

Analysis of the Financial Feasibility of the Proposed City of Fairwood



Analysis provided by:



by contract with:
King County Office of Management & Budget

Final Report
January 17, 2006



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ANALYSIS OF THE FINANCIAL FEASIBILITY OF THE PROPOSED CITY OF FAIRWOOD

EXECUTIVE SUMMARY

Purpose and Mandate of the Analysis

In February 2005, a group of citizens in the Fairwood area completed signature-gathering for a petition to place the incorporation of the City of Fairwood on the ballot. The group collected nearly 2,300 signatures and filed the Notice of Intent to Incorporate with the Washington State Boundary Review Board of King County, beginning the process to allow for Boundary Review Board review and for a 2006 public vote among Fairwood residents on the question of incorporation.

In early 2005, the King County Office of Management and Budget contracted with Berk & Associates Inc., a consulting firm, to analyze the financial feasibility of the proposed City of Fairwood.¹

This assessment of the financial feasibility of Fairwood incorporation is provided as a reference document for members of the public, both inside and outside of the proposed incorporation area, and for members of the King County Boundary Review Board (BRB). The purposes of this study are:

1. To inform the Boundary Review Board as it considers its recommendation regarding Fairwood incorporation;
2. To inform Fairwood residents as they make a decision whether to vote for or against incorporation; and
3. To inform the broader public.

This study answers two straightforward questions:

1. *Is it financially feasible to incorporate a new City of Fairwood?*
2. *What are the potential implications of incorporation on local taxes and levels of service?*

To answer these questions, the analysis team modeled annual revenues and costs of a hypothetical City of Fairwood. To give residents a meaningful point of comparison, the study seeks to answer the question in the context of the status quo: *How do the financial realities of incorporation compare with the status quo (remaining unincorporated)?*

¹ The County undertook a governance study for the area in 2000, and determined that this study should therefore focus primarily on the question of financial feasibility. Findings from the prior 2000 Petrovitsky Governance Study can be found at <http://www.metrokc.gov/budget/tranteam/petrovitsky/study/pgcs.htm>.

The study is designed to clarify what is possible; it is not meant to determine whether residents are better or worse off if they incorporate (compared with remaining part of unincorporated King County, *or* compared with an option of annexing to Renton or any other nearby city).

Summary of Feasibility Findings

The following summary contains three components:

1. Bottom line findings of the feasibility of the proposed city;
2. A big-picture assessment of how Fairwood would compare to other existing cities; and
3. A more detailed presentation of key assumptions and estimated costs and revenues.

The Bottom Line

Does the Proposed Incorporation of Fairwood Appear Financially Feasible?

Yes. If Fairwood residents are willing to pay the *same total combined level of taxes they would pay as part of unincorporated King County*, and are willing to preserve the taxing power to purchase public services over time, then a City of Fairwood would generate enough revenues to provide a slightly higher level of service than Fairwood residents currently receive.

Under a tax structure that would hold Fairwood residents' tax burdens equal to what they would pay as residents of King County, the City would generate \$8.3 million in "core" operating revenues in 2007, and would be able to provide slightly increased levels of service at a cost of \$7.7 million (assuming the City incorporated in 2006). In addition, the City would generate in excess of \$1.7 million in revenue in 2007 that could be directed towards capital improvements.

Effects of Initiative 747

Like most residential cities in Washington State, in order to remain financially sustainable over the long term, the City of Fairwood will need to take actions to maintain its property tax levy rate. Initiative 747, approved by voters in 2001, fundamentally altered the financial reality for all cities, counties and special-purpose districts in Washington state by limiting the growth of the most important revenue source for local government—property tax—to an annual growth rate of 1% plus the value of new construction, which is a rate lower than the effective growth rate of the County's Road Levy district. Thus, in a post-I-747 world, if a city does not act to maintain its property tax levy rate, then I-747 will erode that city's property tax revenues to the extent that most cities will no longer be able to maintain their service levels.

As a newly incorporating City, the City of Fairwood would have *a number of options for protecting itself from the eroding effects of I-747*. One option that would be available to Fairwood but has not been modeled in this analysis is for the City to establish an initially higher property tax levy to establish "banked" property tax capacity (discussed in detail in the footnote on page 20). The more transparent option, and the approach modeled in this analysis, is for the City of Fairwood to ask voters to approve periodic levy lid lifts to maintain the City's property tax levy. Berk & Associates used the assumption of voted levy lid lifts to model financial feasibility because it sends a clear message to voters that, if they vote for incorporation, they should do so with a commitment to maintaining the City's property tax levy rate.

Estimated Cost and Revenue and Key Assumptions

There are many ways that a City of Fairwood could structure the services Fairwood residents receive. For this analysis, the consultant team has assumed that, like many recently incorporated cities, the City of Fairwood would choose from its inception to annex to existing special service districts for provision of fire and emergency medical services, water and sewer services, and library services. The analysis assumes that remaining city services would be provided by the City of Fairwood, primarily through contracts with other service providers such as neighboring cities or King County. Specifically, this "Basic Contract Services City" option assumes that the City would contract with King County for police and jail services, municipal courts, and roads operation and maintenance. This is a reasonable assumption given that every city to incorporate in King County in the last 15 years has adopted a similar basic contract approach to services at start-up.

The Same-Cost Framework

The overarching goal of this assessment is to ascertain *whether, if the City received the same total dollars of tax revenue that Fairwood residents currently pay to the County, the City could provide residents with the equivalent or enhanced services compared to what they now receive?* We believe that answering this question allows residents to make an apples-to-apples comparison between incorporating and remaining unincorporated. This "same cost" approach is consistent with the analytical methods used in prior incorporation analyses in the Puget Sound region over the last decade, and is central to understanding the basis for the finding of feasibility. As noted in the bottom line feasibility discussion above, the answer to this question is "Yes, if taxpayers pay the same taxes they would pay as unincorporated area residents, then the City of Fairwood would have sufficient revenues to provide slightly higher levels of service compared to what Fairwood residents now receive."

There are many ways that a City of Fairwood could structure its *taxes and fees* to generate the revenues that allow the City to run. The revenue structure modeled in this analysis is designed to result in a combined total tax burden for residents that is *the same as what they would pay if they continued to be part of unincorporated King County*. Because taxing tools are different for cities and counties, the mix and type of taxes will vary, but the combined burden of all taxes is designed to be the same. In particular, the shaded rows in Exhibit ES 1 show that under the modeled structure, Fairwood residents would pay property taxes at the maximum rate permitted by cities (still lower than the County's Road Levy), while seeing a balancing *increase* in utility taxes (a taxing mechanism that is provided to cities in Washington State but not to counties).

