth need positive experiences.

Public comments to the Legislative Work Group on Gang-Related Crime point out that prevention is key to finding long-term solutions to gang recruitment and activity.

However, Yakima Valley cities have been forced to make tough choices.

- Sunnyside recently eliminated recreation programs (except the pool) as well as nine positions with others left unfilled. This includes two of the four daytime police officers, two recreation positions and one parks staffer.
- Wapato's parks budget is one-third of what it was several years ago. The city eliminated all recreation programs and gave up all operational responsibilities for the pool.
- Grandview reduced library and museum hours and limited participation in a summer recreation program.

Why is this happening?

Both the local community and national economic trends impact city fiscal conditions. A few examples include:

- The worst economic turmoil the country has seen since the great depression;
- The burst of a nation-wide housing bubble;
- A string of tax-limiting voter-initiatives; and
- Sky-rocketing energy prices, health insurance and critical infrastructure materials costs.

These influences have created budget pressures for cities on the revenue and the expenditure side of the equation.

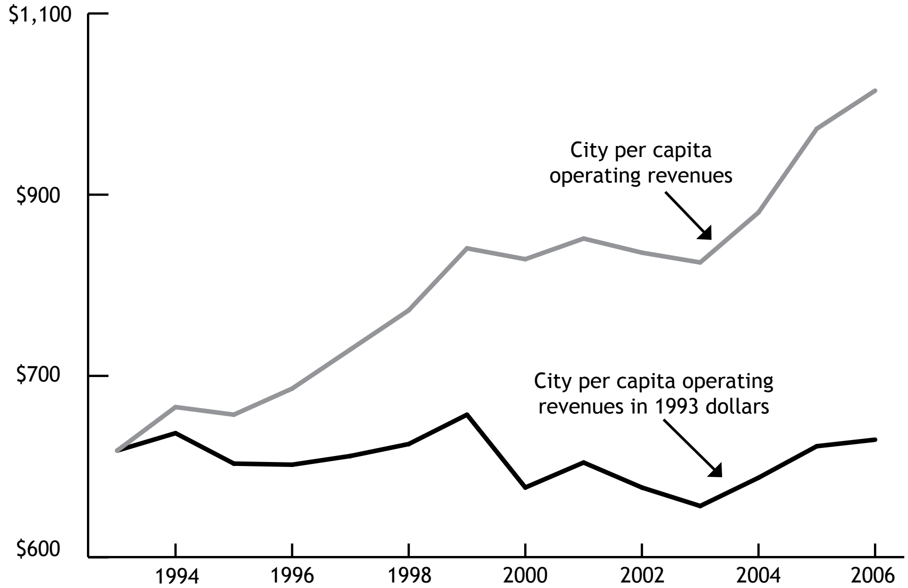
As the housing market continues to slump, revenues associated with construction and housing sales are declining. And as the national economy teeters on recession, people are spending more cautiously. Washingtonians are purchasing less—especially large items—and sales tax revenues reflect this.

In the late 1990s and early part of this century, a chain of tax-limiting voter initiatives and legislative decisions narrowed the city tax base. This strained city finances. Many cities are still struggling from these revenue limitations.

In a focus group discussion, one city official from the Rural Communities cluster noted that his community was in dire straits after sales tax equalization ended and the one percent property tax cap was initiated. Now, after additional revenues from new construction and an increased sales tax base, his community still hasn't been able catch up.

This inability to catch up is understandable. Cities have been asked to expand services for a growing population and meet new mandates with limited revenues. Over the past 15 years, per capita city revenues hardly kept pace with inflation.

When adjusted for inflation, per capita revenues often fell below 1993 levels



Source: State Auditor's Office Local Government Financial Reporting System

> Business recruitment is always difficult in times of a tight dollar. Our area relies on a steady tourist inflow and the hard-hit industries (lumber, orchard and agriculture) are very much driven by a market demand.
>
> *~Kathy Lobdell, City Clerk, Omak*

U.S. cities face budget pressures

Across the U.S. cities face the same troubles as individual citizens:

- Economic stress from the rising costs of basic goods and services;
- Increasing health care premiums; and
- A collapse in home prices.

Unlike the 2001 economic downturn, when revenues from new construction offset declining income, the weak housing market will undoubtedly affect cities' budgets in the coming years.

Sixty-four percent of city finance officers surveyed by the National League of Cities expected cities to have a harder time meeting fiscal needs in 2008. Seventy-nine percent forecasted even bigger problems in 2009.[1]

Nearly all cities are struggling

> How can you reach further into the pockets of people who are barely making it? It's a rainy day for small cities in Washington State.
>
> *~Wayne Hovde, Mayor, Soap Lake*

Nearly all cities, large and small, east and west, are struggling. For some cities this is the "bust" after a booming economy and a rapidly-increasing housing market. These cities are experiencing a sharp decline in one-time revenues as new construction slows. For other cities, this is a continuation of hard times after the repeal of sales tax equalization and tax-limiting voter initiatives.

Forty-seven percent of city officials overall are less able to meet financial needs in fiscal year 2008 than four years ago. More than 40 percent of the city officials in ten of 14 clusters indicate they are less able to meet financial needs in 2008 than four years ago.

[1] Nation's Cities Weekly, "City Fiscal Conditions Take a Turn for the Worse," September 2008

City fiscal ups and downs since 2000

2000

Motor vehicle excise tax repealed. Cities' estimated 2000 loss is over $100M in sales tax equalization, police and fire protection and criminal justice assistance. Rural and residential communities are hardest hit.

Legislature provides limited backfill for MVET losses. Legislature approves $66.3M in backfill funding. Collectively cities receive 51% of 18 months' MVET losses.

2001

Nation enters recession. The Pacific Northwest is particularly affected.

Initiative 747. Local property tax levy increases reduced from a 6% to 1% limit. Estimated 2002 loss to cities is $20M.

Health care costs increase by double digits. Costs continue to rise throughout the decade.

2002

Initiative 776. Local vehicle license fee repealed: Cities lose $19M in 2003.

2003

Public safety sales tax authorized. The Legislature authorizes a 0.3% local option sales tax. County revenues are shared with cities and 1/3 is restricted to criminal justice programs.

Percent of cities within each cluster indicating they are less able to meet financial needs now than four years ago.

0%-19%	20%-39%	40%-59%	60%-79%	80%-100%
Major Commercial Centers (Cluster 13) Largest Cities (Cluster 14)	Light Industrial/ Natural Resources Hubs (Cluster 4) Medium Commercial Centers (Cluster 12)	Rural Commercial Centers (Cluster 2) Tourism Hubs (Cluster 3) Small Residential (Cluster 5) Rural Communities (Cluster 6) Urban Outskirts (Cluster 7) High Income Residential (Cluster 9) Mixed Resources (Cluster 10) Small Commercial Centers (Cluster 11)	Residential Communities (Cluster 8)	Regional Centers (Cluster 1)

More than one of every ten survey respondents is pessimistic about their city's ability to provide mandated or essential services. These services differ by city. However, they most frequently include police and fire and emergency medical services, utilities like water, sewer and stormwater, as well as planning, permitting and general administration.

2004 — 2005 — 2007 — 2008

City MVET backfill cut. Backfill funding undergoes series of cuts from $66M in 1999-2001 biennium to $5M in 2003-2005 biennium.

City-County Assistance Account created. Account provides assistance to low tax-base cities and counties and is funded by a portion of the state's real estate excise tax (REET) previously deposited into the Public Works Trust Fund.

Capital costs soar. Increases in infrastructure costs are unprecedented.

Streamlined Sales Tax. After a multi-year effort, the Legislature passes SSB 5089 to bring the state in compliance with the national Streamlined Sales Tax Agreement and provides full mitigation.

B&O apportionment implemented. As a result of 2003 legislation, 38 cities levying a B&O tax are estimated to lose $30M.

Energy and gasoline prices skyrocket. Cities find it increasingly difficult to maintain and budget for services like police, fire and public works.

Economic downturn. As recession looms, city sales tax and real estate excise tax revenues drop significantly.

As a result of statewide initiatives of the past decade, our city and many others have been forced to use diminishing reserves to balance the general fund budget in recent years.

~Joyce Papke, City Administrator, Stanwood

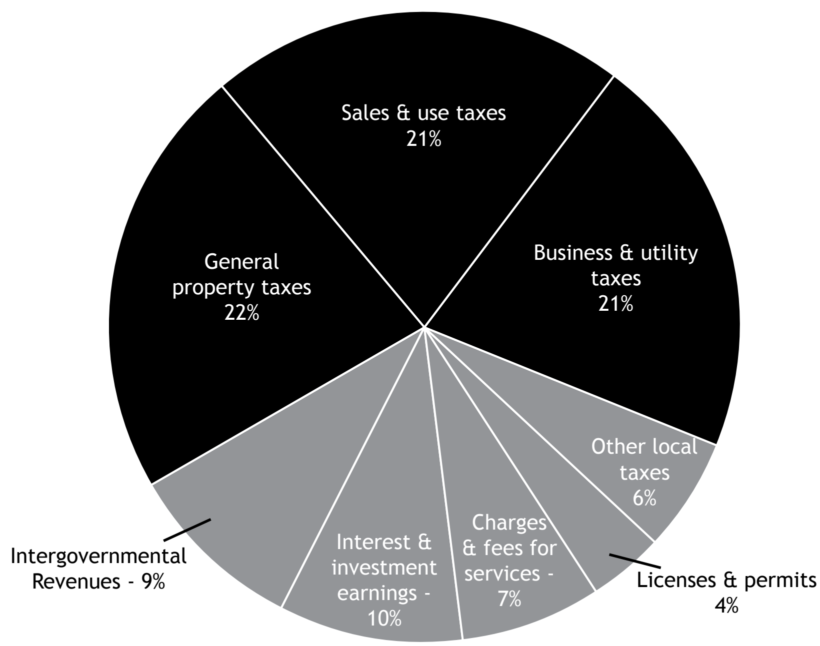
One in four respondents is pessimistic about the ability to provide citizen-demanded services in the future. These services commonly include parks, recreation activities, senior centers, business recruitment and retention. Services like these are what shape a community's character. They attract business to the community and make families want to move there.

Competition for scarce resources

Some city services compete for revenues more than others. Why? They are financed primarily from the operating budget. Other services generate some revenues and still others are designed to be self-sustaining.

The operating budget funds the majority of urban services, such as public safety, parks and recreation, and planning. Property taxes, sales and use taxes, and business and utility taxes are the three major revenue sources for cities, accounting for approximately equal portions of two-thirds of city operating revenues.

Cities rely on property taxes, sales tax and business and utility taxes for the majority of operating revenue (general fund and special revenues)



Source: State Auditor's Office Local Government Financial Reporting System, 2006

Within the operating budget, some revenues are restricted by statute for specific purpose. Restricted revenues include:

- Gas tax;
- Impact fees;
- Criminal justice sales tax; and
- Lodging taxes.

Nearly one out of every six dollars in the operating budget is restricted for a specific purpose.

Most new revenue authority (such as the criminal justice sales taxes and multi-year levy lid lifts) recently granted to local governments by the Legislature includes restrictions. Restricted revenues are included in this overview to show a more complete measure of the city revenue structure, but it does not fully demonstrate city councils' limited discretionary ability to pay for programs.

Generally, unrestricted revenues include:

- Property taxes;
- Business and utility taxes; and
- Basic and optional sales taxes.

In addition to the operating budget, many cities also have enterprise funds for operating utilities, as well as capital and debt funds.

Utility services include water, sewer and stormwater, and sometimes electric energy and natural gas. Enterprise activities are intended to be self-sustaining, meaning the fees and charges the customer pays stay with the enterprise to fund future service, maintenance and capital needs. Utility services and enterprise funds will be discussed in chapter 5.

Major capital expenditures, such as street construction, are funded separately and paid for with a variety of longer-term sources. These include bond issues and other long-term debt, grants, and dedicated sources, such as the real estate excise tax. They are also sometimes subsidized with contributions from the general fund or capital reserves.

"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."

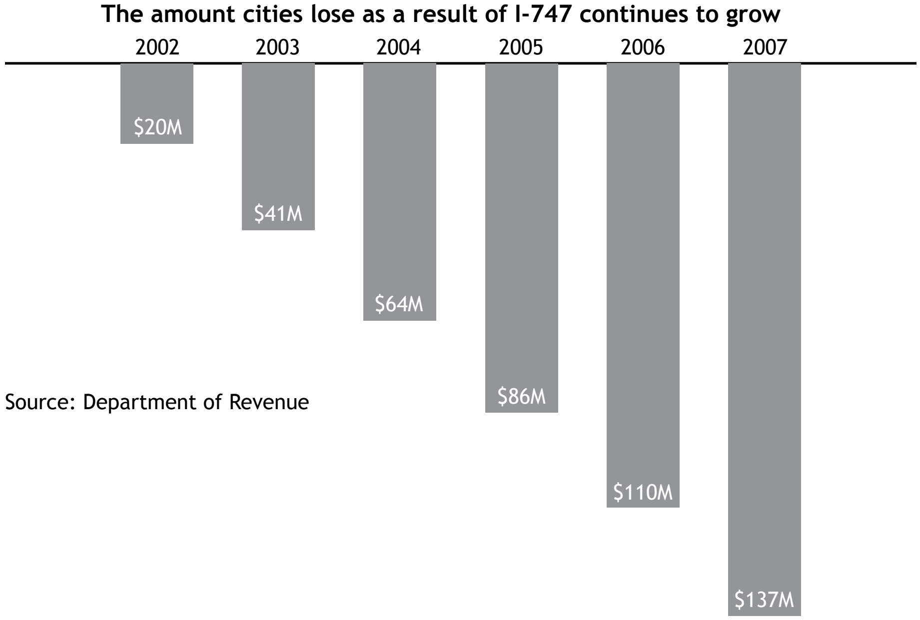
~Deborah Knight, City Administrator, Sultan

Property tax: A capped resource

Cities receive only 13 cents of each property tax dollar

Property tax is an important revenue source for cities, comprising an average of 22 percent of the operating budget. However, since the early part of this decade, when Initiative 747 limited city property tax growth to one percent, cities' reliance on property taxes decreased. Fifty-four percent of city officials say the one percent cap on property taxes has a major impact on the budget; another 30 percent say the impact has been moderate.

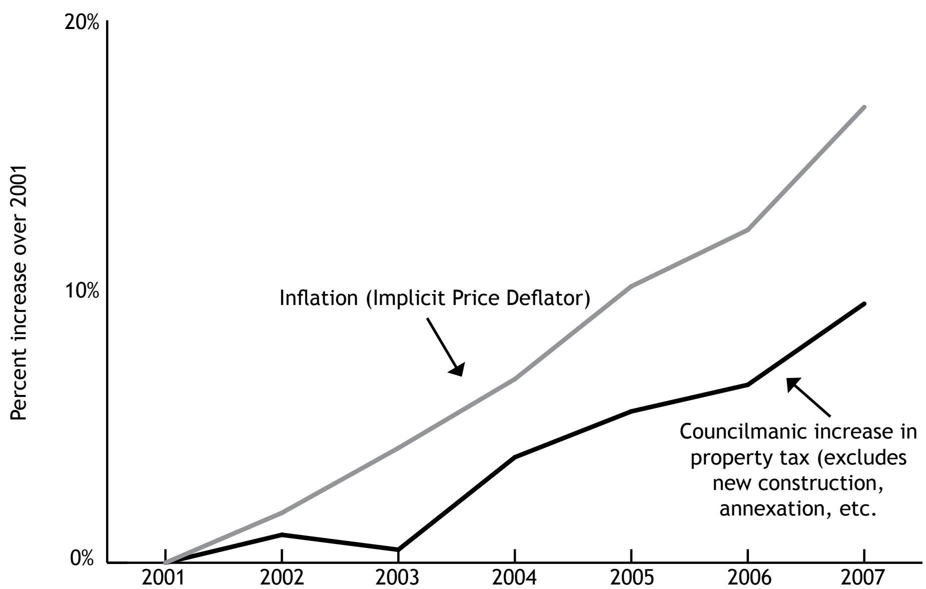
The amount cities lose as a result of I-747 continues to grow



Source: Department of Revenue

Between 2002 (when the one percent property tax cap was implemented) and 2007, council increases in property tax averaged only 1.59 percent annually. This excludes property tax for new construction, adjustments due to annexation, voter-approved levy lid lifts and new levy authorities such as emergency medical services and park districts. This amount is greater than one percent because some cities used banked capacity. Banked capacity is when a city levies less than the maximum amount allowed one year and "banks" the difference to use in the future.