**Exhibit ES 1
Same Cost Example:
Comparison of Taxes Paid by a Typical Fairwood Household**

	Stay Unincorporated	City of Fairwood (As Modeled)
Property Tax (City Levy/Road Levy)	\$549	\$480
<i>Assessed Value</i>	\$300,000	\$300,000
<i>Levy Rate</i>	\$1.83	\$1.60
Other Property Taxes	\$3,291	\$3,291
<i>Levy Rate</i>	\$10.97	\$10.97
Utility Taxes	\$0	\$69
Cable Franchise Fee	\$24	\$24
Surface Water Fee	\$102	\$102
TOTAL	\$3,966	\$3,966

Source: Berk & Associates analysis of current tax and fee levels (King County Assessor's office, Water and Land Resources Division)

Turning now to services, again the City would have a variety of options. As noted, this feasibility study assumes the City uses a contracting model – securing most services under contract from other jurisdictions, rather than staffing up to provide them directly. This is the approach taken initially by every city to incorporate in King County in the last 15 years. In this approach, the City of Fairwood would contract for all general government services except for general administration and city council, parks and recreation, and planning and building/permitting services.

We assume all other services would be secured from others under contract. This approach would generate a slightly enhanced service level as compared to current services in at least two respects: first, in the area of police services, contracts with the County Sheriff's department would typically provide for a dedicated "police chief," which we believe represents a slight increase in service over what residents currently receive from sharing sheriff deputies with a much larger territory. Second, because the County has eliminated recreational programming from its services, our assumption of a modest level of City expenditures on recreation activities, represents a second area of some service enhancement over the present situation.

Big-Picture Comparisons with Other Cities

As a primarily residential city, with relatively little commercial activity, the City of Fairwood would have a smaller tax base than the average city in the Puget Sound Region. Within King County, we estimate that the City of Fairwood would rank above six existing cities in terms of assessed value per resident, and it would rank lowest among King County cities in retail sales taxes.

Notwithstanding those cautions, however, Fairwood *would* have a tax base that is comparable to other, existing residential cities in the region. Exhibit ES 2 compares the core tax bases of Fairwood (property and sales taxes) with those of six cities in King and Pierce counties. All of these cities are comparable to the City of Fairwood as modeled in this analysis in that (1) they are primarily residential in character; and (2) they all receive fire and library services from fire and library districts (in other words, the modeled Fairwood and these cities all provide a similar complement of services). The reason a comparison of property and sales taxes is useful is that, among residential cities, these

are the two tax sources that (1) *all* cities rely on and (2) tend to vary, on a per-resident basis, from city to city.

What Exhibit ES 2 shows is that, if the City of Fairwood existed in 2005, the City would have generated an estimated \$174 in property and sales taxes per resident. This amount exceeds the revenues generated in three of the comparable cities (Des Moines, University Place, and Edgewood) but is less than the four other comparable cities (Covington, Maple Valley, Lake Forest Park, and Normandy Park).

**Exhibit ES 2
Comparison of Property and Sales Tax Revenues – Fairwood and Existing Residential Cities that Provide Similar Services**

	2005 Population	2005 Assessed Valuation	2005 Regular Levy Rate	Taxes Due - 2005 (Regular Levy)	Property Taxes Due per Resident (2005)	Sales Tax Revenues per Resident (2004)	Property and Sales Taxes Combined (per Resident)
Des Moines	28,960	\$2,183,646,900	\$1.2294	\$2,684,471	\$93	\$59	\$152
University Place	30,980	2,158,674,985	\$1.5685	3,385,830	109	53	162
Edgewood	9,460	792,099,105	\$1.4974	1,186,062	125	39	164
Fairwood	26,100	2,208,000,000	\$1.6000	3,532,800	135	38	174
Covington	16,610	1,328,451,595	\$1.2466	1,656,102	100	92	192
Maple Valley	17,870	1,576,144,300	\$1.3725	2,163,241	121	105	226
Lake Forest Park	12,730	1,682,153,299	\$1.5257	2,566,493	202	40	242
Normandy Park	6,385	\$973,248,609	\$1.3515	\$1,315,312	\$206	\$48	\$254

Source: Washington State Municipal Research & Services Center (based on analysis of Washington State Department of Revenue and Office of Financial Management data) and Berk & Associates analysis.

When reviewing Exhibit ES 2, it is worth bearing in mind that, although Fairwood would not have generated as much in revenues as Maple Valley, Lake Forest Park, or Normandy Park, or Covington, a City of Fairwood would have substantially greater population than any of these four cities. One can argue that Fairwood’s larger size would provide the City with economies of scale that smaller cities do not have. For example, larger cities like Fairwood, Des Moines, or University Place can spread the cost of a City Manager, a Police Chief, or a Comprehensive Plan over a larger population and a larger tax base. As a result, the per-resident cost of these expenses may be lower for these larger cities.

Summary of Estimated Costs and Revenues

As modeled for this assessment, the largest expenditures the City of Fairwood would face are for general government, public safety (criminal justice) and roads operation and maintenance. The largest revenues would come from property taxes, sales taxes, and state-shared revenues, which include distribution of state gas taxes (which must be used to fund road maintenance or capital improvements) and distribution of state liquor taxes and profits.

The model also assumes that the City of Fairwood would provide its own surface water management services, while collecting surface water fees at the same rate collected by King County. Because these surface water revenues are restricted to surface water uses, neither surface water revenues nor surface water costs are included in the summary of core operating revenues and expenses.

Based on the modeled cost and revenue structure, we find that the City of Fairwood would generate sufficient operating revenues to provide the modeled services, and after doing so, the City would have between \$500,000 and \$800,000 of revenues “left over” each year. Depending on decisions of the city council, these revenues could be used for capital investments, a modest reduction in tax rates, or increases levels of service (e.g. fielding more patrol officers, increasing recreation services, or increasing staff at City Hall).

**Exhibit ES 3
Summary of Core City Operating Costs and Revenues**

	2007	2008	2009	2010	2011	2012
Operation (non-constrained)						
Revenues						
Property taxes (Regular Levy)	\$3,970,000	\$4,049,000	\$4,129,000	\$4,592,000	\$4,684,000	\$4,776,000
Retail Sales tax	1,147,000	1,187,000	1,230,000	1,275,000	1,321,000	1,370,000
State Shared Revenues	1,022,000	1,033,000	1,043,000	1,054,000	1,064,000	1,075,000
Retail Sales Tax - Criminal Justice	576,000	606,000	636,000	669,000	702,000	738,000
Utility Tax	541,000	557,000	574,000	591,000	609,000	627,000
Permit Fees	487,000	506,000	526,000	547,000	569,000	592,000
Cable TV Franchise Fee	240,000	250,000	260,000	271,000	282,000	293,000
Community Development Block Grant	166,000	171,000	176,000	182,000	187,000	193,000
Interest Income	60,000	90,000	93,000	95,000	98,000	101,000
Gambling Taxes	41,000	42,000	43,000	45,000	46,000	48,000
Total Projected Core Revenues	\$8,251,000	\$8,492,000	\$8,712,000	\$9,320,000	\$9,563,000	\$9,813,000
Expenses						
General Government	\$2,574,000	\$2,677,000	\$2,784,000	\$2,896,000	\$3,011,000	\$3,132,000
Public Safety (Criminal Justice)	2,304,000	2,415,000	2,530,000	2,652,000	2,778,000	2,911,000
<i>Police Services</i>	<i>2,057,000</i>	<i>2,156,000</i>	<i>2,259,000</i>	<i>2,367,000</i>	<i>2,480,000</i>	<i>2,599,000</i>
<i>Jail/Court/Public Defense Services</i>	<i>243,000</i>	<i>253,000</i>	<i>263,000</i>	<i>274,000</i>	<i>285,000</i>	<i>296,000</i>
Roads Operation and Maintenance	1,088,000	1,140,000	1,195,000	1,252,000	1,312,000	1,374,000
Parks and Recreation	143,000	153,000	163,000	169,000	176,000	183,000
Planning/Permitting (Permitting and Land Use Desk)	541,000	562,000	585,000	608,000	633,000	658,000
City Attorney and Prosecution Services	412,000	424,000	437,000	450,000	464,000	478,000
Comprehensive Land Use Plan	150,000	150,000	75,000	75,000	75,000	75,000
Capital Facilities Plan	150,000	150,000	75,000	75,000	75,000	75,000
Human Services (Block Grant expenditures)	166,000	171,000	176,000	182,000	187,000	193,000
Miscellaneous	52,000	54,000	56,000	58,000	61,000	63,000
Operational Contingency	108,000	112,000	117,000	122,000	127,000	132,000
Total Projected Core Expenses	\$7,688,000	\$8,009,000	\$8,194,000	\$8,539,000	\$8,898,000	\$9,273,000
Excess Revenues	\$563,000	\$483,000	\$518,000	\$782,000	\$665,000	\$540,000

Source: Berk & Associates analysis

Notes: Property tax revenues for 2010, 2011, and 2012 assume voter approval of a levy lid lift in 2009, which will restore the City property tax levy to \$1.60 (compared with a rate of \$1.50 in 2009).

“Non-constrained” operating revenues and expenses include day-to-day operating costs and revenues for the City’s general and street fund, including revenue streams that are statutorily constrained in their use, but for which those legal constraints are not binding. For example, by statute, cities must use gas tax revenues to fund road operation, maintenance, or improvement. In practice, cities set up a separate road or street fund to which gas tax revenues accrue. Revenues from this road fund are then used to fund road maintenance. As it turns out, however, estimated “restricted” gas tax revenues that accrue to the city are less than the estimated cost of road maintenance, so the restriction is non-binding. In the above summary, all such functionally unconstrained revenues and costs are grouped together to give readers a bottom-line picture of operating revenue-sufficiency.

Capital Revenues and Needs

In recent years, King County has invested more than \$40 million in roads improvements in Fairwood (a level of investment the new City would be challenged to match). Looking beyond 2006, however, the County has no additional investments planned in the area through 2011. If Fairwood were to incorporate in the latter half of 2006, the City could expect to generate roughly \$10 million in capital revenues from real estate excise taxes (REET) through 2011, or \$1.7 million per year. By law, REET must be dedicated to capital projects. The City would also generate an additional \$2 to \$3 million in surface water management utility revenues that would exceed requirements for operation of that utility and thus could be dedicated for surface water management capital improvements. Combined, these REET and surface water management utility revenues substantially exceed what King County currently plans to spend on capital investments in Fairwood over the same period, and could address known capital needs using these funds if phased over time. A forecast of Fairwood's future capital needs is difficult and in any detail is beyond the scope of this study.

Context for the Analysis

When considering the findings of this study, we believe it is useful for readers to bear in mind a few key points:

- This study is not a blueprint for how to run the City of Fairwood and does not bind a future City Council to the assumptions included here. This study only addresses the issue of financial feasibility. It analyzes sufficiency of revenues using hypothetical service and revenue structures and concludes that the City would earn enough revenue to meet its core expenses. If the voters choose to incorporate, they will elect a City Council that will have to make many decisions that will influence the actual revenues and expenses of the City. Nothing presented in this document should in any way be interpreted as binding on a future Council. The elected officials in many newly incorporated cities choose to provide additional types and levels of public services to their citizens. The City Council of Fairwood may choose to raise taxes and service levels, keep them the same, or lower them.
- Projections of revenues and expenses are estimates; readers should not attach undue significance to individual numbers. Any particular number in this analysis, such as the amount of sales tax expected to be generated by the City of Fairwood, will almost certainly differ from the actual number in that year should the incorporation occur. However, while any specific number will be off, we believe the overall findings reflect the best knowledge available about the fiscal feasibility of the proposed City. The analysis builds an estimate of total revenues by making explicit estimates for each revenue and cost. Our goal is to reach an estimate of total revenues by making all of the assumptions explicit, allowing interested readers to push and prod at assumptions to judge for themselves the reasonableness of our findings.
- The basic procedure to incorporate is set out in Chapter 35.02 RCW - Incorporation Proceedings. The process includes a petition requirement, review by a boundary review board, and a vote by Fairwood residents.

If the voters approve incorporation, a primary election to nominate candidates for city council and an election to select the city council must be held. The new city must officially incorporate, at a date set by the initial city council, within 360 days of the incorporation election. This means that if

the Boundary Review Board hearing was in October 2005, and the incorporation vote was in February, 2006, then new council elections would be held in May or June of 2006 and the new City would need to be open for business, at the latest, by February, 2007. This analysis assumes for the purposes of financial feasibility that the official incorporation date for the City of Fairwood, if approved by voters, will be September 1, 2006.

How This Report Is Organized

The remainder of this report is organized into 11 sections.

The introductory section of the analysis focuses on the **governance context** in which incorporation is occurring; how the question of feasibility is answered; and explains the study's **same-cost, same-level-of-service framework** for the analysis, modeled after prior incorporation studies in the Puget Sound region.

Section 2 outlines the **major assumptions** of the analysis, including the legal framework for creation of a new city, incorporation steps, organization of city government, how financial feasibility is determined using a same cost/same level of service framework; and the options a new city has for providing municipal services. **Baseline information** is provided in Section 3, including the geographic location of the incorporation area, population and demographic information, tax base, and junior taxing districts that provide services to the area.

The study's **findings of financial feasibility** are the focus of Section 4, including key issues related to feasibility and an explanation of the need to maintain the proposed city's property tax rate.

Sections 5 and 6 provide a **detailed review of operating revenue and expenditure assumptions** that underpin findings of feasibility, and explanations of the analysis team's assumptions for how the new city might use the range of revenue options and authorized tax and fee structures to provide city services. Revenues that are not included in the analysis but are available to the city are also discussed in this section. Within the *Revenue* section, operating and capital revenues and expenditures are addressed separately, with a description of what is known about **capital needs and revenues** available to meet them outlined in Section 7.

Section 8 provides an overview of the monthly revenues and expenses the City could expect for **start-up financing**, and discusses early choices about staffing and debt that the city might face if incorporated.