Because of the one percent cap on property tax revenues, cumulative increases in property taxes are below the rate of inflation

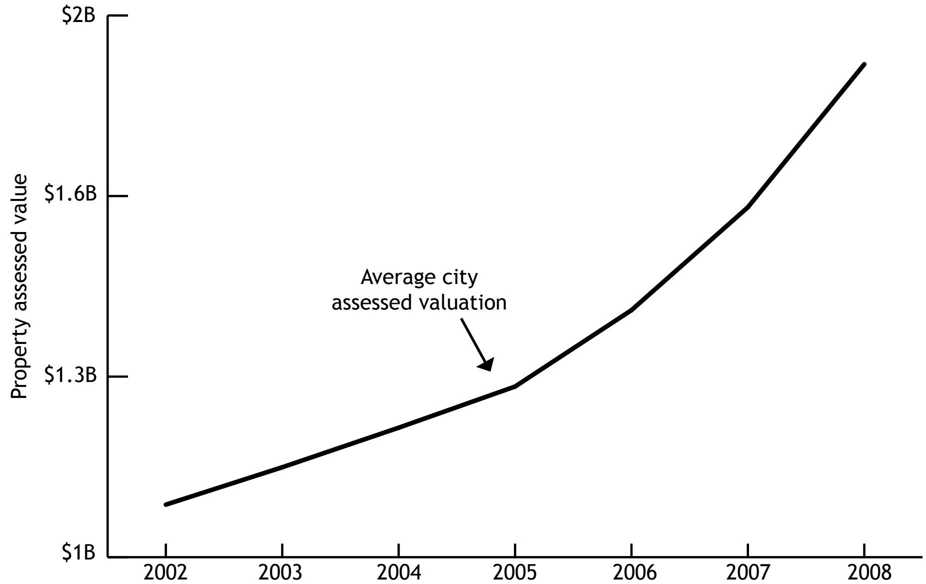


Source: Office of Program Research

Property taxes are collected based on city levy rates per $1,000 of assessed property value. Maximum allowable levy rates vary based upon whether or not a city has a pre-LEOFF fire pension fund and is annexed to a fire and/or library district.

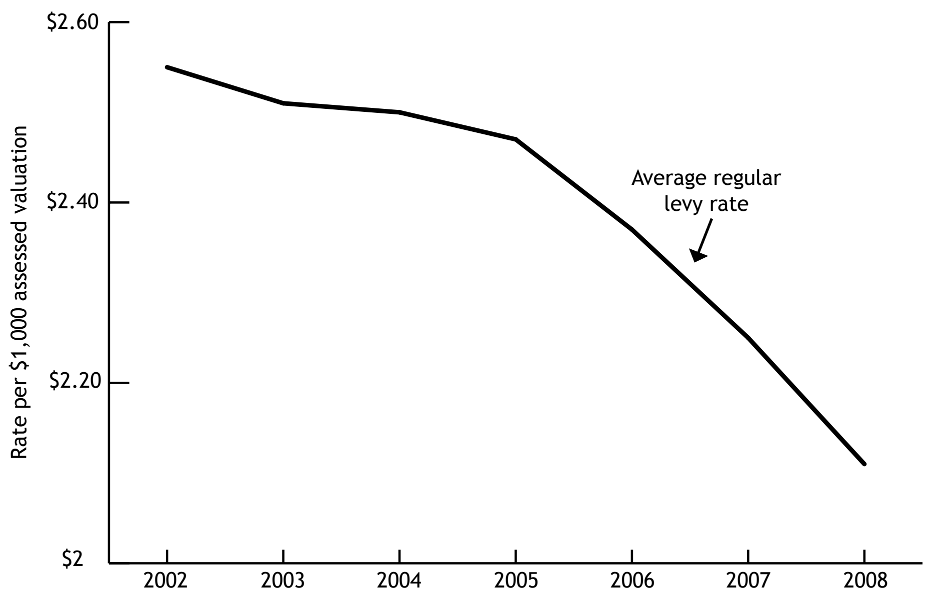
Many cities are not at their maximum allowable rate. In fact, as assessed values throughout much of the state increased in recent years, average levy rates fell.

As assessed values in cities throughout much of the state increased in recent years…



Source: Department of Revenue

City levy rates decreased



Source: Department of Revenue

Although many cities' rates fell over the last few years, some cities are at or near their statutory limit and more will reach their limit as the housing market cools. Smaller cities in particular tend to be closer to their levy limit.

In 2008:

- Seven cities were at 100 percent of their statutory limit—average population of 3,063;
- Forty-four cities were within 90 percent of their statutory limit—average population of 4,782; and
- Ninety-six cities, more than one-third of cities, were within 80 percent of the statutory limit—average population of 5,751.

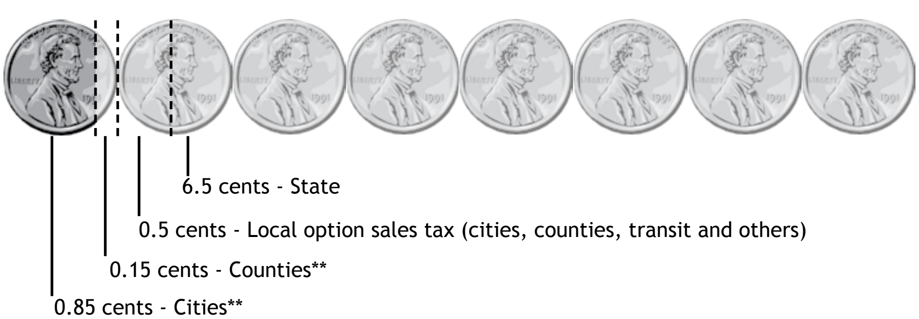
As the housing market throughout the state continues to fall, cities that are close to their statutory maximum rate will not only be limited by the one percent cap, they will also be limited by their maximum rate. This could cause actual decreases in property tax revenues.

Finding new ways to stay afloat

As cities struggle to meet rising expenditures with limited resources, they will look to new ways to fund costly services. Sixty-four percent of city officials report that over the past four years property tax due to new construction and improvements had one of the most positive impacts on the budget. Fifty-seven percent of city officials report the same regarding an expansion of their commercial base. However, as revenue growth from new construction continues to fall, cities will depend even more on the benefits of ongoing commercial activity.

The average sales tax levied in cities is about eight percent. Of this amount, 6.5 percent goes to the state. Most cities levy an additional one percent sales tax, of which 15 percent is sent to the county. The additional half cent (on average) represents any number of different local option sales taxes. Many of these local option taxes are levied county-wide, such as the mental health, communications, and public safety sales taxes.

For every retail dollar spent, cities receive less than one cent of the sales tax (excluding local options)*



* Based on city sales tax average of 8%.
** For sales sourced to unincorporated areas, counties receive the full 1 cent.

Even though cities only receive a portion of the sales tax, this revenue source is significant. Many cities work to increase retail corridors and revitalize mainstreets as an economic development strategy to help diversify their revenue base. AWC's 2007 State of the Cities report on economic development found that 68 percent of cities focus economic development efforts on retail and service. Fifty percent of cities also focus efforts on tourism and hospitality, while 31 percent focus on manufacturing recruitment (many cities focus efforts on more than one area).

For this report, 63 percent of city officials responded that the vitality of mainstreet and retail corridors is one of the most important things for the community to address in the near future.

This growing reliance on the sales tax can have its drawbacks. The sales tax can be volatile. As the economy turns downward sales tax revenues are quick to follow. There can also be inter-jurisdictional competition to grow the sales tax base. This can sometimes lead to greater sprawl and can prove contrary to the state's growth management vision.

Many cities have also increase user fees and utility taxes to sustain essential services. Over the past four years, 47 percent of cities established or increased utility taxes, and 44 percent established or increased user fees, such as business licenses, ambulance or recreation fees.

Chapter 3

Essential Service Providers

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Essential Service Providers

Very simply, cities provide vital services and afford a certain quality of life for their residents and local enterprises. Cities connect with citizens and businesses to create the communities they desire to live in.

As essential service providers, city governments provide specific services according to state and federal laws as well as those desired by their citizens. This typically includes the following:

- **Public safety and security**—protecting residents and businesses with 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, recreation activities and libraries**—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.

None of these services can operate in total isolation. They are interdependent, and when one service is lacking, others suffer. For example,

- Poor streets and traffic congestion create barriers for public safety personnel in their ability to arrive timely at an emergency site.
- Recreational activities help keep teens out of trouble, providing alternatives to gang activity.
- Strategic comprehensive planning achieves sustainable neighborhoods, with design standards that promote greater walkability, reduce traffic congestion and help protect our environment.

Lack of funding for one critical service can produce unfavorable unintended consequences in other areas. This increases costs and erodes a city's desirability as a place to reside and conduct business.

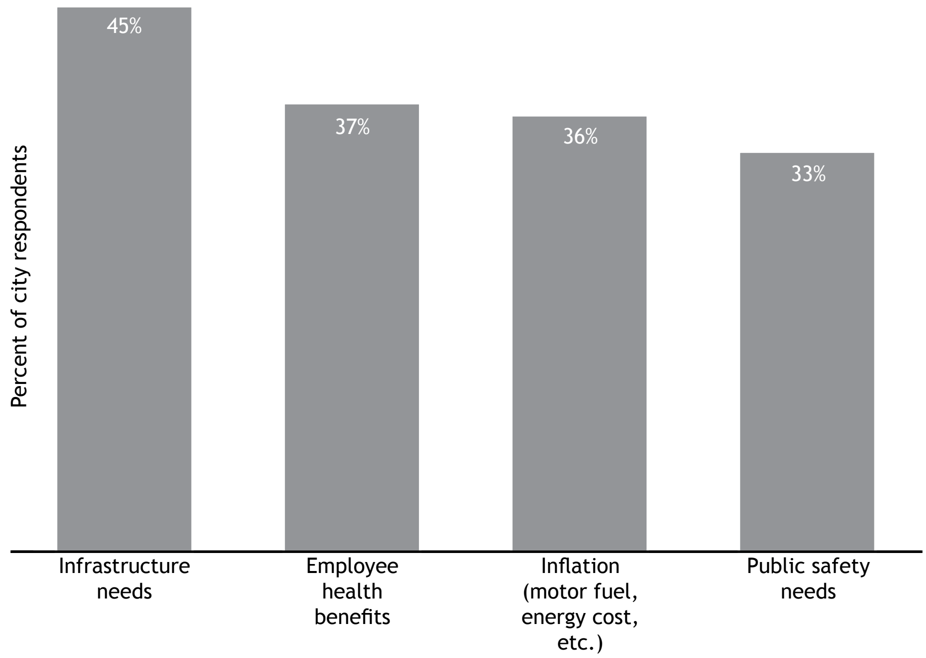
"We need folks to move here, which will encourage new business, which will increase our tax base. But if the city can't afford to keep up its parks, who's going to choose to move here?"

~Norm Childress, Mayor, Grandview

Rising costs, erosion of services

Infrastructure needs, employee health benefit cost increases, inflation and public safety costs are identified by city officials as some of the most negative impacts on the budget.

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



Some of these budget influences are interrelated. Volatile fuel prices make public safety costs unpredictable. Additional state and federal environmental mandates increase infrastructure costs. Escalating employee health benefits make the delivery of nearly every city service more expensive.

As costs increase, competition for resources grows. The end result is that fewer capital projects are completed, fewer police officers are hired, and the quality of life within these cities erodes.

Infrastructure costs

Cities provide critical infrastructure systems that keep Washington's economy moving forward. These systems maintain public health and protect the environment from pollution and waste. Services that many cities provide include:

- Streets, bridges and sidewalks;
- Centrally-treated water supply, stormwater and sewer systems;
- Parks and other capital facilities such as fire stations, libraries, and senior centers; and
- Curbside garbage and recycling collection.

The most frequently-cited negative budget influence is infrastructure costs. Contributors to the problem include:

- Increases in infrastructure material costs such as steel and asphalt;
- Growing populations that place additional pressure on aging systems; and
- State and federal environmental mandates that require cities to make costly improvements to infrastructure systems.

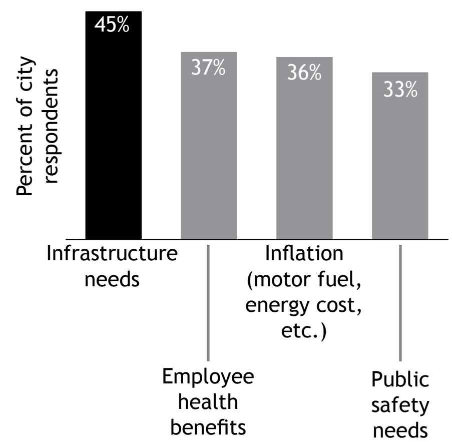
Fifty-five percent of city officials indicate they increased their capital budget over the past six years. However, due to higher material costs and regulations, the capital budget increase did not always translate to more projects completed. Fifty-two percent of cities delayed or reduced spending on capital development projects in the past six years because of lack of funding. And even worse, 60 percent of cities forecast a decrease or reduction of capital projects in the next six years.

Overwhelmingly, city officials report that the projects most commonly impacted by rising costs and dwindling resources are street projects. This message was consistent in survey responses as well as focus group discussions.

Other projects, whether a park, a drinking water system upgrade or repairs to city hall, will likely be deferred as well. These projects vary greatly from one community to another.

This topic will be addressed in more detail in chapter 5 of this report.

> "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*

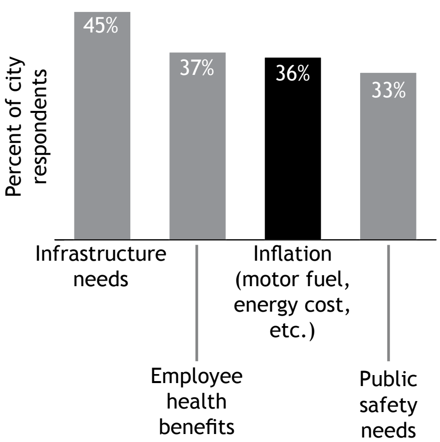


The cost of doing business

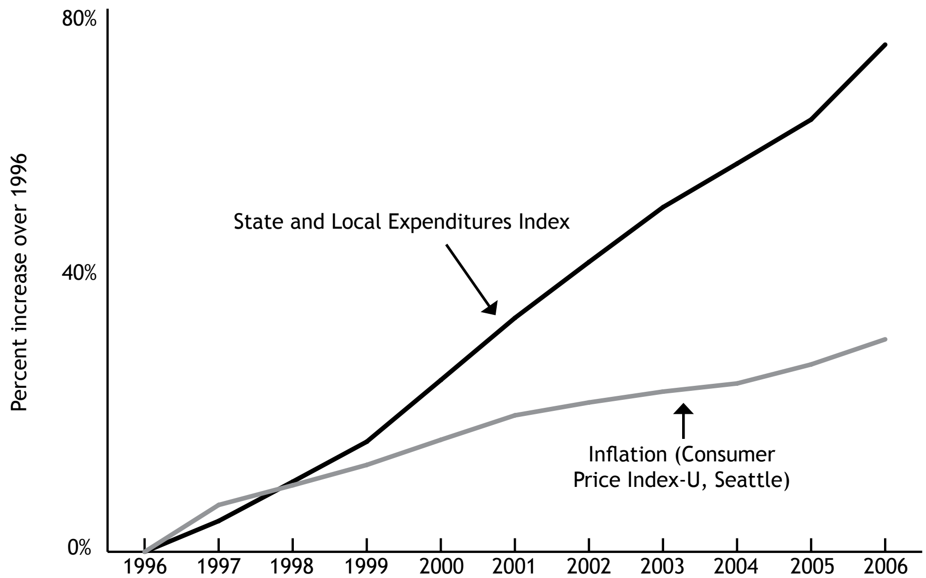
Just as citizens and businesses face increased health insurance and fuel costs, so do governments. The Government Price Index measures the cost of governmental services over time. This shows that government expenditures increase at a much higher rate than inflation.

> We exceeded our fuel budget in August. The cost of fuel is having a major impact on all aspects of our day to day operations.