Section 9 addresses information requested by the King County Boundary Review Board, including the impact of incorporation on the **governance prospects for the Cascade area**, and estimated impact that **exclusion of the Maplewood Addition** might have on the financial position of the City of Fairwood.

Section 10 provides an **assessment of market factors** that could influence what Fairwood may look like in the future.

The final section describes a future influence on city revenues: **Streamlined Sales Tax**. The Washington State Legislature is expected to consider actions to address changes in sales tax sourcing rules in the coming legislative session. The intent is to provide a resource for Fairwood voters in the event that rules are put in place by the Legislature in advance of an incorporation vote.

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OF THE PROPOSED CITY OF FAIRWOOD**

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ANALYSIS OF THE FINANCIAL FEASIBILITY OF THE PROPOSED CITY OF FAIRWOOD

1. GOVERNANCE CONTEXT

In urban unincorporated King County, there are currently ten large areas (including Fairwood, North Highline, Juanita, and West Hill) that have yet to be annexed to a city or incorporate into a new city. There are now about 218,000 residents in these urban areas for whom King County currently provides local services.

The Growth Management Act, King County Countywide Planning Policies, and the King County Comprehensive Plan encourage all unincorporated areas within King County's Urban Growth Boundary to pursue incorporated status through either annexation or incorporation. State law (RCW 36.70A.110) provides the underlying rationale for these policies: "In general, cities are the local government most appropriate to provide urban governmental services."

In response to the direction of the Growth Management Act (GMA), in the early 1990s, King County and the suburban cities worked together to develop a framework of policies intended to guide jurisdictions as they planned for the future. These policies, referred to as the Countywide Planning Policies, are King County and the suburban cities' interjurisdictional plan for implementing the goals of the Growth Management Act. As directed by the GMA, these Countywide Planning Policies explicitly address the status of unincorporated urban areas. Among other things, the policies call for:

- Elimination of unincorporated urban islands between cities.
- The adoption by each city of a Potential Annexation Area, in consultation with residential groups in the affected area.
- The annexation or incorporation of all unincorporated areas within the urban growth boundary within a 20-year timeframe (1993 – 2013).

In the context of the Growth Management Act and the Countywide Planning Policies, a group of residents in Fairwood have sought to establish a new City of Fairwood. In February 2005, the Fairwood Task Force completed signature-gathering for a petition to put the incorporation of the City of Fairwood on the ballot. The group collected nearly 2,300 signatures and filed the Notice of Intent to Incorporate (NOI) with the Washington State Boundary Review Board (BRB), beginning the process to allow for BRB review and a possible public vote in 2006.

Overview: Fiscal and Governance Issues

Fairwood residents have three governance options available to them: (1) remain unincorporated, (2) incorporation, or (3) annexation to Renton (an option that requires action by the City of Renton). When residents consider incorporation, their considerations will take place in the context of those options.

This study answers two straightforward questions:

1. *Is it financially feasible to incorporate as a new City of Fairwood?*

2. What are the potential implications of incorporation on local taxes and levels of service?

To give residents a meaningful point of comparison, we seek to answer the question in the context of the status quo: *How do the financial realities of incorporation compare with the status quo—remaining unincorporated?*

It is worth noting that there are implications to remaining unincorporated. Unless King County gets new authority to increase taxes in unincorporated areas, departments that are providing services funded by King County's general fund will face significant fiscal pressure to reduce expenditures in urban unincorporated areas like Fairwood. (This includes Sheriff, Parks, Human Services, Land Use & Planning, and Economic Development.) The principal factor causing this fiscal pressure is the effect of the 1% limit on property tax revenue growth enacted by voters when they passed Initiative 747 in 2001. The new 1% limit restricts property tax revenue growth for the County's general fund to 1% plus the value of new construction. The previous limit was 6% and was established in state legislative action.

It is difficult to say which services may be cut or reduced in unincorporated areas as available County revenues fail to keep up with growth in the cost of public services. Decisions about service cuts must be made each year through the County's budget adoption process. However, until the County is able to fully address its structural deficit, it is clear that the County will be forced to make cuts across all service areas, including services to local urban unincorporated areas like Fairwood.

There are many other important questions about incorporation which this study cannot answer. Voters will want to know, "Will my taxes go up or down?", "Will the City provide better, more responsive services than King County?", and "Will the City slow development in our area?". The answer to these questions depends on who is elected to the new City Council and whom they hire to run the City.

This study is not a blueprint for how the City will be run. If Fairwood votes for incorporation, decisions about taxes, service levels, and capital investments will be made by seven citizens elected from the roughly 26,100 people who live in the proposed City, instead of by the County Council and County staff. This study cannot predict what a new City Council would do. We *can* describe how much revenue a new City could generate if it maintains current taxing rates and the levels of service it could provide if it does. Voters will need to weigh this information about financial feasibility with their own perceptions about what forms and structures of government can best provide them public services and represent their positions in matters of public policy.

On a broader scale, this feasibility study does not seek to answer the big question: **Is incorporation a good idea?** The answer to that question will be the subject of much debate over the coming months, and the ultimate answer for each participant in that debate is likely to depend on his or her individual perspective.

The goal of this report is relatively narrow: to assess the financial feasibility of the proposed City. The answer to the question of feasibility will *inform* the debate about whether incorporation is a good idea, but clearly, it will not settle that debate.

Feasibility Study Process and Analytical Framework

In February of 2005, Berk & Associates worked with King County Office of Management and Budget staff to define a process for pursuing an Incorporation Feasibility Study that would achieve the goals

stated above. Our goal was to build on what we believed were successful frameworks we had developed in completing previous incorporation feasibility studies in King County and more recent studies elsewhere in the states of Washington and Oregon.

Members of the Berk & Associates analysis team and the King County project manager also met with representatives of the Fairwood community and with the Boundary Review Board early in the project (Spring 2005) to brief each group on the proposed framework of the project, to ensure that each group had an opportunity to identify additional or alternative areas of analysis that should be pursued. Based on their feedback, the project team committed to developing a financial feasibility study that the team believed represented improvements to incorporation feasibility studies that had been performed in the preceding decade.

In our experience, the most informative feasibility studies provide a full picture of a proposed city's fiscal conditions: (1) assessing the short- and medium-term fiscal conditions that the proposed city would face and (2) assessing potential future fiscal developments that voters might want to bear in mind as they weigh the alternative paths that are available to their community. Given this experience, the framework the team selected for pursuing the financial feasibility study of the proposed City of Fairwood relies on three fundamental pillars:

Pillar 1. The study should be rigorous and robust. The analysis should combine the most reliable sources of data with state-of-the-art analytic techniques to provide reliable analyses to serve as the basis for decision-making for Fairwood residents, for the Boundary Review Board, and for other stakeholders in the process.

Pillar 2. The process should actively engage representatives of the Fairwood community and the Boundary Review Board. Throughout the development of the feasibility assessment, Berk & Associates staff and members of the King County project team met with the Fairwood Citizen Advisory Group to discuss various aspects of the study. We met with the CAG to discuss preliminary findings of the analysis, cost and revenue issues the proposed city would face, and alternative tax structures that might be available to the proposed city.

The Fairwood Citizens Advisory Group and other meeting attendees included finance experts, including acting and retired municipal finance directors, financial analysts from cities and other public service providers, and CPAs and finance experts from the private sector. A benefit of having community members with financial expertise at each of the meetings was that it allowed in-depth discussion of very complex fiscal issues. No figure included in the analysis escaped scrutiny and no assumption went unchallenged. From our perspective, this process was beneficial because it ensured a rigorous and robust analysis, and it allowed the analysis team and residents to arrive at a shared understanding of the fiscal conditions that a City of Fairwood would face.

Pillar 3. The feasibility analysis should draw clear distinctions in a way that is most useful to residents. Fairwood residents face an immediate choice between two governance options: (1) incorporate as a new city or (2) vote to remain unincorporated. Given this clear-cut decision, the most useful feasibility analysis draws a *clear-cut distinction* between the two alternatives. From a fiscal perspective, the one question that residents have is:

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Should we expect a City of Fairwood to have a stronger financial basis for delivering local services than King County?

In our experience, the best way to answer this question clearly is to hold taxes constant and ask:

If Fairwood residents continue to pay the same taxes they would pay as an unincorporated area, would a City of Fairwood have sufficient revenue to provide at least the same levels of service as would be provided by the County over the same period?

It is important to note that, under this framework, both taxes and levels of governmental services are *fixed*, benchmarked to what would happen under King County. To provide a clear answer, the analysts must model a revenue structure that generates the same tax burden as what residents would face if they remained unincorporated (as long as such a tax structure is available). Likewise, analysts should go to great lengths to estimate costs of city services that reflect levels of service the area would receive if it remains unincorporated.

Again, the bottom line for a financial feasibility study is that, in order for it to be useful in helping residents make an informed decision, it has to directly answer the above questions. For Fairwood, as it turns out, the answer to both of the questions posed above is: Yes. *If Fairwood residents continue to pay the same taxes they would pay as an unincorporated area, the City of Fairwood **would** have sufficient revenue to provide at least the same levels of service as would be provided by the County over the same period.*

2. KEY ASSUMPTIONS

The findings of this feasibility analysis depend upon a wide range of assumptions. We have identified most of these assumptions in our descriptions of specific statistical data, revenues, and expenses. There are, however, a few overriding assumptions that apply to all areas of this study, and are therefore key to understanding the implications of our findings. These assumptions are:

Legal Framework

The incorporation feasibility analysis is conducted within the statutory framework of city creation and operation (RCW 35.02), and state laws distinguishing between county and city powers and services (guided more generally by RCW Chapters 35 and 36). This analysis takes that structure and process as given. While state law sets out the framework and processes, another very useful and detailed description of how a city is created is provided by the Municipal Research and Services Center (MRSC) in a publication called *The New City Guide*.² Rather than repeat the presentation of that document here, we recommend that interested readers read *The New City Guide* for a useful overview of the process of city creation. The focus of this analysis is to identify the fiscal conditions a City of Fairwood would face if it were to attempt to operate within the existing statutory framework.

Date of Incorporation

This analysis assumes that the official incorporation date for the City of Fairwood, if approved by voters, will be September 1, 2006. The baseline assessment of feasibility looks at the first six years of full operation (2007 through 2012). The start-up cash flow analysis looks at revenues and costs on a month-by-month basis for 2006 and 2007.

The actual date of incorporation will depend on when the vote is held and the logistical considerations that result from that date. As things currently stand, September of 2006 appears to be the earliest possible date of incorporation. If the date of incorporation were to be pushed back into 2007, then we expect that the fiscal picture for the proposed City may improve slightly (mostly stemming from an additional year of appreciation in property values prior to setting the City's initial property tax levy).

The basic procedure to incorporate is set out in Chapter 35.02 RCW - Incorporation Proceedings. The process includes a petition requirement, review by a boundary review board, and an election. If the voters approve incorporation, a primary election to nominate candidates for city council and an election to select the city council must be held. The new city must officially incorporate, at a date set by the initial city council, within 360 days of the incorporation election.

The summary table below shows that if the Boundary Review Board hearing was on October 1 and the community group supporting incorporation wanted to hold an election in February, new City elections might be in June, 2006 and the new City of Fairwood would need to be open for business, at the latest, by February, 2007.

² MRSC New City Guide: <http://www.mrsc.org/Publications/textnccg.aspx>

**Exhibit 1
Incorporation Steps**

Timeline	Incorporation Step (also see RCW 35.02)
6 months or more	Organization and Study. A group of citizens organizes and surveys the community to determine interest in incorporation. The citizens' group commissions a Governance Options Study (for the Fairwood area, a governance options study was conducted for the Petrovitsky Corridor in 1999).
Open	Preliminary Boundaries and Notice. If community interest in incorporation exists, the Committee sets the preliminary boundaries for the incorporation area. The Committee submits a preliminary Notice of Proposed Incorporation to the County Clerk who transmits it to the Boundary Review Board.
Open	Public Information Meeting. The Boundary Review Board sets up a Public Information Meeting where the Committee reports on the proposed incorporation, including service providers and representatives of surrounding cities, or citizens, in support of or opposition to boundaries; new boundaries may be suggested.
Immediately	Refine Boundaries, Initiate Petitions. Following the public meeting, if the Committee wishes to go forward with the incorporation efforts, the boundaries are selected. The King County Council Clerk will assign an Identification Number to incorporation proposal petitions. The King County Office of Records and Elections assists in setting requirements for the incorporation petition, and the Committee must administer petitions as set by State law.
Next 180 days	Petition Circulation. The Committee may then circulate the petitions. The petitions call for a future election to allow community members to decide if incorporation should occur. The petitions to conduct an election must be signed by ten percent of the registered voters living within the area to be incorporated.
Immediately upon completing petitions	Notice of Intention to Incorporate. Within 180 days from the date of the Public Information Meeting the Committee must collect the necessary signatures and submit the petitions to the Boundary Review Board with a Notice of Intention to Incorporate (NOI). The NOI should ideally include descriptive information, copies of petitions, maps, demographic and land use information, service analyses, consistency with current laws, and government planning information.
30 days for validation +5 for notification	Verification. The Boundary Review Board submits petitions to the King County Office of Records and Elections and the King County Assessor for verification of their validity.