~Paul Ingram, Councilmember, Ferndale

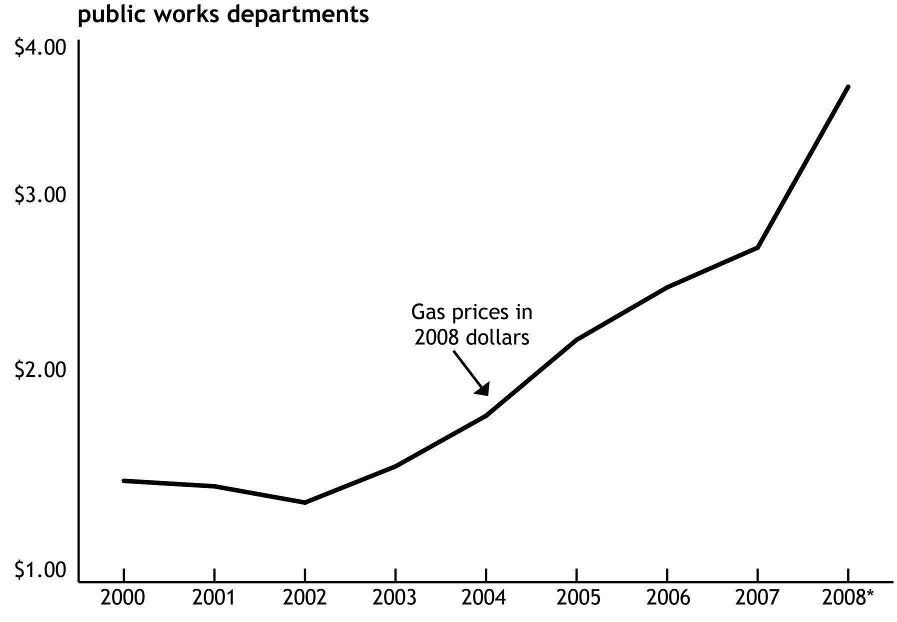


Government expenditures increase at a much higher rate than inflation



Source: U.S. Bureau of Economic Analysis

Increasing fuel costs place a particular squeeze on police, fire and public works departments



Source: U.S. Bureau of Labor Statistics

* As of June 2008

The people behind city services

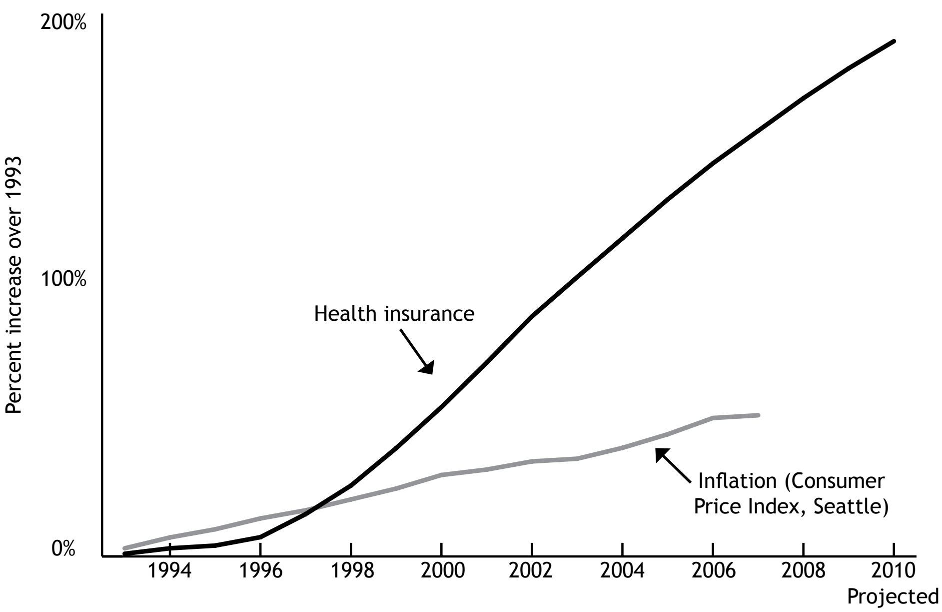
Washington cities' primary function is to provide services to citizens and businesses. Whether the service is fighting fires, preventing crime, preserving community character, or ensuring that clean, safe drinking water reaches people's homes, the common denominator is people. This means the majority of city costs are personnel related.

In 2006, 58 percent of city operating budget expenditures (more than $2 billion) were for personnel costs. Eighty-three percent of city officials report rising personnel costs had a major or moderate impact on the budget over the past four years.

Continued increases in health care costs

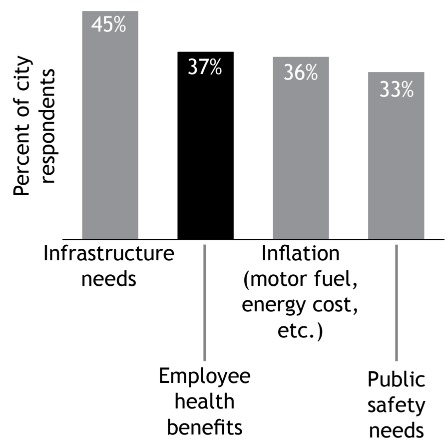
Cities continue to struggle with significant increases in health care costs. Eighty-two percent of city officials report that the rising cost of employee health benefits impacted the budget over the past four years, with 52 percent reporting it was a major impact. Unfortunately, this trend is expected to continue into the next decade.

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



Source: AWC Employee Benefit Trust

> "Employee costs are unsustainable. There is an expectation to increase wages at the rate of inflation, but our revenues are capped and in many cases declining. This isn't realistic."
>
> *~Dean Maxwell, Mayor, Anacortes*



The Cost of Meeting LEOFF 1 Liabilities

Hoquiam (population 9,097) is a coastal community that has one of the state's oldest fire and police departments. The city is one of 147 cities mandated to cover lifetime medical and long-term-care costs for members and retirees of the LEOFF Plan 1 system.

The State Actuary estimates $1.745 billion is needed statewide to plan for future liabilities. Divided equally among LEOFF 1 members, that's $235,000 per member. Hoquiam would need to invest $9.9 million today to meet future liabilities for their 38 retirees and four active members—only $1.6 million less than the city's 2008 operating budget.

To pay current LEOFF 1 costs the city budgeted a half million dollars in 2008—a figure that is estimated to increase annually until 2020. Without this stranglehold on the budget, the city could fix roads, replace playground equipment, offer recreation programs or re-open the jail.

LEOFF 1 medical and long-term care liabilities

The Law Enforcement Officers' and Fire Fighters' Retirement System Plan 1 (LEOFF 1) provides a defined benefit pension to police and fire personnel hired before 1977. Cities are mandated to cover the lifetime medical and long-term-care costs of their LEOFF 1 members and retirees.

An actuarial study completed by the State Actuary in December 2007, estimates that the statewide liability for LEOFF 1 medical and long-term care costs for all local governments, including 147 cities, is $1.745 billion. This is the amount of money that would be required to be invested today to pay for all of the expected obligations. This equates to nearly $235,000 for each of the 7,447 active and retired LEOFF 1 members.

Long-term-care is the largest unfunded liability. Although future care needs cannot be predicted for any one individual, trends indicate that an ever-increasing percentage of people will need long-term-care services. This translates into an increasing burden on cities with LEOFF 1 members.

Pension Contribution Costs

Seventy percent of city officials indicate that increased pension contributions had an impact on their budget in the past four years.

Most city employees are members of a state retirement program, with city and employee pension contribution rates established by state law. The Washington State investment board manages the pension funds.

Due to the recent national economic turmoil, these funds have experienced a decline in value which will likely result in future increased city contribution rates.

Time is money

Because personnel costs are such a large part of city expenditures, efficiencies in time translate to real cost-savings. However, city officials point to several ways in which city operations became more cumbersome in recent years, not less.

While city officials support open government practices, many cities have experienced an increase in both the number of requests and the breadth of those requests. A single public record request might involve locating and providing thousands of pages of information, copying the information, and sending it through a legal review. Staff time spent on public record research and reproduction is charged to the city. The more obscure and vaguely-worded the request, the more difficult and costly the search.

Smaller cities in particular also struggle to provide the personnel needed to comply with mandated reporting requirements. Additional reporting requirements accompanying recently-granted revenue authorities create a hardship for small cities that have few employees.

> 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*

Keeping the public safe

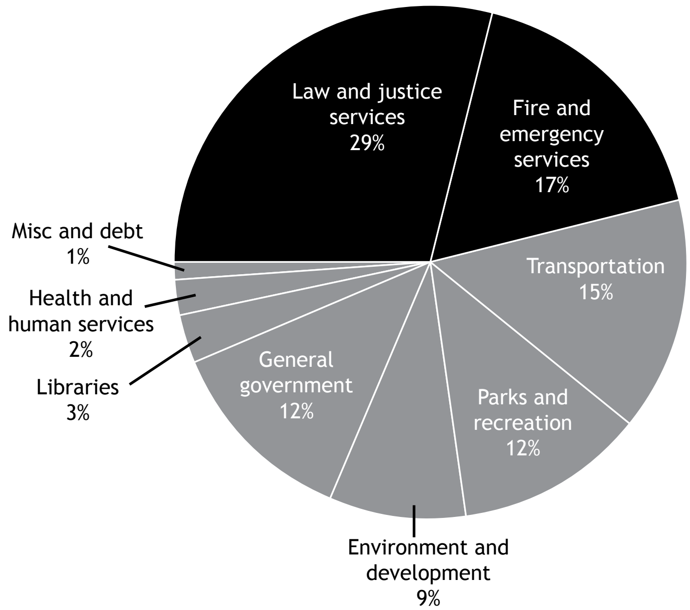
Whether in good or bad economic times, people have an expectation that their city police officers and fire fighters provide a high level of safety and protection and respond in a timely manner.

The state relies on city public safety services. Cities employ:

- Sixty-nine percent of local law enforcement offers; and
- Two-thirds of fire fighters.

Nearly 50 percent of the average city budget is directed to public safety. This is approximately the same amount as city property and sales tax revenues combined.

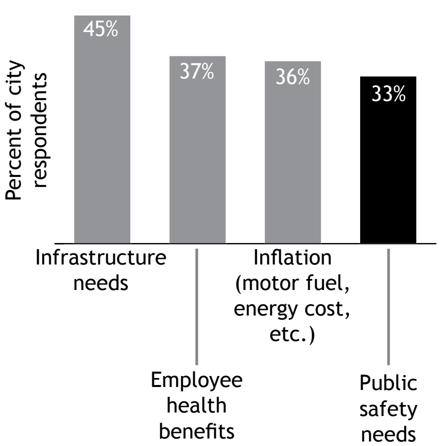
Nearly half of the city operating budget is directed to public safety (general fund and special revenues)



Source: State Auditor's Office Local Government Financial Reporting System, 2006

> 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



Cities bear a tremendous responsibility in protecting the public. Citizens expect adequate service levels in terms of:

- Rapid response time;
- Intensive police patrol;
- Traffic control;
- Property surveillance;
- Animal control;
- Higher law enforcement officer per 1,000 population;
- Twenty-four hour fire department staff; and
- Emergency medical services.

Yet cities frequently struggle to fund these vital services at a level that meets citizen expectations.

Difficulties in sufficiently funding public safety include cost escalations for:

- Employee wages and benefits;
- Jail and offender medical obligations; and
- Enhanced technology and emergency communication systems.

"The amount of money necessary to sustain and improve police services is daunting.

~Neal Beets, City Manager, Federal Way

Employee wages and benefits

Employee costs are the bulk of city operating budget expenditures, and public safety is no exception. Sixty-seven percent of public safety expenditures are directed toward personnel benefits, salaries and wages.

The growing gap between revenues and expenditures puts pressure on the operating budget. As wages and benefits continue to increase, less discretionary revenue is available for other city services. Because of the availability of interest arbitration to determine salary and benefit levels, decisions are made outside of local control.

Jail and offender medical costs

Not only is it costly to employ police officers to patrol and maintain safety, it is also costly to house offenders once arrested. The costs of jail beds, as well as the potential liability of offender medical services, are a significant concern for city officials.

Many cities are experiencing the difficulty of paying for—or even locating—jail beds for their offenders. Twenty cities own their jails and the remainder contract for jail services with other jurisdictions. Even with low crime rates and a small proportion of the state's population going to jail, additional jail space is needed. However, cities are finding themselves "squeezed out" of available jail space. This creates financial pressures for cities, forcing them to release misdemeanants or pay exorbitant amounts for them to be transported and housed.

Once cities have made an arrest, they not only pay for misdemeanant offenders to be housed but also assume the liability of providing medical care. These costs are unpredictable. At any time an arrestee may have an expensive medical condition.

> Today's world is driven by technology. New devices in ambulances are great, but you can only get what you can afford.
>
> *~Tim Browning, Mayor, Centralia*

Emergency communication systems

In the 21st century there is an expectation that public safety officers use 21st century communication technology. Incompatible radio frequency equipment and limited funding to update that equipment present an enormous challenge for our public safety personnel and to the public's health and wellbeing.

The Washington State Interoperability Executive Committee has determined that the majority of public safety responders in our state are not able to communicate effectively or directly with their federal, state and local counterparts. The committee has found that:

- One in three public safety agencies have experienced operational difficulties due to lack of wireless interoperability;
- Public safety communications are spread over ten different bands of the radio spectrum; and
- Washington's diverse geography presents logistical problems.

The committee estimates that in order to comply with federal requirements to bring the state's public safety communications devices up to current day standards more than $435 million in investments is needed. This does not include the costs to local jurisdictions to comply with new federal requirements.

Chapter 4

Growing Cities

Chapter 4

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.

Sixty-two percent of the state's population now lives in cities, up from 52 percent in 1990. And as the state's population grows, this percentage is also expected to climb.

This growth comes with both benefits and challenges. Yes, cities' revenue base expands with growth. But, these additional revenues aren't enough to keep cities on pace with the growth in essential service requirements. Cities will still be challenged to:

- Provide a reliable infrastructure;
- Maintain low crime rates;
- Expand parks and open spaces;
- Plan for affordable housing and a growing workforce; and
- Manage the impacts of growth on the environment.

Diverse cities, diverse economies

The collective force of our 281 cities fuel the economic powerhouse known as Washington State.

In the 21st century, technology has changed the speed of communications and the location of traditional workplaces. Innovation and economic growth occur in areas that attract a critical mass of creative talent. Communities must compete to recruit businesses and workers, not only requiring a sound infrastructure and other accommodations but creating and maintaining the communities where workers want to live.

City economic development strategies provide for a diversified economy and quality jobs for residents. They provide revenue growth to support services that residents and businesses depend upon. Recent city economic development successes show us that when cities and the state work as partners, the result is a stronger, more prosperous Washington.

A Smart Investment

When the state partners with local governments on economic development strategies, the outcome is a win for Washington's residents, businesses, cities and the state.

Vancouver reinvented its downtown, transforming the 30-block area, retaining several major employers and creating new jobs. The state was an important partner in this development.

Between 1997 and 2006 the state invested $28 million in Vancouver's convention center and the city invested nearly the same. This investment, along with other key city infrastructure projects, helped as a catalyst for an additional $275 million in private economic development.

What is the return on investment through 2025?

- Vancouver will see an estimated $27 million in revenue;
- Clark County, the library, port and school district will receive an estimated $24 million in revenue; and
- The state is estimated to recoup $113 million in revenue—four times the amount invested.

Local residents benefited. These developments helped create more good jobs, new housing, transportation improvements, and better amenities.

Foundation for growth

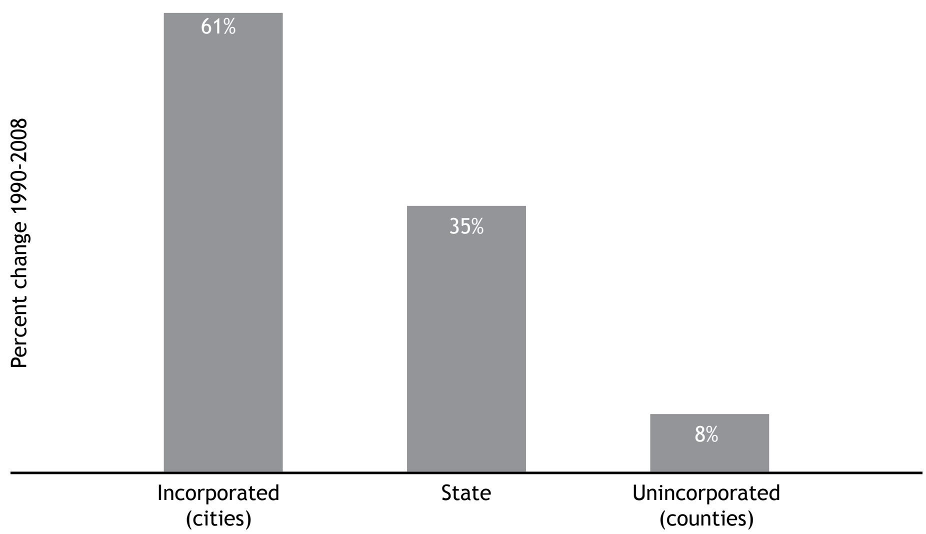
The Growth Management Act (GMA) passed in 1990 clearly mandates that 217 cities plan for and accommodate future growth. This mandate requires cities to provide a foundation for growth by establishing and maintaining a sound infrastructure system.