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Timeline	Incorporation Step (also see RCW 35.02)
maximum 120 day review period	Boundary Review Board Assessment. The Boundary Review Board circulates the NOI (and staff analysis of that document) to King County offices and other affected governments and agencies for an initial review and comment period. Maximum 120-day time for BRB actions in response to the NOI, however, is usually requested to be waived as it is not sufficient for incorporations, which generally require several months for required studies, analysis and public review processes.
4-6 months + 30-45 days for public review and comment	Study. An Economic and Fiscal Analysis Study is commissioned to determine the financial viability of the proposed new city. The study provides conclusions as to the potential viability of an incorporation under the various scenarios. This analysis represents such a study for the proposed City of Fairwood.
30 days minimum (notification must be 30 days in advance of the hearing)	Boundary Review Board Public Hearing. Under RCW 35 and RCW 36, a public hearing is generally required for an incorporation. In King County, all incorporations go to a public hearing conducted by the Boundary Review Board. At the public hearing, the Board takes testimony from all interested parties - the Incorporation Committee, the consultant, citizens who will be affected by the incorporation, King County staff members, and service providers.
within 40 days following the public hearing	BRB Recommendation. The Board considers whether the incorporation is consistent with Boundary Review Board criteria (RCW 36.93.180); countywide planning and Growth Management Act. At the conclusion of the hearing, the Board makes a recommendation on the incorporation. The Board may recommend in favor of the incorporation, against the incorporation or may recommend changing the incorporation boundaries.
no less than 60 days following the Boundary Review Board action	Incorporation Election. Following the Board recommendation, the Committee decides whether to continue with the incorporation process. If so, then an election must be held. The election may be held even if the Board recommended against the incorporation. If the Committee decides to go forward with the election, the Committee works with King County Records and Elections, to prepare the ballot language and to place the issue on a ballot for election by registered voters in the incorporation area.
60 days following incorporation election	New City Government Elections. If incorporation is approved, then elections are held to nominate city officials and select city officials. State (RCW 35/35A) sets the time frame for the elections. Primary elections must be held no less than 60 days following the election for incorporation. Final elections must be held at least 60 days following primary election.
Within 360 days of voter approval of the initial incorporation	City Open for Business. The City begins operations - setting up departments, selecting staff members, adopting interim operating regulations, defining immediate, short term and long term policies, objectives and actions, developing and implementing preliminary budgets, etc.

Source: Berk & Associates summary of RCW 35.02, and King County Boundary Review Board website, September 2005 (<http://www.metrokc.gov/annexations/process/becomeacity.aspx>)

Organization of City Government

Municipal governments in Washington are classified according to population at the time of incorporation. The proposed City of Fairwood could choose several forms of organization upon incorporation, including incorporation (1) as a first-class city and adopt a charter; (2) as a second-class city (without a charter); (3) most common among cities, as a code city. Washington State has 281 cities; 181 are code cities (over 75% have a mayor-council form of government); 73 are towns with a mayor-council form of government; 16 are second class cities (the vast majority of which have a mayor-council form of government); and 10 first-class cities exist, split evenly between council-manager and mayor-council forms of government.

There exists a debate about forms of government and the tradeoffs each form offers between centralized decisionmaking and strong professional experience, which this report does not seek to resolve. Although the mayor-council form remains the most common form of government found in Washington cities and towns, for purposes of assessing feasibility, we assume that the proposed City of Fairwood would start, as most recently incorporated cities have, with a City Council and appointed City Manager. We assume this form of government primarily because all recently formed cities in King County have used this form (including Burien, Kenmore, Maple Valley, Sammamish, Covington, and Newcastle).

In this form, power is concentrated in the elected council, which hires a professional administrator to implement its policies. This appointee serves at the pleasure of the council and has responsibility for preparing the budget, directing day-to-day operations, hiring and firing personnel, and serving as the council's chief policy advisor. Washington has exhibited a trend toward professional management since the 1940s which continues to be popular today because of increasing number and complexity of services, and growing external demands in the form of federal and state mandates and reporting requirements.

“Same Cost” Framework

The overarching goal of this assessment is to provide residents with an estimate of what it would cost the City of Fairwood to provide the same level of services that residents would receive if they voted to remain unincorporated. The two areas where the model deviates from this “same cost” framework are in the areas of (1) police services (where we believe inclusion of a dedicated City of Fairwood Police Chief represents a slight increase in service over what residents would see if they remained unincorporated); and (2) recreation (where we assume a low level of City expenditures on recreation activities, a service that King County does not now provide).

As with services, there are also many ways that a City of Fairwood could structure its *taxes and fees* to generate the revenues that allow the City to run. The revenue structure modeled in this analysis is designed to result in a tax burden for residents that is the same as what they would pay if they continued to be part of unincorporated King County. Because taxing tools are different for cities and counties, the mix and types of taxes will vary, but the combined burden of all taxes is designed to be the same. In particular, the shaded rows in Exhibit ES 2 show that under the modeled structure, Fairwood residents would see a slight *decrease* in property taxes, while seeing a balancing *increase* in utility taxes (a taxing mechanism that is provided to cities in Washington State but not to counties). This is a reasonable assumption because 1) with incorporation, the property tax levies of other jurisdictions would not change and the new city would have the most flexibility to change tax levels

within their control; and 2) the assumption is consistent with the mix of taxes assumed in prior incorporation studies (such as Sammamish and Maple Valley, which assumed the use of utility tax).

**Exhibit 2
Comparison of Taxes Paid by a Typical Fairwood Household**

	Stay Unincorporated	City of Fairwood (As Modeled)
Property Tax (City Levy/Road Levy)	\$549	\$480
<i>Assessed Value</i>	\$300,000	\$300,000
<i>Levy Rate</i>	\$1.83	\$1.60
Other Property Taxes	\$3,291	\$3,291
<i>Levy Rate</i>	\$10.97	\$10.97
Utility Taxes	\$0	\$69
Cable Franchise Fee	\$24	\$24
Surface Water Fee	\$102	\$102
TOTAL	\$3,966	\$3,966

Source: Berk & Associates analysis of current tax and fee levels (King County Assessor’s office, Water and Land Resources Division)

The term we use to refer to the structure discussed above is the **“same cost” framework**. The goal is for the tax burden and level of service of the modeled City to reflect what residents would see if they remained part of unincorporated King County. We believe this framework allows residents to make an apples-to-apples comparison between incorporating and remaining unincorporated. This approach is consistent with the analytical methods used in prior incorporation analyses in the Puget Sound region over the last decade, and is central to understanding the basis for the finding of feasibility.

Property Taxes: I-747 and Levy Lid Lifts

In recent years, a series of statewide initiatives have eroded most cities’ and counties’ financial support from taxes and fees. From a city’s perspective, the most damaging blows resulted from statewide passage of three initiatives: I-695 [ending collection of the State’s motor vehicle excise tax (MVET)]; I-747 (limiting the growth of property tax levies on a city’s existing property to less than the rate of inflation); and I-776 (ending the collection of vehicle license fees). Combined, these initiatives have resulted in the immediate reduction of millions of dollars of city revenues, and have set up the long-run erosion of cities’, counties’, and special districts’ property tax bases.

If left unchecked, I-747 limits cause property tax revenues for most cities to fall over time (in inflation-adjusted terms), particularly on a per-resident basis. I-747 limits the growth of property tax revenues to 1% per year (limitations exclude new construction). This revenue growth typically fails to keep up with inflation. Due to compounding effects over time, erosion of property tax revenues becomes more pronounced over a number of years.