The GMA directs local governments to:

- Ensure public facilities and services are in place when development is available for occupancy;
- Encourage development in urban areas where adequate public facilities and services exist;
- Accommodate a growing population based on state forecasts; and
- Reduce the inappropriate conversion of undeveloped land into sprawling, low-density development.

Since the GMA was enacted, more people are living in cities—a clear indicator that GMA works. City population growth since 1990 dramatically outstripped growth in both unincorporated areas, and in the state.

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



Citizens choose cities

Why has city population grown at such a faster rate than unincorporated areas?

- Consistent with the GMA, cities annex territory in urban growth areas.
- Some areas incorporated, adding new communities to the city family.
- As people move to Washington, they relocate in cities.
- People are drawn to cities—the economic and cultural hubs of the state.
- As baby-boomers retire, many are moving to urban areas to accommodate their desire for city services and proximity to medical and emergency facilities.

Today, a half million more people live in cities than in 2000. The Office of Financial Management reports that one-third of this increase is due to annexations and incorporations. Recent annexations include Auburn's Lea Hill which added 11,448 people to the city and Renton's Benson Hill which added 16,272 people.

Over the last quarter century, 16 cities incorporated

City	Year of Incorporation	2008 Population
Mill Creek	1983	17,770
Federal Way	1990	88,040
SeaTac	1990	25,720
Burien	1993	31,540
Woodinville	1993	10,560
Newcastle	1994	9,720
Shoreline	1995	53,440
University Place	1995	31,440
Edgewood	1996	9,595
Lakewood	1996	58,780
Covington	1997	17,360
Maple Valley	1997	20,480
Kenmore	1998	20,220
Sammamish	1999	40,550
Liberty Lake	2001	6,980
Spokane Valley	2003	88,920

Which cities grew?

Most cities grew since the beginning of the millennium, some at a faster pace than others. Generally, cities in metro areas experienced more population and housing growth than cities in non-metro areas. These metro-area cities are nearest to the state's business centers.

Some clusters experienced more population growth than others (2000-2007)

0%-5%	5%-9%	10%-19%	20%-29%	30%+
Natural Resources/ Light Industrial Hubs (Cluster 4) Rural Communities (Cluster 6)	Regional Centers (Cluster 1) Small Residential (Cluster 5) High Income Residential (Cluster 9) Largest Cities (Cluster 14)	Rural Commercial Centers (Cluster 2) Tourism Hub (Cluster 3) Medium Commercial Centers (Cluster 12) Major Commercial Centers (Cluster 13)	Urban Outskirts (Cluster 7) Residential (Cluster 8) Small Commercial Centers (Cluster 11)	Mixed Resources (Cluster 10)

> 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*

Average city population growth from 2000 to 2007 is approximately 13 percent. The average population growth among cities in half of the clusters is near or above the citywide average, while the remaining city clusters grew at a rate below the citywide average.

Other than Tourism Hubs (Cluster 3), all the cities that grew at or above the citywide average are in metro areas. Conversely, most of the city clusters that grew below the citywide average are in non-metro areas. The exceptions are High Income Residential (Cluster 9) and Largest Cities (Cluster 14).

The average 2000 U.S. Census poverty rate for city clusters that grew at or above the citywide average is lower. The median income is also higher in these city clusters.

City clusters with higher population growth	City clusters with lower population growth
City clusters • Tourism Hubs (Cluster 3) • Urban Outskirts (Cluster 7) • Residential (Cluster 8) • Mixed Resources (Cluster 10) • Small Commercial Centers (Cluster 11) • Medium Commercial Centers (Cluster 12) • Large Commercial Centers (Cluster 13)	**City clusters** • Regional Centers (Cluster 1) • Rural Commercial Centers (Cluster 2) • Natural Resources Hubs/Light Industrial Hubs (Cluster 4) • Small Residential (Cluster 5) • Rural Communities (Cluster 6) • High Income Residential (Cluster 9) • Largest Cities (Cluster 14)
Characteristics • Mostly metro area cities—other than Tourism Hubs (Cluster 3) • Lower poverty rate—cluster average 11% • Higher median household income—cluster average $49,973	**Characteristics** • Mostly non-metro area cities—other than High Income Residential (Clusters 9) and Largest Cities (Cluster 14) • Higher poverty rate—cluster average 15%; or 17% when the High Income Residential (Cluster 9) is excluded • Lower median household income—cluster average $47,979, but only $33,787 when High Income Residential (Cluster 9) is excluded

Growth and fiscal implications

For many cities, recent population growth contributes to current fiscal challenges.

Growth carries positive and negative fiscal implications.

On the positive side, it provides a city with one-time revenues such as the real estate excise tax and sales tax on new construction. It expands the tax base creating greater sales tax or property tax potential (although the one percent cap on property tax revenues creates challenges).

On the negative side, growth results in increased service demands. While these service demands are ongoing, many of the revenues associated with growth are not.

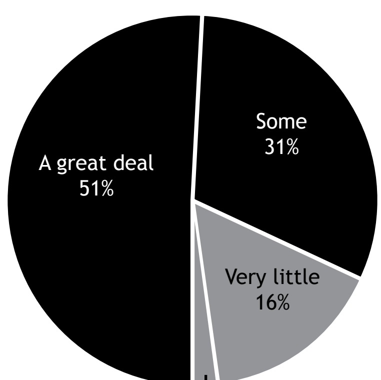
Growing service demands

City officials note that although growth can be beneficial in the short term, it can lead to some distinct long-term challenges, such as:

- Building and maintaining a sufficient infrastructure;
- Expanding public safety; and
- Meeting community goals, like providing sufficient parks, libraries and recreational activities.

Eighty-two percent of the city officials surveyed for AWC's 2008 State of the Cities report responded that growth influences the city's need to update or expand infrastructure systems. Financing and providing an adequate infrastructure to support growth is a primary challenge for both Washington State and its cities in the first half of this century.

Most city officials indicate they need to update or expand infrastructure systems a great deal or somewhat due to growth



Source: State of the Cities, 2008

Providing for Growth in an Uncertain Economy

Lacey experienced significant growth in recent years:

- Total housing units grew by 32% between 2000 and 2008;
- Property assessed value nearly tripled over the same period; and
- Job growth and commercial development remained strong.

Yet, despite a relatively vibrant local economy and a concerted effort to contain spending, Lacey struggles to keep pace with basic service demands and address the overwhelming water, wastewater, and transportation infrastructure pressures that are so critical to the city's future health.

Lacey is not immune to the recent economic crisis and rapidly-rising costs:

- Permit fees and real estate excise taxes have declined by 50 percent;
- Sales and business tax receipts are dropping at an alarming rate;
- The capital budget has been dramatically reduced; and
- Vacant positions are filled only if warranted.

Of the city officials responding that growth is influencing their need for updated or expanded infrastructure, 97 percent indicated they needed to expand or update infrastructure systems due to residential growth. Seventy-seven percent identified commercial growth, and 37 percent pointed to industrial growth as other reasons to expand or update their infrastructure. Additionally, cities listed growth outside city boundaries, public or nonprofit facility expansion (such as hospitals or prisons) and tourism as impacting expansion and update needs.

These different types of growth have different fiscal implications—both in terms of revenues and expenditures.

- Residential growth can produce a short-term spike in property taxes and sales and use taxes, but the service needs are ongoing. The higher the density, the greater the need for public safety, parks, and other important services. This creates even more competition for funds within city operating budgets.
- Commercial growth—particularly retail—can be good news for city sales tax and/or business tax revenues but service demands follow. Cities experience increased traffic congestion and greater public safety needs.
- Industrial growth can increase city business taxes and assessed value. However, city infrastructure systems—particularly streets—take a beating from increased traffic and heavy trucks.

Growth spurt

In recent years, many cities benefited from one-time revenues associated with the construction boom. Some city officials recognize that growth during the last few years has been their saving grace, helping them meet service needs despite a one percent property tax cap.

Without voter approval or using banked property tax capacity, cities are limited to increasing property taxes by one percent annually, excluding new construction. Between 2002 and 2007, new construction added an annual average of 2.4 percent to property tax revenues.

In an era when the costs of maintaining basic city services outpaces increases in general property tax revenues, new construction revenues helped some cities temporarily meet service level expectations. Sixty-four percent of cities say the property tax base has been one of the most positive impacts on the budget during the last four years.

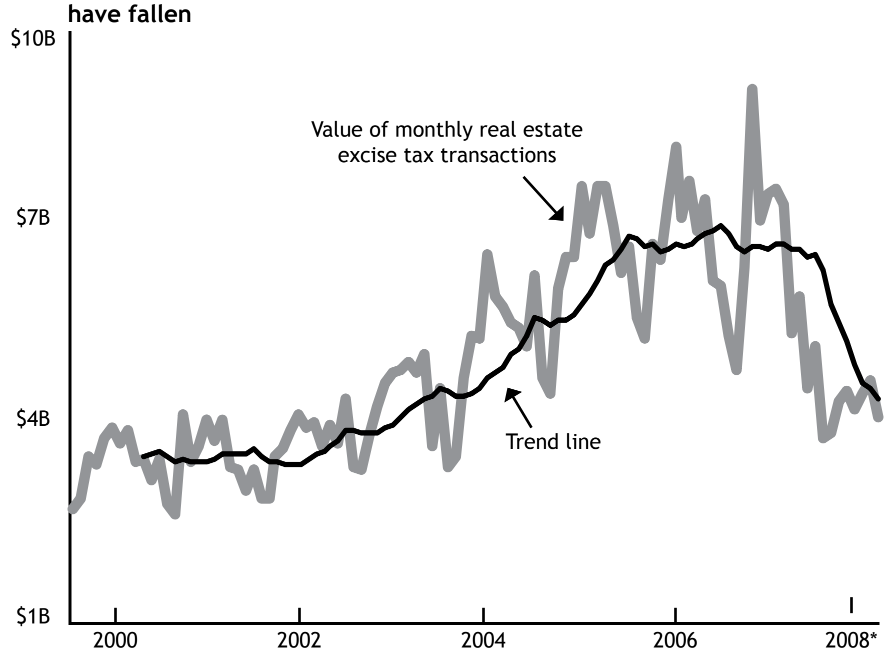
Excise taxes (such as real estate excise taxes) and some fees (like impact fees) also increased because of the recent housing boom.

The bursting bubble

People moving from out of state into Washington significantly boosted the rising populations. However, this trend is slowing statewide. The Office of Financial Management reports that Washington's overall population gains as a result of migration dropped from about 81,000 in 2006 to less than 60,000 in 2008.

While Washington's housing economy hasn't experienced the same collapse as seen throughout the U.S., the market has certainly cooled. This is a tremendous hit to cities' finances. Revenues from sources like the real estate excise tax have fallen sharply.

The value and number of statewide real estate excise tax transactions have fallen



Source: Department of Revenue
*Through August 2008

Growing pains

The challenges of growth don't stop with the financial strains of the housing market decline or the slowdown in new commercial and industrial construction. Cities must also:

- Provide services for annexed territory;
- Alleviate traffic congestion;
- Protect the environment;
- Work to lower crime rates;
- Preserve open spaces and set aside park land; and
- Ensure an adequate affordable housing supply.

Affordable Housing: A Regional Issue

Contrary to the national housing slump, Wenatchee area cities have bucked trends. Homes have sold quickly and at higher prices. As people moved into the area from elsewhere, costs have increased and many locals are pushed out of the local housing market.

Today:

- Nearly 90 percent of housing in the Upper Valley are second homes;[1]
- More than half of the Leavenworth workforce commutes[1]; and
- Chelan's assessed value grew 51 percent between 1998 and 2007, while the population only increased 18 percent.

Wenatchee-area city officials responding to AWC's survey say housing is one of the most important issues that must be addressed in the next four years.

Even with neighboring East Wenatchee doubling in size since 2000, Wenatchee's housing availability is at a minimum. Wenatchee's rental vacancy rate is 1.8 percent (healthy vacancy is around five percent). The city council is working to promote density, but finds citizens and developers continue to prefer low-density housing.

[1] Wenatchee World, "Study tracks Upper Valley housing problem," September 30, 2008

Looking at the big picture, city officials realize that while there are challenges associated with certain types of growth, how they manage that growth can also provide some of the solutions. Ensuring a balance of commercial and industrial growth, as well as housing for a variety of income levels, is crucial to long-term vitality.

Affordable housing

Seventy-eight percent of city officials indicate that the absence of low-income and affordable housing is a problem for their community, with 28 percent indicating it is a major problem.

Cities within each cluster indicating that the availability of low-income and affordable housing is a problem for the community

50%-59%	60%-69%	70%-79%	80%-89%	90%-100%
High Income Residential (Cluster 9)	Small Commercial Centers (Cluster 11) Medium Commercial Centers (Cluster 12) Major Commercial Centers (Cluster 13)	Urban Outskirts (Cluster 7) Residential (Cluster 8)	Regional Centers (Cluster 1) Rural Commercial Centers (Cluster 2) Natural Resources/ Light Industrial Hubs (Cluster 4) Rural Communities (Cluster 6) Mixed Resources (Cluster 10)	Tourism Hub (Cluster 3) Small Residential (Cluster 5) Largest Cities (Cluster 14)

More than 60 percent of respondents in three clusters indicate the availability of low-income and affordable housing as one of the three most important conditions to address in future years:

- Regional Centers—Cluster 1
- Tourism Hubs—Cluster 3
- Small Residential—Cluster 5

In recent months some communities experienced reductions in housing values. There are fewer housing starts and sales of existing homes are slowing. In some areas this has driven up the rental market, placing greater pressure on the housing situation. As cities continue to address the lack of low-income and affordable housing in the future, they will also need to evaluate potential responses to these and new market conditions.

Annexations and governance transition

There are many issues that can arise across the state between cities, counties and/or special districts when growth occurs or is planned adjacent to existing city boundaries. Sometimes a proposed annexation triggers a dispute over urban services or competition for tax base. Other times, an issue may arise regarding the type, scale and design of unincorporated development adjacent to one or several cities.

These disputes are not new and oftentimes, the jurisdictions involved find ways to work out their differences. Since the state's adoption of the GMA in 1990, there is a growing recognition that GMA-planning cities plan for growth and services not only within their existing city boundaries, but to some extent, also within their urban growth area. There is also an acknowledgement that it is increasingly difficult for counties to plan for and fund urban services and infrastructure within the unincorporated areas. As a result, there are changing roles and responsibilities for cities, counties and in some instances special purpose districts.

Climate change

As our climate continues to change, Washington's cities potentially face water shortages, a rise in sea levels and increasing temperatures. These changes could impact cities more than other localities.

- Communities in all parts of the state depend on snow pack for summer stream flows that feed municipal water supplies and hydroelectric power.
- Any potential rise in sea levels threatens property, infrastructure and the local economies of our coastal cities.
- Increasing temperatures and small increases in winter precipitation could lead to more frequent flooding in some river basins, threatening property and potentially impacting management of urban stormwater.

> Parks are a classic citizen-desired service, yet, they are not a revenue generator and while it seems that everybody wants parks, not everyone wants to pay for them.
>
> *~Mark Kulaas, Councilmember, Wenatchee*

Washington's cities are already engaging in many activities that will help address these problems. Moving more people to cities—creating compact communities and reducing emissions—is a high priority mitigation option recommendation by the state's Climate Action Team. This is also consistent with the goals of the GMA.

Parks and open spaces

Healthy communities need healthy options. As communities become more compact, open space preservation and park development becomes even more essential. Well-designed public spaces foster a sense of community, encourage friendly relations among neighbors, and help create an increased sense of mutual trust, civic pride and ownership.

Yet 81 percent of city officials report that replacement or enhancement of their parks is needed to meet new capacity demands. Further, they note that parks are one of the services most difficult to sustain in times of tight budgets.

Chapter 5

City Infrastructure Systems: Cracks in the Foundation

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City Infrastructure Systems: Cracks in the Foundation

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 covers a broad range of systems including:

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

These city 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 crumbling due to a host of challenges, including:

- Aging, deteriorating systems that are nearing the end of their structural life and cannot keep up with existing conditions;
- Systems that lack the capacity needed to accommodate growth;
- Soaring infrastructure costs that capital replacement reserves could not have anticipated; and
- Unfunded federal and state mandates that require costly system improvements.

There are financial struggles as well. Growing competition for city revenues requires city councils make tough funding choices, often opting to delay maintenance projects over cuts to public safety and other immediate needs. State and federal grant and loan assistance programs are underfunded and new appropriations are not keeping up with inflation—or in some cases shrinking. City councils struggle to find a balance between affordable utility rates for users and sufficient revenues to address vital capital needs.

City infrastructure systems need attention now. Without adequate funding, these costly systems are headed down a path of deterioration. The result will jeopardize our economic vitality, public health, and the environment.

Supporting the state's priorities

Cities are the state's economic engine. They are where software is developed, airplanes are assembled and scientific discoveries are made.

Cities are also where the people are. Recent population and housing growth has taken place in cities and this trend will continue. Significant capital investments are required in order to meet the needs of growing populations.

Town centers and compact, dense communities surrounding the state's economic hubs support statewide priorities. Investing targeted and strategic infrastructure in cities promotes economic growth. This is a key element in preserving our economic strength, maintaining our position as a leader in world trade, supporting climate change, protecting Puget Sound, and addressing the transportation crisis. Washington's cities require a sound infrastructure foundation.

Hurdles to economic prosperity

Although the GMA directs 217 cities to provide public facilities and accommodate increased density to support and encourage development, cities struggle to satisfy this mandate. Since the GMA was enacted in 1990, cities accepted the burden of growth without adequate financial support.

Without this support, cities encounter more and more infrastructure barriers. And when city infrastructure falters, new businesses do not invest in Washington, permits are denied and economic opportunity is lost.

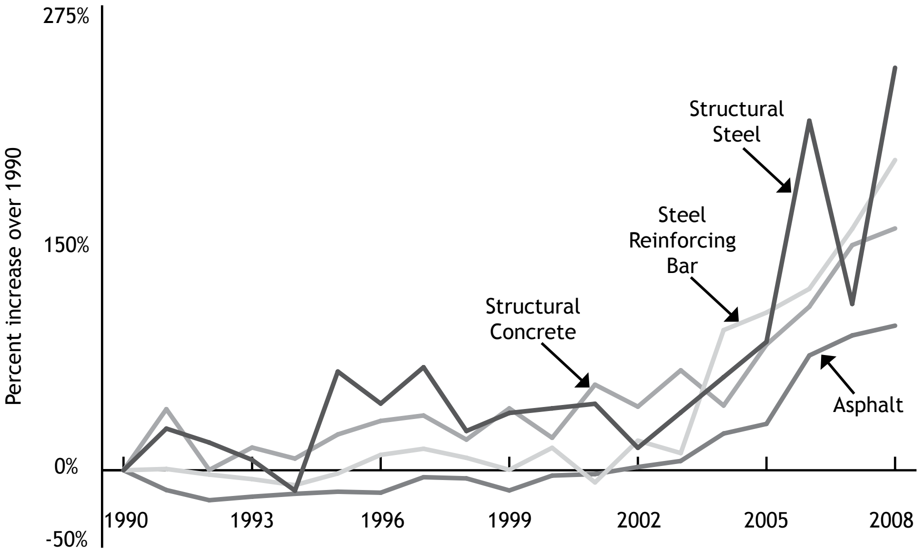
The 2008 State of the Cities report found the lack of capacity of important infrastructure systems is a barrier to economic development for many cities.

- One in three cities has inadequate street capacity;
- One in four cities lacks sewer/waste water capacity; and
- One in five cities lacks drinking water capacity.

Soaring costs

Seventy-six percent of city officials report that infrastructure costs increased over the past four years, and 60 percent of city officials indicate this had a major impact on the budget. Nearly half of city officials (45 percent) report that infrastructure needs are among the top three most negative impacts on the city budget.

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



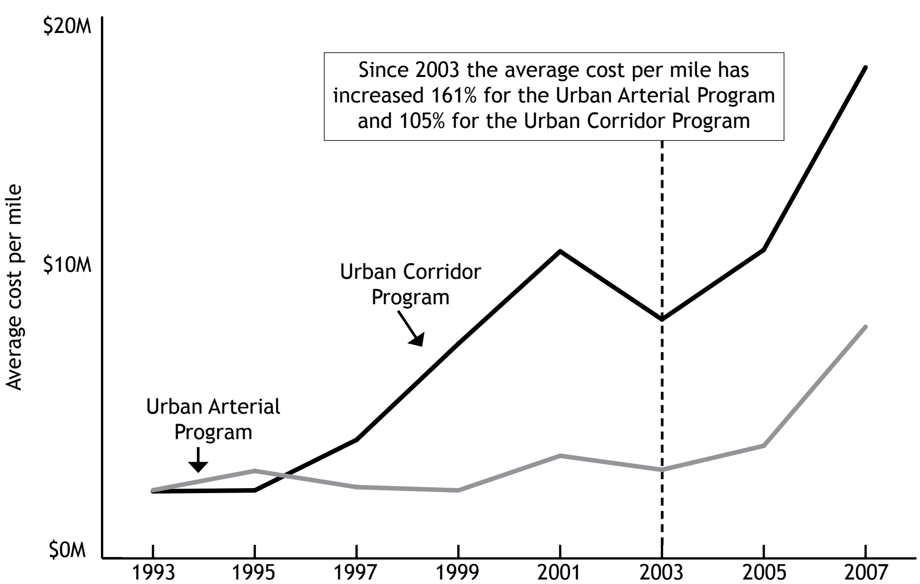
Source: Department of Transportation

> With the increase in costs, there's an urgency to start infrastructure projects now. Don't wait.
>
> *~Craig George, Mayor, Dayton*

The Public Works Board estimates that for every construction cycle that passes, project costs increase an average of 30 percent. Between the 2001-2003 and 2005-2007 biennia, the average total project costs increased by approximately 54 percent.

Between 2003 and 2007, city projects receiving funds from the Transportation Improvement Board's Urban Arterial Program experienced a 161 percent increase in the average cost per mile, and a 105 percent increase for the Urban Corridor Program.

Average costs per mile for Transportation Improvement Board funded projects have escalated in recent years



Source: Transportation Improvement Board

The impact is undeniable. Increasing material costs outpace most cities' ability to fully fund capital facilities plans. This frequently results in deferred maintenance which leads to future and expensive replacement costs.

Which systems need help?

To some extent, 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 their lifecycles while others have recently been replaced. But the statewide trends are very clear.

> "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*

Overwhelmingly, more city officials report their streets need repair than any other portion of the infrastructure system.

- Sixty-six percent of cities say that major replacement or enhancement is needed for their city streets simply to meet current demand—another 29 percent report some replacement or enhancement is needed; and
- Fifty-one percent of city officials say this service is one of the most difficult to sustain (26 points higher than the next most commonly-cited service).

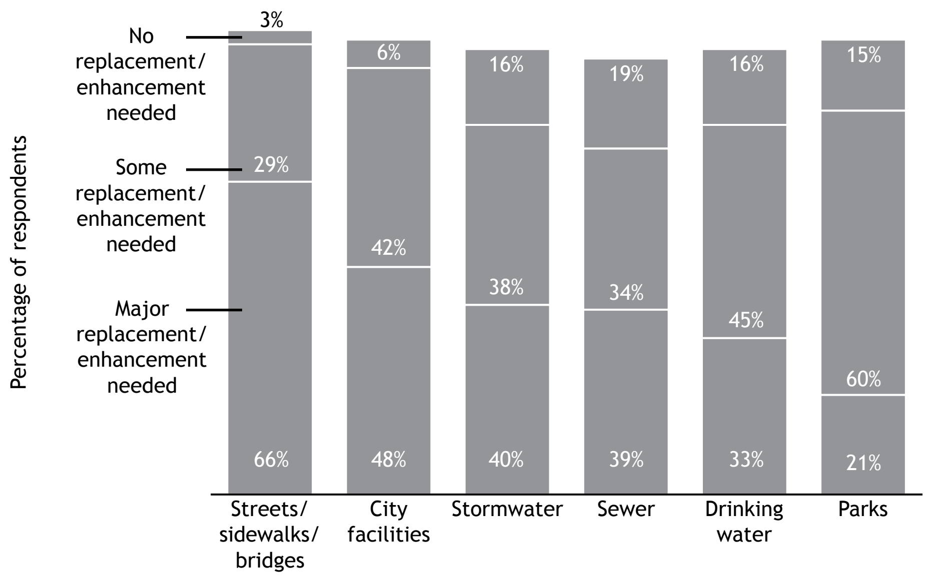
Forty percent or more of the city officials in 11 of 14 city clusters indicate that streets are among the most difficult services to sustain.

Percent of cities within each cluster indicating that streets are one of the three services most difficult to sustain during the last four years

0%-19%	20%-39%	40%-59%	60%+
Medium Commercial Centers (Cluster 12)	Tourism Hubs (Cluster 3)	Regional Centers (Cluster 1)	Rural Commercial Centers (Cluster 2)
	Major Commercial Centers (Cluster 13)	Small Residential (Cluster 5)	Light Industrial/ Natural Resources Hubs (Cluster 4)
		Urban Outskirts (Cluster 7)	Rural Communities (Cluster 6)
		Residential Communities (Cluster 8)	High Income Residential (Cluster 9)
		Mixed Resources (Cluster 10)	Small Commercial Centers (Cluster 11)
		Largest Cities (Cluster 14)	

Other important capital systems, such as city facilities, stormwater facilities, sewer/waste water, drinking water and parks also need investments.

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



City streets move Washington forward

Nearly every trip begins and ends on a city street or county road. City streets comprise over 16,000 centerline miles, over which one-quarter of traffic is carried. City arterial streets total more than 3,000 centerline miles and carry three-quarters of city traffic. Cities are also responsible for nearly 700 bridges over rivers, rail road tracks, and other roadways.

An urban city street is more than just a paved surface. Above ground, it includes sidewalks, streetlights, parking, and other amenities. Below ground, streets provide rights of way for water, sewer, and electric lines and cables, and natural gas transmission systems. Unlike a highway or country road, a city street often has curbs, bike lanes, sidewalks and wheelchair accessible ramps.

For AWC's 2008 State of the Cities report, 30 percent of city officials reported that the overall condition of their streets was poor, very poor or failing. Of all city streets, residential streets fair the worst with 34 percent of city officials responding that these streets are in poor condition.

The Department of Transportation reports that the average condition of city arterial streets continues to decline. The straight average pavement rating for 2008 fell three points over the previous biennium, from 67 to 64. More than one-third of city arterials (35.8 percent of centerline miles) are in fair, poor or failed condition.

> "The cost of O&M for our streets is killing us. We get grants and developers build them, but the O&M costs outpace revenues on hand."
>
> *~ John Doan, City Administrator, Sumner*

> Streets decline in quality rather slowly and they don't have a strong interest/advocacy group in the community.
>
> *~Lloyd Halverson, City Administrator, Camas*

Of the nearly 700 city-owned bridges that are federally reported, one of four is functionally obsolete, and approximately one out of ten is structurally deficient or weight restricted. In addition, millions of dollars are needed to repair and replace structures under 20 feet, which are not reported to the federal government.

Street amenities, like sidewalks and bike lanes, require more costly work and materials. Yet, many of these elements are in poor condition or simply nonexistent. Forty-three percent of city officials responding to a survey for the 2008 State of the Cities rated the condition of city bicycle facilities as poor and 28 percent reported their sidewalks to be poor.

Financing challenges

Street capital expenditures rely on a variety of revenue sources, including:

- A city's general fund;
- Real Estate Excise Taxes;
- Impact fees;
- SEPA mitigation; and
- State and federal grant and loan programs.

Unlike a sewer or water utility, streets do not have a dedicated revenue source. Washington's cities pay for nearly three-quarters of their transportation funding. The gas tax only funds seven percent of city streets. The remainder comes from federal and other state sources.

Cities use gas tax revenues to finance street improvements. Even with recent increases in the gas tax, cities only receive 2.96 cents (or eight percent) of the state's gas tax. This is approximately $90 million annually or the equivalent of six miles of an urban street.

Gas tax distributions are allocated on a per capita basis. However, as city population increases, the per capita distribution decreases. Even with an additional half cent gas tax authorized in 2005, distributions aren't keeping up with inflation. A September 2008 WSDOT revenue forecast projects that future gasoline prices will be substantially higher. With higher gasoline prices, motor fuel consumption is projected to be lower than forecasted, resulting in fewer dollars distributed to cities and towns.

State grant and loan programs, a critical funding source for city street projects, is discussed in chapter 6.

Basic utilities at luxury prices

City utilities generally include drinking water, sewer/wastewater, and stormwater. While these services appear routine to the average person, they actually play a significant role in our economic prosperity, public health and safety, and environmental protection.

These systems are critical, yet their sustainability is in jeopardy. Cities work hard to build and preserve their utility systems, yet still are forced to deal with significant disrepair. These cities shoulder substantial costs to:

- Upgrade systems to meet new and higher regulations;
- Rebuild aging systems; and/or
- Construct utilities from scratch.

Often, utility systems that require upgrades and/or repairs:

- Exceed their recommended capacity;
- Operate on the cusp of public health risks; or
- Extend well beyond their structural lifespan.

Why don't utilities pay for themselves?

Utility systems operate as enterprise activities. They are intended to be self supporting through user fees. And to a certain extent this is true. City officials report that the dedicated revenue sources for water and sewer systems—user fees paid by residents and businesses—at least removes these services from competition with other services (like public safety and parks).

However, well-structured fees cannot always cover capital needs.

- It is difficult, if not impossible, for cities to anticipate future mandates and plan for these through establishment of reserve funds.
- Smaller communities lack economies of scale and rates can exceed their residents' ability to pay for multi-million dollar facilities.
- Infrastructure costs have dramatically outpaced inflation and typical rate setting.

Competing Priorities

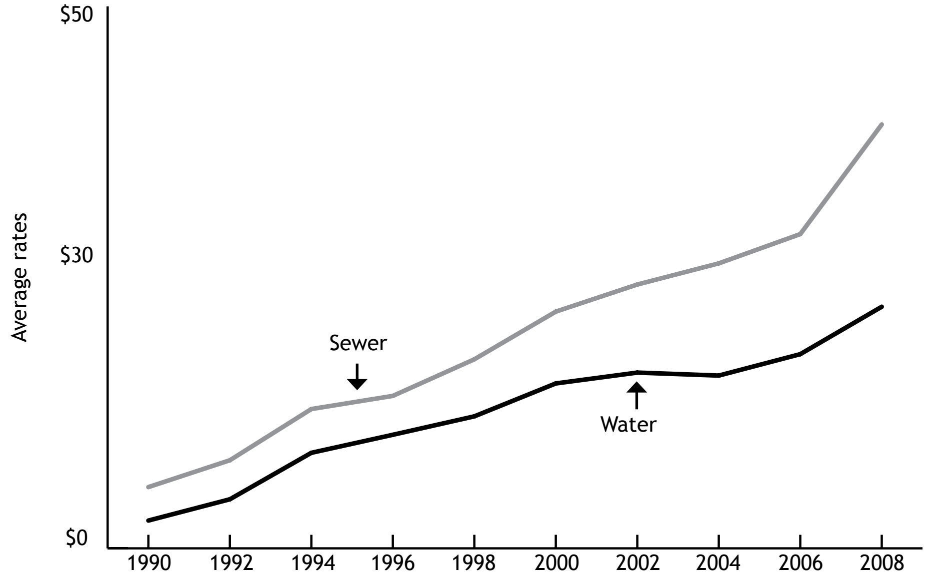
Under the Growth Management Act (GMA), cities are required to develop an infrastructure to accommodate growth. But many cities struggle to update aging infrastructure, expand systems for new homes and businesses, while also navigating state and federal regulations.