Property taxes remain the most important source of revenue for many cities, and are critically important for areas such as Fairwood with little commercial tax base to generate sales tax revenue. As a result of I-747, cities are beginning to regularly consider actions to maintain their property tax levy, which entails voter-approved levy lid lifts that were not common in the pre-I-747 era.

Like most residential cities in Washington State, in order to remain financially sustainable over the long term, the City of Fairwood will need to take actions to maintain its property tax levy rate. Fortunately, as a newly incorporating City, the City of Fairwood would have a number of options for protecting itself from the eroding effects of I-747. The most transparent of these options is to ask voters to approve periodic levy lid lifts to maintain the City's property tax levy.³ Berk & Associates used this assumption to model financial feasibility because (1) it is transparent, and (2) it sends a clear message to voters that, if they vote for incorporation, they should do so with a commitment to maintaining the City's property tax levy rate.

An assumption that Fairwood city residents would vote to maintain a City levy rate of \$1.60 is consistent with the "same cost" framework used throughout this study. The rate for the King County Road Levy, which Fairwood's City Levy would replace, has actually *risen* in recent years (from \$1.73 per thousand in 2001 to \$1.83 per thousand in 2005). These increases occur, in part, because the King County Road Levy is generally not constrained by I-747 limits, and King County accrued banked capacity during the 1990s when many annexations and incorporations occurred.

If one assumes that King County continues to be successful with annexations and incorporations, then the County Road Levy rate would be stable at this rate or continue to increase as it has recently. Keeping the "same cost" framework in place, if Fairwood voters approve levy lid lifts that hold Fairwood's City Levy rate steady at \$1.60, Fairwood property owners would still see a *decrease* in future-year property taxes (compared to what they would have paid if they had remained part of unincorporated King County).⁴

Overview of Municipal Services

In 1990, the Washington State Legislature's passage of the Growth Management Act (GMA, RCW 36.70.210) clarified that counties are the regional governments within their boundaries and cities are the primary providers of urban governmental services within urban growth areas. RCW 36.70.030 defines "urban services" to "include those public services and public facilities at an intensity [sic] historically and typically provided in cities, specifically including storm and sanitary sewer systems, domestic water systems, street cleaning services, fire and police protection services, public transit services, and other public utilities associated with urban areas and normally not associated with rural areas."

³ Another option for preserving Fairwood's property tax base would be for the City to take actions that would allow it to establish a higher initial property tax levy, and then in subsequent years, scale back the levy to the modeled level. This would create so-called "banked levy capacity" for the City and, in effect, inoculate the City from the eroding effects of I-747 for years. For example, if the City of Fairwood were to take on provision of Fire and/or Library services in its first full year of existence, the City could set its initial levy rate at as much as \$3.60 per \$1,000 of assessed value (as opposed to the \$1.60 levy modeled in this analysis). The City could then contract for fire and library services with the existing districts (ensuring that the districts were financially unaffected). In subsequent years, the City might choose to annex to a library and fire district, bringing the City's levy rate back to \$1.60 per \$1,000, but the city would retain so-called "banked levy capacity" that would negate the eroding effects of I-747 for many years. For a complete discussion of "banked levy capacity" readers should see the Municipal Research & Services Center publication *A Revenue Guide for Washington Cities and Towns* (www.mrsc.org).

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The GMA requires cooperative planning between counties and cities subject to the GMA, and coordination is encouraged in RCW 36.115 to encourage “voluntary transfers of functional responsibility among units of local government to allocate the financing and provision government services and facilities using the most efficient geographic units regardless of jurisdictional boundaries.”

A city has powers of home rule authority that are only available when it officially becomes a city. During the interim period and until the official date of incorporation, a city’s powers and governing body (council) are limited to initial functions set out in chapter 35.02 RCW.

Upon incorporation, a new city becomes the primary urban service provider to residents within its boundaries. It is common for new cities to choose not to provide, at the time of incorporation, the full slate of services that cities are *allowed* to provide. Typically, cities incorporate and take over local services that had previously been provided by the county (often contracting with the county for their provision), while leaving special districts in place, including library districts, water and sewer districts, and fire and emergency medical service districts. Although such an approach is typical, each interim council must decide what services the city will initially provide, what level of services will be provided, what services will be provided by contract, and with whom the city will contract for those services.

MRSC’s *New City Guide* suggests that “In addition to the administrative and legislative ‘services’ provided by the mayor or manager and the executive branch and by the city council respectively, a city government commonly provides services in the general areas of public safety, public works, land use planning, and parks and recreation. Some of these services, such as police, fire, and land use planning, may have been the focus of much debate during the incorporation process, and issues relating to them will likely continue to generate controversy during the interim period and beyond. The very fact of incorporation as well as decisions by the new council concerning certain services may have significant impacts upon special purpose districts such as fire protection and water-sewer districts.” The *New City Guide* further outlines an overview of service provision decisions in table format that is recreated below for reference, to explain the categories of service that a city may provide without considering timing or priority, and choices for future service delivery.

To this original table we have created Exhibit 3, and included a column explaining the modeled assumptions about service provision by the proposed City of Fairwood for the purposes of this incorporation analysis. Generally, our rationale for these assumptions were to identify the least-cost, most administratively straightforward option for City operations, that would add the fewest number of permanent City staff at startup. This assumption allows the City the maximum amount of flexibility, administratively and financially. We believe, also, that this is the approach that allows the analysis team the best opportunity to remain true to our “same cost” framework.

Exhibit 3 Overview of City Services; Options for Service Provision; and Study Assumptions

Service	Pre-Incorporation Provider	Post-Incorporation Provider	Incorporation Study Assumptions
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Service	Pre-Incorporation Provider	Post-Incorporation Provider	Incorporation Study Assumptions
City Administration (Executive and Legislative)	County	City Council and either City Manager or Administrator, or elected Mayor	Council-Manager
Legal (City Attorney)	County	City, by either: establishing city attorney position, or contracting with private firm.	Contract with private firm
Land Use Planning and Zoning	County	City, although may contract with county for transitional period	City, costs 90% recovered through fees
Police	County	City or contract with county or with another city; contract may be for short-term during a transition period or be long-term/permanent	Contract with King County
Fire Protection	Fire protection district	Options: City provides, or city contracts with fire district or another city, for transition, or city annexes into fire district	Annex to Fire District
Roads (Public Works)	County	City or contract with county until city attains ability to provide such services at level provided by county or for longer period upon agreement (RCW 35.02.225)	Contract with King County
Surface water management (Public Works)	County, special purpose district, or PUD	City either through use of own public works departments or through creation of own surface water drainage utility (can adopt county policies and regulations on interim or permanent basis) or contract with county, or with other city, or private contractor	Contract with King County
Solid waste collection & recycling	Private hauler and recycler	City or contract with private hauler (existing hauler stays in place for 7 years post-incorporation even if City provides)	City continue franchise agreement with existing hauler
Building code review, inspection, enforcement	County	City or contract with county or another city or private contractor	City