Incorporated in the late 1800s, the City of Snohomish is struggling to retrofit an old infrastructure while simultaneously working to lay a foundation for future growth. The city is in one of the state's fastest-growing counties, expected to grow 35 percent by 2025.

The city's infrastructure challenges include:

- Upgrading the wastewater treatment plant as a result of tighter discharge permit requirements on the Snohomish River.
- Dealing with combined sewer overflows from the old sections of town.
- Replacing 80-year-old iron drinking water pipes.
- Upgrading the water treatment plant to keep up with new Department of Health rules.
- Meeting new stormwater permit requirements.
- Providing new sewer hook ups so future homes can be connected to city sewer rather than septic systems.

Water and sewer rates have steadily increased throughout the years



Source: AWC Tax and User Fee Survey
Note: Service providers responding to survey vary each year

Between 2006 and 2008, average user fees increased 24 percent for sewer and 14 percent for water. Yet these increases still can't always cover the costs of major system overhauls, capacity expansion improvements, or compliance with new requirements.

Cities rely on state and federal grants and low-interest loans to help close the gap between what a utility can afford and major project costs. The state's vital partnership in assisting with these projects is discussed in chapter 6.

Drinking water

Cities supply millions of Washingtonians with safe, reliable drinking water. This requires an adequate water supply, treatment for water quality, and distribution systems to homes and businesses.

Cities derive their water from a variety of sources:

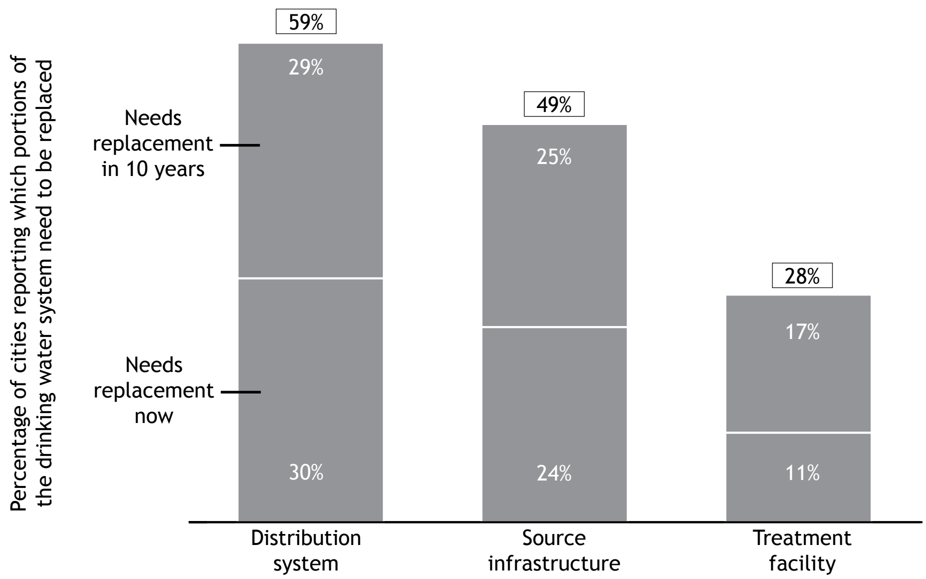
- Surface water from streams and lakes;
- Ground water from wells or aquifers; and/or
- Water purchased from another provider.

Drinking water is tested to ensure public health and safety. Most water is treated by filtration, disinfection, aeration or pH adjustment. The water is then distributed to homes and workplaces through miles of pipe.

Seventy-eight percent of city officials report that in order for their drinking water system to meet current demands, enhancement or replacement is needed.

For the 2008 State of the Cities report, 59 percent of city officials reported they need to replace a portion of their distribution system within the next ten years. Forty-eight percent of city officials also responded that a portion of the source infrastructure (such as a well or intake pipes) needs replacement within the next ten years.

In the near future many cities will need to update drinking water systems



Source: State of the Cities, 2008

Many failing distribution systems are due to old, corroding pipes. The Environmental Protection Agency reports that over the past decade 24 percent of the waterborne disease outbreaks reported in community water systems were caused by contamination of the water distribution system.

Cities are now beginning to see the impacts of the new Water Use Efficiency Rule. This rule requires no more than ten percent of the supply be lost in transmission. While this is good public policy, some cities will be required to make significant improvements to their utility system with no direct funding source attached to the requirement.

Water capacity issues also present a significant problem for some cities. Without sufficient access to water or additional water rights, economic development efforts are halted.

Sewer systems

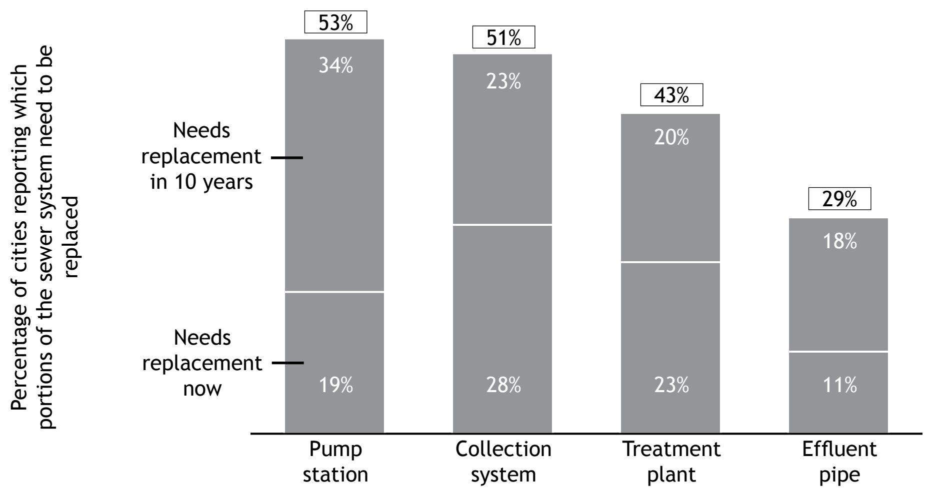
"The sewer is an ongoing project for which we have received some funding, but far from enough to meet all requirements."

~Lorna Pearce, Clerk-Treasurer, Coulee City

Sewer systems ensure that waste generated from residences and businesses is collected and treated before being released back into the environment. This fundamental service preserves our environment and our public health.

However, 39 percent of city officials report their sewer system is in need of major replacement/enhancement and an additional 34 percent report it needs some replacement.

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



Source: State of the Cities, 2008

For the 2008 State of the Cities, 53 percent of city officials indicated sewer/waste water pump stations will need to be replaced within the next ten years, and 51 percent of city officials indicated the collection system needed to be replaced within the same time period.

Stormwater systems

Stormwater is rain and snow melt that runs off surfaces such as rooftops, paved streets, highways, parking lots and even urban landscaped yards.

Stormwater contains pollutants from a vast number of sources. For example, water flowing in the streets picks up:

- Motor oil dripped from cars;
- Fine particles of rubber;
- Trace metals from brake pads and other mechanical sources;
- Metals from tire wear; and
- Settled air pollutants.

Stormwater systems designed and built today are intended not just to convey water, but to catch any initial rush of water, such as from rainfall on streets or runoff from watering the lawn, treat and release it. This allows stormwater to seep more slowly into the groundwater system.

However, many older city stormwater systems still do nothing more than carry stormflows to the nearest stream or shoreline area. Pollution from stormwater is now recognized as a major contributor to the declining health of Puget Sound, and retrofitting these old systems to include some type of treatment options will be a very costly and time-consuming process.

In addition, new stormwater regulations went into effect in 2007, requiring nearly 100 cities to obtain National Pollutant Discharge Elimination System (NPDES) Phase II permits. These permit requirements are costly and impose conditions that exceed Federal Clean Water Act standards. The permit is required in urbanized areas and cities with a population of 1,000 or more people per square mile.

Achieving Higher Stormwater Standards

Covington is a young city that experienced a lot of growth in its short existence. The city is working to bring old infrastructure systems up to date, while planning for future growth.

Covington is one of approximately 100 cities required to obtain the NPDES Phase II permits. To prepare for the permits, the city took proactive steps. They:

- Conducted a downstream study with the help of a Department of Ecology grant;
- Adjusted user fees to cover anticipated costs; and
- Established hookup fees so future residential and commercial development offsets stormwater capital costs.

Even after taking these calculated steps, the city will still encounter financial shortfalls in complying with the NPDES Phase II permit.

"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

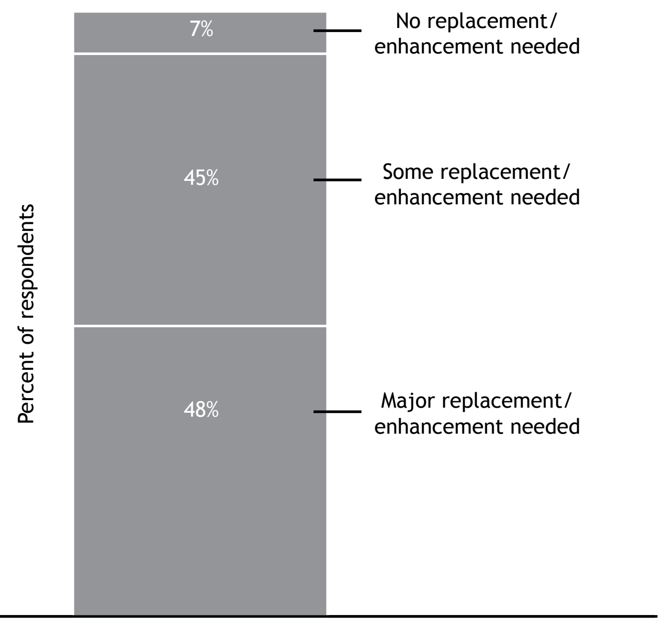
> We have to divert money and increase rates to meet NDPES Phase II paperwork, mapping, inspection, and maintenance requirements.
>
> *~John Starbard, City Manager, Newcastle*

The NPDES Phase II permits require cities to comply with several minimum measures:

- Public education and outreach;
- Public involvement and participation;
- Illicit Discharge Detection and Elimination (IDDE);
- Controlling runoff from development; and
- Pollution prevention from municipal operations.

To meet these requirements cities must invest in their stormwater systems, and also hire appropriate personnel to develop and manage the overall effort and maintain permit compliance. City officials from 93 percent of these cities report replacement or enhancement of their stormwater systems is needed, with 48 percent indicating major replacement or enhancement is needed.

Most cities required to obtain the NPDES Phase II permit report enhancement/replacement of stormwater systems is needed



Small city struggles

Cities of varying sizes and locations struggle with inadequate utility systems. However, a larger portion of cities in rural areas report having poorer utility conditions than cities as a whole. These smaller and often rural communities lack economies of scale which results in higher costs per customer and rates that may exceed lower income residents' ability to pay.

Eighteen of the 20 cities with the highest base water rates have a population of 5,000 or less. The median population among these cities is only 1,048. The median base water rate for cities of 5,000 or less is 20 percent higher than the median rate for all cities, and 116 percent higher than cities with a population of 25,000 or more.

Challenges for economic hubs

Larger cities have their own unique challenges. Many of our state's economic centers are also our oldest cities with some of the state's oldest infrastructure systems.

These large commercial centers need major infrastructure enhancements and improvements to ensure that services are delivered efficiently and effectively. Crumbling bridges, inadequate water flow, deteriorating arterials and barriers to freight mobility are not just a problem for cities; they are major problems for statewide commerce.

These cities also must be ready to accommodate the majority of new residential growth. They face the challenge of encouraging greater density, while keeping housing affordable.

Local resources alone can't meet these challenges. It takes another level of infrastructure investment. These cities may have larger budgets, but they are also dealing with large-scale, mega-million dollar projects.

Utility Rates: Big Hurdles for Small Cities

In smaller cities, utility rates frequently exceed residents' ability to pay. These communities lack the economies of scale necessary to spread the price of costly sewer and drinking water treatment plants across many residents.

- After building a water treatment facility in 2001, and a wastewater treatment facility in 2005, and making other infrastructure improvements, Kalama is over $10 million in debt. The city increased water and sewer user fees over several years and is proposing another three-year sewer rate hike. With one of the highest sewer rates in the area ($76 a month), the rates are extremely hard on Kalama's small pool of citizens.
- Cashmere faces a $20 million sewer improvement project. Even with grants from the state, customers will likely see their bill increase from $45 to $100.
- Airway Heights originally projected the cost of a new wastewater treatment facility at $38.6 million, but escalating construction costs increased the estimate to $43.3 million. By 2010, rates will increase to $80.

Competing pressures

Cities face the pressures of satisfying competing needs and setting funding priorities for capital investments. With limited resources, how do they identify which priorities to focus on? Should they…

- Replace aging city infrastructure systems that are nearing the end of their useful life?
- Meet basic capacity requirements and plan for future growth?
- Comply with state and federal mandates? or
- Build and maintain citizen-demanded capital projects?

Streets and utilities like drinking water, sewer and stormwater systems are all affected by federal and state mandates. While cities clearly support high standards of public health and environmental stewardship, they struggle to find adequate funding to meet these requirements. In fact, 75 percent of city officials report environmental mandates over the past four years had major or moderate impacts on the budget.

As cities work to accommodate increasing density, citizens and businesses are demanding enhanced parks and open space, trails, ballfields, and greenway corridors. These infrastructure elements help promote livability, recreation and healthy lifestyles. But significant funding shortfalls for parks and open spaces exist and city officials report this is one of the first areas to be cut in times of budget shortfalls.

Important state and federal mandates and legislation impacting cities

1990		1996	1998	2003	2005
Growth Management Act (GMA) The GMA specifies that all cities (and counties) in Washington designate and protect critical areas and ensure new residential subdivisions have appropriate public services and facilities. Directs GMA-planning cities to develop and implement comprehensive plans.	**National Pollutant Discharge Elimination System (NPDES) Phase I** Seattle and Tacoma required to implement NPDES Phase I stormwater programs.	**Safe Drinking Water Act amendments.**	**Endangered Species Act—Proposed listing for Chinook Salmon in Puget Sound basins.**	**Transportation Package (Nickel Package)** Gas tax increases 5 cents, from 23 to 28 cents. Cities do not receive an increase in distribution.	**Transportation Partnership Legislation** Gas tax increases from 28 to 37.5 cents. Cities receive a half cent of the 9.5 cent tax increase.

While few cities have their own jails, all must arrange to incarcerate offenders sentenced to jail. The availability of jail space is a vital concern for cities—particularly cities in urban areas. Many city jails are old facilities with limited capacity that need improvements. Cities also find they are being "squeezed-out" of county facilities, causing more cities to consider building their own jail.

City halls and other capital facilities such as community centers, fire stations and senior centers serve as the home to many vital services and help create community identity and pride. The condition of these buildings affects the way many services are delivered—the speed with which fire fighters can respond to an emergency, how planners interact with their customers, and where citizens and city councils collaborate to shape the community they want. Yet, 90 percent of city officials report these buildings need replacement or enhancement, with 48 percent indicating they need major replacement or enhancement.

"Our aging water infrastructure requires frequent repair and partial failure in one lagoon pond required extra budgeting to repair."

~Gary Wagner, Mayor, Rockford

2006		2007			Pending
Job Development Fund A fund of up to $50 million a biennium is created to aid in the construction of large infrastructure projects associated with economic development. Funding for these grants is diverted from the Public Works Assistance Account but the program ends in 2008.	**Local Infrastructure Financing Tool** Uses sales tax, property tax and selected other excise tax increases generated by an economic development project in a local government's revenue development area.	**DOE issues NPDES Phase II permits** Permit requires nearly 100 cities to make costly improvements and be held accountable for local stormwater programs.	**Transportation Benefit District** A local option becomes available which allows cities or counties to impose the first $20 of the vehicle license fee. The remaining $80, and other options, remains voter approved.	**Water Use Efficiency Rule** A new rule requires that no more than 10% of the water supply be lost in transmission, requiring some cities to make significant improvements to utility systems.	**Additional mandates for Puget Sound cleanup and climate change.**

Chapter 6

Strong Cities, Strong State: Recommendations for City and State Action

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Strong Cities, Strong State: Recommendations for City and State Action

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

As the economic, social and cultural hubs of the state, cities also support statewide priorities. Cities play a vital role in the state's efforts to foster a prosperous economy, a clean environment and healthy communities.

- Cities are the state's economic engines, providing good jobs for residents.
- Cities create and maintain a strong infrastructure foundation to prepare the state for economic and residential growth.
- City public safety personnel are first responders, protecting the public daily and in times of natural disaster.
- Cities are charged with a leadership role in protecting the environment, whether cleaning up Puget Sound or curbing the impacts of climate change.

When cities meet service expectations, businesses, residents, and the whole state prosper. When any one of these elements is lacking, communities and their economic vitality decline.

"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

Cities and their citizens

As the hierarchy of government expands from city to region to state, the sense of distance the average citizen feels toward that larger entity grows ever wider. Local government is the most accessible:

- City hall is visible – people might drive or walk by it daily;
- Councilmembers' children and grand-children attend local schools; and
- Mayors mingle with constituents at local plays or festivals.

This accessibility explains why citizens trust their local government more than government as a whole. Eighty-three percent of city officials agree that residents of their city trust their city government. Only 59 percent of city officials agree that residents trust government as a whole.

> In the past five years our criminal justice costs have increased 32% compared to 15% for all of the other city services over the same time frame. This increase has far outpaced existing revenue growth. We need a greater and more reliable share of state financial support to help sustain these escalating costs.
>
> *~Dick Zais, City Manager, Yakima*

Because of this inherent intimacy, cities are perceived as working more closely with citizens. Citizens see and read about their city officials setting spending priorities based on their actual desires and needs. How do local officials know what the community considers important?

- Seventy-one percent of city officials report engaging in regular community outreach or hosting forums; and
- Fifty-four percent conduct surveys.

Approaching the breaking point

In the wake of an economic downturn, revenues are declining while service level expectations remain high. Many cities are approaching a breaking point.

City officials are forced to make tough choices. Sixty-three percent of survey respondents say they will be less able to meet financial conditions in 2009 than in 2008. How will they deal with this budget shortfall? They will make cuts and use reserves:

- Fifty-three percent anticipate increasing reliance on ending cash balances and reserves;
- Forty-six percent plan to decrease infrastructure spending;
- Thirty percent expect to decrease their workforce; and
- Eighteen percent may decrease public safety spending.

As nearly half of cities decrease infrastructure investments, maintenance and critical repairs will be deferred. Undoubtedly, deferred maintenance today adds to the taxpayers' bills tomorrow. It also jeopardizes the state's economic vitality, public health and safety and the environment.

Twenty-five percent of cities indicate they are pessimistic about their ability to provide citizen-demanded services. How cities categorize citizen-demanded services varies, but it most often includes parks, recreation services, and business recruitment and retention. Unfortunately, these services are also the ones that are most likely to influence community character, encourage businesses to locate in the area and ultimately create revenue growth for the city and the state.

It is possible that 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.

Helping ourselves

Cities are doing more than just cutting services; they are also relying on their citizens and the business community to help.

Although cities are limited to a one percent property tax cap, many have asked their voters for additional revenue authority. A few examples include:

- Port Townsend passing a levy lid lift in 2008 to pay for operation and maintenance of the library;
- Redmond passing two levy lid lifts in 2007 to fund additional fire and police personnel as well as park maintenance and programs; and
- Palouse annually passing operation and maintenance levies for its streets and swimming pool.

Two hundred and sixty-six cities in 32 counties partner with counties to impose the criminal justice sales tax (0.1 percent). Another 42 cities in five counties partnered with counties to obtain voter approval to levy the public safety sales tax (up to 0.3 percent).

Over the past four years, 44 percent of survey respondents report increasing user fees.

Cities also frequently strategize to implement daily efficiencies. This do-more-with-less mindset has been the mantra of recent years. 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 fewer resources, simply delivers fewer results.

Additional expenses

In the midst of nation-wide economic woes, city officials fear a larger service delivery burden will be handed down to local governments. History shows us that as federal, state and county governments begin the process of dealing with their respective budget shortfalls, more financial responsibility for essential services is placed upon cities.

In a focus group, one city official pointed out that when the county and state governments don't provide adequate funding for mental health or public health, the city picks up the pieces. Public safety departments in particular recognize the impact of an under-funded social service system.

"All of the cities around us are having financial problems. The mayors have talked about creating a parks and recreation district for the area, so we can share costs. We might also look at combining forces to meet our public safety needs, like a new jail."

~Loren Belton, Mayor, Toppenish

Enhancing a city-state partnership

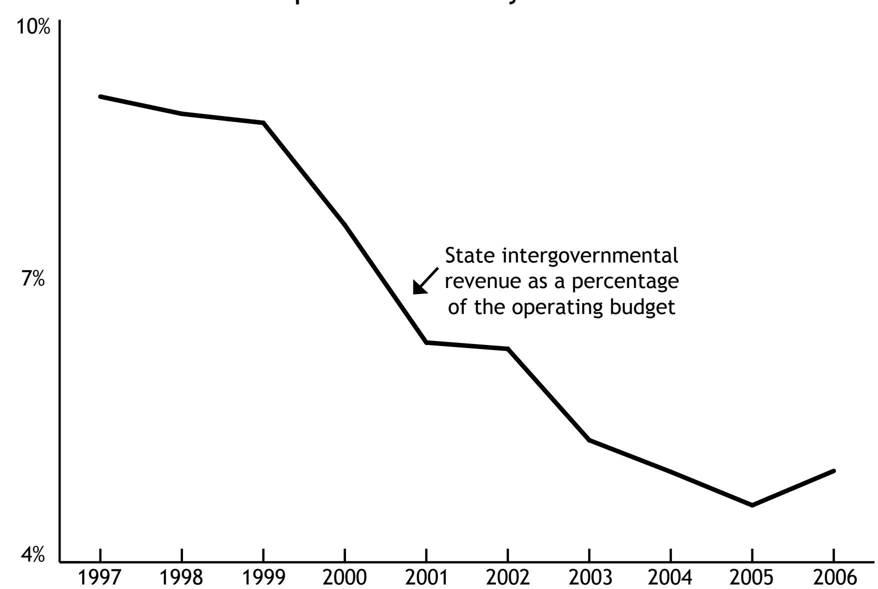
There is no doubt the state is an invaluable partner. More than half of respondents say relations with the state have improved over the past four years. The state provides some:

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

> 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*

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 revenues declined by nearly half. State unfunded mandates place additional financial pressures on cities to meet certain service standards.

State assistance as a percent of total city revenues has declined



Source: State Auditor's Local Government Finance Reporting System

City-County Assistance Account

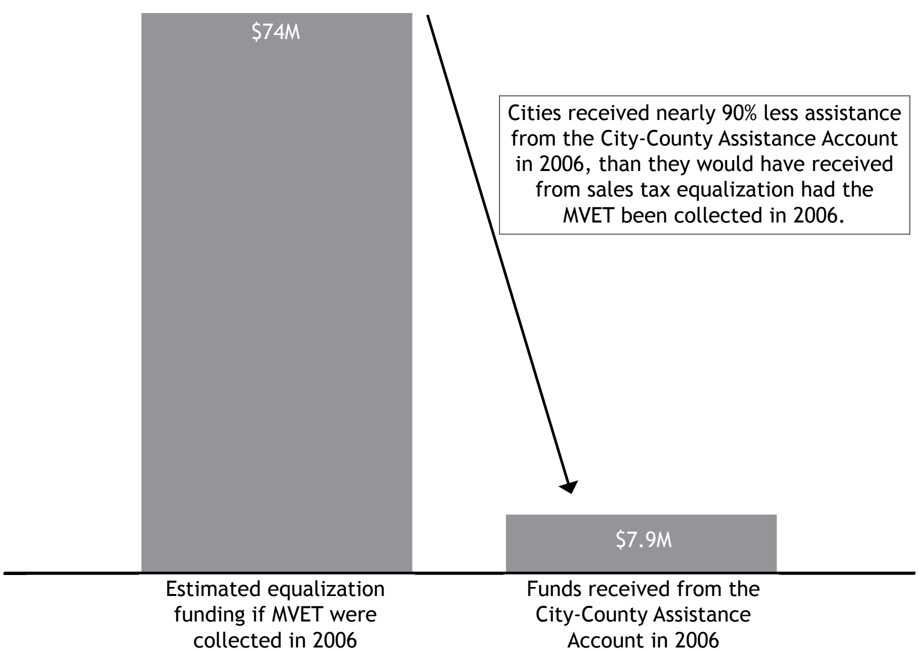
Created in 2005, the City-County Assistance Account provides assistance to low tax-base cities that were impacted by the repeal of the motor vehicle excise tax (MVET). MVET revenues provided funds to local governments in a variety of areas, including:

- Sales tax equalization
- City police and fire protection
- Municipal criminal justice account

But in 2000 this tax was repealed by the Legislature after the Supreme Court invalidated Initiative 695. The total estimated loss to cities in 2000 was more than $100 million.

The City-County Assistance Account now provides approximately 170 cities with assistance based on a sales tax or property assessed value equalization formula. The Joint Legislative Audit and Review Committee estimates that if the MVET were still collected in 2006, cities would have received about $74 million solely for the sales tax equalization portion of the formula. In comparison, the City-County Assistance Account provided about $7.9 million to cities in 2006.

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



Source: Joint Legislative Audit and Review Committee

Small City Impacts from Initiatives

Cities continue to feel reverberations from the wave of tax-limiting initiatives, especially I-695 and I-747. Small cities in particular suffered acute consequences from these anti-tax measures.

Of the 37 cities that lost 30 percent or more of their general fund with the repeal of the motor vehicle excise tax:

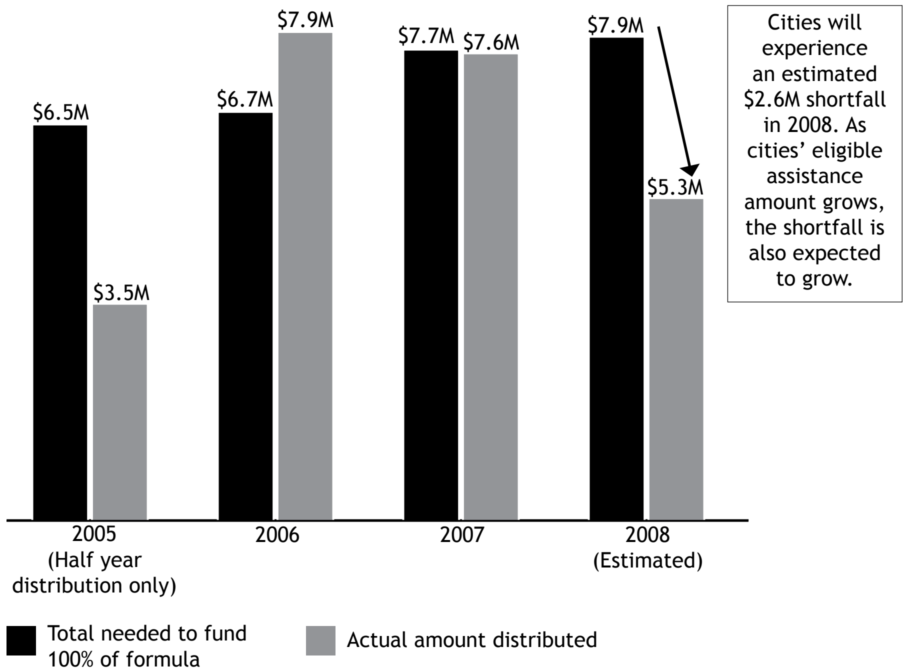
- The average population is less than 2,000; and
- Eighty-six percent of those cities had a population of less than 5,000.

Even with the creation of the City-County Assistance Account in 2005, small cities realize only a portion of former MVET revenues.

2001 MVET Loss		2007 City Assistance
Albion	$83,685	$32,035
Bridgeport	$238,724	$102,666
Granger	$227,861	$105,552
Malden	$26,915	$12,116
Nespelem	$21,879	$9,161
Pe Ell	$70,797	$28,666
Vader	$52,406	$25,502

One significant concern to cities is that the account is funded by a portion of the state's real estate excise tax. This volatile funding source has fallen sharply with the declining housing market. In 2008 cities will receive about 30 percent less than in 2007.

The funding source for the City-County Assistance Account, the REET, is a volatile funding source



Infrastructure assistance

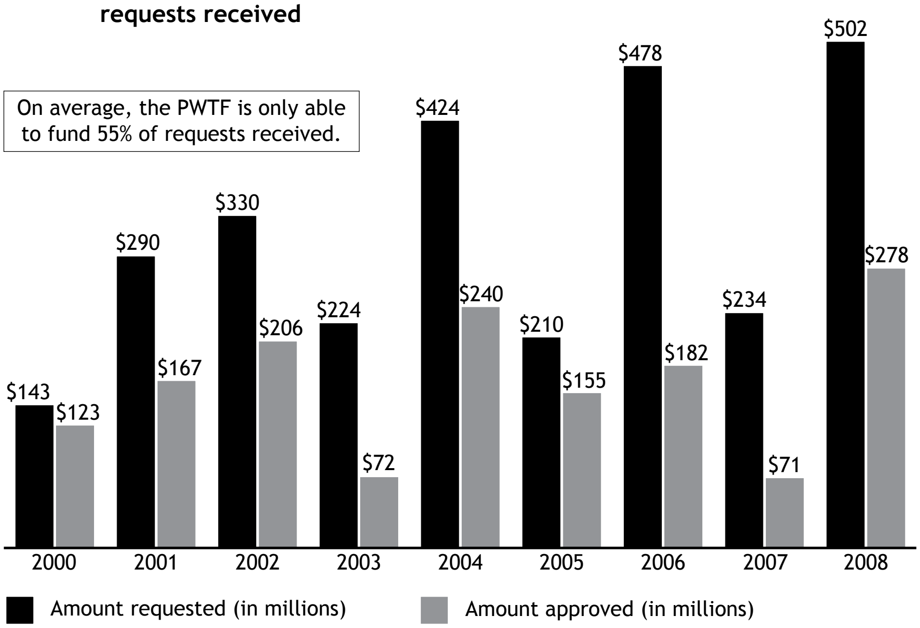
Cities rely on the state as an important partner in building a strong infrastructure system. Today, the most serious deficit in city infrastructure is the mismatch between growing needs and available resources. Competition for resources within cities' operating budgets, over-subscribed state assistance programs, and restricted local revenue-raising options leave many capital development needs unmet.

State grant funds and low-interest loans provide cities with vital assistance. In sheer size, the Public Works Trust Fund (PWFT) affords the most assistance to local governments primarily in the form of low-interest loans. Other significant state grant and loan programs include:

- Revolving Water Fund
- Transportation Improvement Board (TIB)
- Community Economic Revitalization Board (CERB)
- Washington Wildlife and Recreation (WWRP)

But these programs aren't enough to help all cities meet local needs. The PWTF fund has fallen short of funding all worthy applicants. In 2008, the fund turned away $224 million in requests (of the $500 million awarded).

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

The Transportation Improvement Board receives about $8 in request for every $1 it has available for grants. The WWRP receives nearly $4 in requests for every $1 available, and several kinds of parks and community projects don't qualify for funding.

These programs' funding shortfalls mean cities are unable to build, repair and maintain critical infrastructure systems that are essential to the entire state's well-being.

Mandates

State and federal mandates contribute to the increase in service costs. City officials identify environmental mandates as requiring significant additional local expenditures. Sixty-nine percent of city officials say these mandates increased their budgets over the past four years, and nearly half (46 percent) say the budget impact has been major.

These environmental protection responsibilities include:
- NPDES Phase I and II permits
- Shoreline plans and management
- Critical areas ordinances

"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

Non-environmental state and federal mandates also impact city budgets. Forty-nine percent of city officials say non-environmental mandates impacted the budget, and 25 percent say the impact was major.

Other mandates include public safety requirements:

- Mandatory criminal sentencing requirements;
- Sex offender address verification;
- Emergency preparedness;
- Communications interoperability; and
- Enhanced public safety employee pension benefits.

Conclusions

A strong city-state partnership is critical to meet cities' current and upcoming challenges. Cities are the "face" of the State of Washington. Large and small, urban and rural, these communities are the state's cultural and economic hubs.

City revenues have not kept pace with expenditures. Since the early part of this decade, vital revenue sources such as the property tax and motor vehicle excise tax were capped or eliminated. Coupled with an increase in expenditures, many cities struggle with basic service delivery. Others have been able to maintain services in light of rising expenditures because of unprecedented growth. However, those days are over.

Competition for dwindling operating budget resources requires city councils to make tough choices. Particularly as the national economic downturn continues to impact Washington, cities will be forced to prioritize services. Choosing between police officers on the street, recreational programs for teens, or street maintenance and preservation won't be an easy task.

City budget shortfalls jeopardize Washington's economic vitality. City streets, parks and utility systems provide a foundation for businesses and residents. As cracks in this critical foundation continue to grow, cities will turn away businesses and housing permits will be denied. These actions aren't desirable and are in direct conflict with state goals to encourage growth in urban areas.

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 city officials 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.

  Our state's largest cities, the smallest, and essentially all cities in between have their own infrastructure crises. Streets, utility systems, parks and other capital facilities are all critical to supporting economic vitality, quality of life and environmental protection. The state's portfolio of infrastructure programs—like the Public Works Trust Fund and Transportation Improvement Board—needs a catch-up allocation to fund more qualified projects.

- **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 smallest, most vulnerable communities. Although this account provides only a portion of the support cities received before the loss of MVET, it offers vital operating assistance for cities.

  Unfortunately, this account is funded by a portion of the real estate excise tax, a volatile funding source. As the housing market continues to cool, this fund will not keep pace with inflation. 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 optional local government revenue sources are restricted, even when voter-approved. Other funds are dedicated to specific purposes or cannot be supplanted.

  Cities need greater fiscal flexibility with these revenues to meet the needs identified by their communities. Voter-approved multi-year levy lid lifts, the criminal justice optional sales tax, and the real estate excise tax are just some examples of revenue sources where fewer restrictions could prove vital in helping cities meet community needs during this economic crisis.

- **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** within designated urban growth areas;
  - **Incentives to facilitate agreement** between cities and counties to jointly plan for and have consistent development regulation in unincorporated urban areas; and
  - **Opportunities to foster better working relationships** with special purpose districts serving urban areas.

- **Convene a workgroup to study local governments' fiscal conditions.** Local governments have struggled for years to provide essential services with inadequate resources. It is now time the Legislature convenes 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, working with citizens and local businesses to achieve a common community vision. Cities need to work even closer with constituents to determine service level expectations. What services need enhancing? Which services need cutting? And what projects can be deferred?

  As expenses continue to increase, cities must work with their communities to uncover unexplored revenue and cost-cutting options.

- **Invest in economic development.** As cities closely examine the services they may need to cut to balance the budget, many city officials acknowledge they are pessimistic about their ability to provide economic development services. Cities also recognize that the inability to fund critical infrastructure needs stalls economic development.

  In the coming years, cities need to work closely with their business community, educational institutions and regional economic development councils to implement strategies that attract and retain good jobs for residents, while also expanding the 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 and establish reserves to fund upgrades and unexpected emergencies. Particularly with utility systems, current and forecasted cost increases should be taken into account when setting rates. Making annual adjustments that reflect costs can help cities avoid large rate increases.

Appendix

Appendix A: Washington cities by cluster
(as designated for this study only)

Regional Centers (Cluster 1)

- Anacortes
- Centralia
- Ellensburg
- Longview
- Moses Lake
- Mount Vernon
- Port Angeles
- Pullman
- Walla Walla
- Wenatchee

Rural Commercial Centers (Cluster 2)

- Aberdeen
- Chehalis
- Colville
- East Wenatchee*
- Ephrata
- Grand Coulee
- Kelso
- Morton*
- Napavine*
- Okanogan
- Omak
- Oroville
- Quincy
- Sedro-Woolley*
- Shelton
- Tonasket
- Twisp
- Woodland*

Tourism Hubs (Cluster 3)

- Burlington
- Chelan
- Cle Elum
- Friday Harbor
- La Conner
- Leavenworth
- Long Beach
- Ocean Shores
- Port Townsend
- Sequim
- Stevenson
- Westport*
- Winthrop

Natural Resources/ Light Industrial Hubs (Cluster 4)

- Bingen
- Brewster*
- Cathlamet*
- Chewelah
- Colfax
- Conconully
- Concrete
- Coulee City
- Elma
- Forks
- Goldendale*
- Ilwaco
- Kalama*
- Montesano
- Mossyrock
- Newport
- Othello*
- Pateros
- Raymond
- Republic
- Ritzville*
- Roslyn*
- Springdale
- St. John
- Toledo
- Uniontown

Small Residential (Cluster 5)

- Albion
- Cashmere
- Castle Rock
- Colton
- Cosmopolis
- Coulee Dam
- Davenport
- Electric City
- Entiat
- Krupp
- Lind
- Metaline Falls*
- North Bonneville
- Prescott
- Reardan
- Rock Island
- South Cle Elum
- White Salmon

Rural Communities (Cluster 6)

- Almira
- Asotin
- Bridgeport
- Clarkston
- College Place
- Creston
- Cusick
- Dayton
- Elmer City
- Endicott
- Farmington
- Garfield
- George
- Hamilton
- Harrington
- Hartline
- Hatton
- Hoquiam
- Ione
- Kettle Falls
- Kittitas
- LaCrosse
- Lamont
- Lyman
- Malden
- Mansfield
- Marcus
- Mattawa
- McCleary
- Metaline
- Nespelem
- Northport
- Oakesdale
- Oakville
- Odessa
- Palouse
- Pe Ell
- Pomeroy
- Riverside
- Rosalia
- Royal City
- Soap Lake
- South Bend
- Sprague
- Starbuck
- Tekoa
- Vader
- Waitsburg
- Warden
- Washtucna
- Waterville
- Wilbur
- Wilson Creek
- Winlock

* Cities that changed cluster membership from 2005 to 2009. More information can be found on AWC's website, www.awcnet.org.

Urban Outskirts (Cluster 7)

- Airway Heights
- Algona
- Battle Ground
- Benton City
- Buckley
- Bucoda
- Carbonado
- Carnation*
- Cheney
- Connell
- Coupeville
- Darrington
- Deer Park
- Eatonville
- Everson
- Fairfield
- Ferndale
- Gold Bar
- Grandview
- Granger
- Granite Falls
- Harrah
- Index
- Kahlotus
- Latah
- Lynden
- Mabton
- Medical Lake
- Mesa
- Millwood
- Milton
- Moxee
- Naches
- Nooksack
- Orting
- Pacific
- Prosser
- Rainier
- Rockford
- Roy
- Ruston
- Selah
- South Prairie
- Spangle
- Steilacoom
- Sultan
- Sumas*
- Sunnyside*
- Tenino
- Tieton
- Toppenish
- Wapato
- Washougal
- Waverly
- Wilkeson
- Yacolt
- Zillah

Residential (Cluster 8)

- Bainbridge Island
- Beaux Arts Village*
- Black Diamond
- Bonney Lake
- Brier
- Camas
- Covington
- Des Moines
- Duvall
- Edgewood
- Edmonds
- Fircrest
- Kenmore
- La Center
- Lake Forest Park
- Lake Stevens
- Maple Valley
- Marysville
- Mercer Island*
- Mill Creek
- Mountlake Terrace
- Mukilteo
- Newcastle
- Normandy Park
- Sammamish
- Shoreline
- University Place
- West Richland

High Income Residential (Cluster 9)

- Clyde Hill
- Hunts Point
- Medina
- Woodway
- Yarrow Point

Mixed Resource Cities (Cluster 10)

- Arlington
- Issaquah
- Redmond
- Snoqualmie
- Tumwater*
- Woodinville

Small Commercial Centers (Cluster 11)

- Blaine
- DuPont
- Gig Harbor
- Langley
- Liberty Lake
- Monroe*
- North Bend*
- Port Orchard
- Poulsbo
- Ridgefield*
- Skykomish
- Snohomish
- Stanwood
- Sumner
- Union Gap
- Yelm

Medium Retail Hubs (Cluster 12)

- Bellingham*
- Bremerton
- Burien
- Enumclaw
- Federal Way
- Kennewick
- Lacey
- Lakewood
- Oak Harbor
- Pasco
- Richland*
- Spokane Valley*
- Yakima*

Major Commercial Centers (Cluster 13)

- Auburn
- Bothell*
- Fife
- Kent
- Kirkland*
- Lynnwood
- Olympia
- Puyallup
- Renton
- SeaTac
- Tukwila

Largest Cities (Cluster 14)

- Bellevue
- Everett
- Seattle
- Spokane
- Tacoma
- Vancouver

Appendix B: City survey and focus group participation

	Survey I Part I	Survey I Part II	Fiscal Condition Update Survey	Focus Group
Aberdeen	X	X	X	
Airway Heights	X	X	X	
Albion				
Algona	X	X	X	X
Almira	X	X		
Anacortes	X	X		X
Arlington	X	X		
Asotin		X		
Auburn	X	X		
Bainbridge Island		X	X	
Battle Ground		X	X	
Beaux Arts Village		X		
Bellevue	X	X	X	
Bellingham	X	X		
Benton City		X		
Bingen	X	X	X	
Black Diamond	X	X	X	
Blaine	X	X	X	
Bonney Lake	X	X		
Bothell		X		
Bremerton		X	X	
Brewster				
Bridgeport	X	X	X	X
Brier	X	X	X	
Buckley	X	X	X	X
Bucoda	X	X		
Burien		X	X	
Burlington	X	X	X	X
Camas	X	X	X	
Carbonado	X	X		
Carnation		X	X	
Cashmere	X	X		
Castle Rock	X	X	X	
Cathlamet		X		
Centralia	X	X	X	X
Chehalis		X		
Chelan	X	X	X	X
Cheney	X	X	X	
Chewelah	X	X	X	X
Clarkston	X	X	X	
Cle Elum	X	X	X	
Clyde Hill	X	X	X	
Colfax	X	X	X	
College Place	X	X	X	
Colton	X	X	X	
Colville		X	X	
Conconully				
Concrete	X	X	X	
Connell		X	X	
Cosmopolis		X	X	
Coulee City	X	X	X	
Coulee Dam		X	X	
Coupeville		X	X	
Covington	X	X	X	
Creston	X	X	X	
Cusick	X			
Darrington				
Davenport	X	X	X	
Dayton	X	X	X	X
Deer Park	X	X	X	
Des Moines	X	X		
DuPont	X	X		
Duvall	X	X	X	X
East Wenatchee		X	X	
Eatonville	X	X		
Edgewood	X	X	X	
Edmonds		X		
Electric City	X			
Ellensburg			X	
Elma	X	X		
Elmer City		X	X	
Endicott		X	X	
Entiat		X	X	
Enumclaw	X			
Ephrata	X			
Everett	X	X	X	
Everson	X	X	X	
Fairfield	X	X		
Farmington	X	X	X	
Federal Way	X	X		X
Ferndale	X	X		X
Fife	X	X	X	
Fircrest	X	X	X	
Forks				
Friday Harbor	X	X	X	
Garfield	X	X		
George		X		
Gig Harbor	X	X		
Gold Bar	X			
Goldendale			X	
Grand Coulee	X		X	

	Survey I Part I	Survey I Part II	Fiscal Condition Update Survey	Focus Group
Grandview		X	X	
Granger	X	X	X	
Granite Falls				
Hamilton	X	X	X	
Harrah	X	X	X	X
Harrington		X		
Hartline	X	X		
Hatton	X	X		
Hoquiam	X	X		
Hunts Point	X	X	X	
Ilwaco		X	X	
Index	X	X		
Ione				
Issaquah	X	X	X	
Kahlotus		X	X	
Kalama		X	X	
Kelso				
Kenmore	X	X	X	
Kennewick	X	X	X	X
Kent	X	X	X	
Kettle Falls	X		X	
Kirkland	X	X	X	X
Kittitas	X	X		
Krupp				
La Center	X	X	X	X
La Conner	X	X	X	
Lacey	X	X	X	
LaCrosse		X	X	
Lake Forest Park	X	X	X	X
Lake Stevens	X	X	X	
Lakewood	X	X	X	
Lamont		X	X	
Langley				
Latah				
Leavenworth	X	X		
Liberty Lake				X
Lind				
Long Beach	X	X		
Longview	X		X	
Lyman		X		
Lynden	X	X		
Lynnwood	X	X		
Mabton	X	X	X	
Malden		X		
Mansfield	X	X	X	
Maple Valley		X	X	

	Survey I Part I	Survey I Part II	Fiscal Condition Update Survey	Focus Group
Marcus	X	X	X	
Marysville	X	X	X	
Mattawa				
McCleary	X	X		
Medical Lake	X	X		
Medina	X			
Mercer Island	X	X	X	X
Mesa		X	X	
Metaline	X	X	X	
Metaline Falls		X	X	
Mill Creek	X		X	
Millwood	X	X	X	
Milton				
Monroe		X		
Montesano	X		X	
Morton		X		
Moses Lake	X	X	X	
Mossyrock			X	
Mount Vernon		X		
Mountlake Terrace	X	X		X
Moxee		X	X	
Mukilteo	X	X		
Naches		X	X	
Napavine		X		
Nespelem	X	X	X	
Newcastle	X	X	X	X
Newport			X	
Nooksack	X	X		
Normandy Park	X	X	X	
North Bend	X	X	X	
North Bonneville		X		
Northport	X			
Oak Harbor	X	X		
Oakesdale	X	X	X	
Oakville	X	X	X	
Ocean Shores		X		
Odessa	X	X		
Okanogan		X		
Olympia		X	X	
Omak	X	X	X	X
Oroville	X	X	X	
Orting	X		X	
Othello	X	X	X	
Pacific		X		X
Palouse	X	X	X	X

	Survey I Part I	Survey I Part II	Fiscal Condition Update Survey	Focus Group
Pasco	X	X	X	
Pateros	X	X	X	
Pe Ell	X	X	X	
Pomeroy		X	X	
Port Angeles	X	X	X	
Port Orchard	X	X	X	
Port Townsend	X	X		
Poulsbo		X	X	X
Prescott	X	X	X	
Prosser	X	X	X	
Pullman	X	X	X	X
Puyallup	X		X	
Quincy	X	X	X	
Rainier	X	X		
Raymond	X	X	X	
Reardan			X	
Redmond	X	X	X	
Renton	X	X	X	
Republic	X	X	X	
Richland	X	X	X	
Ridgefield	X	X	X	X
Ritzville		X	X	
Riverside				
Rock Island	X	X		
Rockford	X	X	X	
Rosalia	X	X		
Roslyn		X		
Roy	X	X		
Royal City		X	X	
Ruston	X	X	X	
Sammamish	X	X	X	
SeaTac	X	X	X	
Seattle		X	X	
Sedro-Woolley		X	X	
Selah	X	X		
Sequim		X		
Shelton	X	X	X	
Shoreline	X	X		X
Skykomish	X	X	X	
Snohomish	X	X	X	
Snoqualmie	X	X		
Soap Lake	X	X		
South Bend	X	X	X	
South Cle Elum	X	X	X	
South Prairie		X	X	
Spangle		X		
Spokane	X			
Spokane Valley	X	X	X	
Sprague	X	X		
Springdale		X	X	

	Survey I Part I	Survey I Part II	Fiscal Condition Update Survey	Focus Group
St. John		X		
Stanwood	X	X	X	
Starbuck	X	X		
Steilacoom	X	X	X	
Stevenson	X		X	
Sultan	X			
Sumas	X	X	X	
Sumner	X	X		
Sunnyside	X	X	X	
Tacoma	X	X	X	
Tekoa	X	X		
Tenino	X	X	X	
Tieton	X	X		
Toledo	X	X		
Tonasket	X	X	X	
Toppenish	X	X		
Tukwila	X	X	X	
Tumwater	X	X	X	
Twisp	X	X	X	
Union Gap			X	
Uniontown	X	X	X	
University Place	X	X		
Vader	X	X	X	
Vancouver	X	X		X
Waitsburg		X		
Walla Walla	X	X		X
Wapato	X	X	X	
Warden	X			
Washougal				
Washtucna		X		
Waterville	X	X	X	
Waverly	X			
Wenatchee	X			X
West Richland	X	X	X	
Westport	X	X	X	
White Salmon	X	X		
Wilbur		X		
Wilkeson				
Wilson Creek				X
Winlock	X	X	X	
Winthrop	X	X		
Woodinville	X	X	X	
Woodland	X	X	X	
Woodway	X	X	X	
Yacolt		X	X	
Yakima	X	X	X	X
Yarrow Point		X		
Yelm	X	X	X	
Zillah	X	X		

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