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Service	Pre-Incorporation Provider	Post-Incorporation Provider	Incorporation Study Assumptions
Municipal Court	District Court	City creates own municipal court or through municipal department established in district court, or contract with district court, contract with another city for municipal court services, or provide no judicial services (choose to have no criminal code or traffic code)	Contract with King County
Public Defender	County or contract	City may provide own public defender department, contract with a private firm or organization, or contract with county	Contract with King County
Jail	County	City may provide own jail or contract with county or another city for jail services, or combination of both	Contract with King County
Water	Water-sewer district, another city, county, PUD, public corporation, private water association, community water system, other private water purveyors, or individual property owners	<ul style="list-style-type: none"> • If territory of new city encompasses all or part of water-sewer district, city may assume jurisdiction of that part within its boundaries and provide own water service, or water district continues providing service, or • If new city does not overlap water-sewer district, city may provide own water service or provide no water service, or it may contract with another city or with a water-sewer district • If all or part of territory of new city is served by another city, the latter could continue to provide water service, and new city could provide its own water service in that area not served by other city, or new city could purchase facilities of other city and provide its own service 	Cedar River Water & Sewer District and Soos Creek Water & Sewer District

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Service	Pre-Incorporation Provider	Post-Incorporation Provider	Incorporation Study Assumptions
Sewer	Water-sewer district, another city, county, PUD, metropolitan municipal corporation (e.g., METRO), or individual septic systems	<ul style="list-style-type: none"> • If territory of new city encompasses all or part of water-sewer district, city may assume jurisdiction of that part within its boundaries and provide own sewer service, or water-sewer district continues providing service, or • Provide its own sewer service, or contract with another city or a water-sewer district, or become part of metropolitan municipal corporation, or provide no sewer service or • If all or part of territory of new city is served by another city, the latter could continue to provide sewer service, and new city could provide its own service in that area not served by other city, or new city could purchase facilities of other city and provide its own service 	Cedar River Water & Sewer District and Soos Creek Water & Sewer District
Animal Control	County/humane society	City or contract with county/humane society	Contract
Public Health Services	County board of health or multi-county health district	County board of health, multi-county health district	No change - County board of health
Human Services	County or private non-profit	Provide own human services, contract with county or private group, or provide no such services (private groups, if any, would provide)	City (assume that City would apply for CDBG grants and would expend an equivalent amount on human service expenditures)
Library	County library, regional library, rural county library district, intercounty rural library district, or island library district	Provide own library services, contract with public library or library district, annex into library district, or not provide library services	Annex into library district

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Service	Pre-Incorporation Provider	Post-Incorporation Provider	Incorporation Study Assumptions
Parks & Recreation	County (although King County no longer provides local parks services)	City public works department or separate department; or contract with another city for park maintenance; or provide no park & recreation services	City parks maintenance and recreation
Transit Services	County	Regional service (no change)	No change – King County Metro and Sound Transit
Public Education	School District	No change	No change – Renton and Kent School District

Source: RCW citations from apps.leg.wa.gov; Municipal Research & Services Center

3. FAIRWOOD AREA CHARACTERISTICS: BASELINE INFORMATION

Location of Incorporation Area

The Fairwood incorporation area is an urban unincorporated area located southeast of the City of Renton in King County, approximately bounded on the north by SR 169 and the City of Renton, on the west by 128th Avenue SE, on the south by SE 208th Street, and on the east by the Urban Growth Boundary.

**Exhibit 4
Fairwood Incorporation Area**



Source: Berk & Associates analysis of data provided by King County and other regional sources.

The majority of Fairwood’s development took place in the late 1960s through the 1980s. Development in the area slowed in the early and mid-1990s, but has picked up recently. The study area is roughly 7 square miles in size and is roughly 3.5 miles from north to south, at its longest point, and 3.5 miles from east to west, at its widest.

Description of Remaining Annexation Area

The proposed incorporation area comprises only a part of the City of Renton's existing Fairwood potential annexation area (PAA). The remainder of Renton's Fairwood PAA lies to the west of the incorporation area. This "remainder" area, the portion of Renton's Fairwood's PAA not included in the incorporation area, has an estimated 2005 population of 16,100 persons, and is bounded on the north and west by the City of Renton, on the south by the City of Kent and the Kent's potential annexation area, and on the east by 128th Avenue SE (the western boundary of the Fairwood incorporation area). The "remainder" area includes the residential areas of Spring Glen, Auria Woods, Chinoaupin, Village Gate, Springfield, Benson Hill, Gainsborough Commons, and Youngs Lake Commons. These areas are not included in the proposed incorporation area.

For a discussion of the implications that a Fairwood incorporation would have on the prospects for annexation of the Cascade area to Renton, please see Section 9 of this report, *Related Factors*.

Population

Base Population and Growth Rate

Population growth is an important driver of city costs and revenues. In any city, many of the major revenue sources as well as a large number of expenses depend either directly or indirectly on the city's population. While the proposed City of Fairwood is not growing rapidly, the process of growth itself can generate significant amounts of short-term revenues from taxes levied on new construction.

The estimated population of the Fairwood area in 2005 is 26,100.⁵ In 2000, the estimated population of the Fairwood area was 23,400, which means that the area has increased by an average 540 residents per year over the past five years.

For purposes of assessing feasibility, this study assumes that population growth will slow in coming years, with an expected addition of 275 residents per year through 2012. This estimate is lower recent growth trends (1) to reflect the fact that Fairwood is beginning to approach residential build-out and (2) to ensure that estimates of feasibility are conservative.

High rates of construction can serve as a short-term fiscal windfall to cities because of sales taxes the city collects on construction, and real estate excise taxes the city collects on initial property sales. By estimating a lower rate of growth for Fairwood for the period of analysis, this feasibility assessment seeks to be conservative in estimating these revenues.

Our understanding of residential construction potential in Fairwood is informed by (1) discussions with King County's Chief Demographer; (2) discussions with Fairwood residents; and (3) Berk &

⁵ The estimated population of Fairwood is based on Berk & Associates analyses of (1) U.S. Census Bureau 2000 census data; (2) King County Assessor's database extract data describing the distribution of current housing units in the Fairwood Area; (3) Puget Sound Regional Council data describing recently permitted housing units; and (4) review of King County Annual Growth Reports. Using these data sources, Berk & Associates used spatial analysis to develop current estimates of population in the Fairwood and Cascade unincorporated areas in consultation with King County's Chief Demographer.

Associate's own GIS-driven overview assessment of the nature and extent of vacant and redevelopable properties in the proposed incorporation area boundaries.

Assessed Value of Property

Having established our estimates of population, the next important driver of revenue for a residential city like Fairwood is the assessed value (AV) of the taxable property lying within the city's boundaries. It is the assessed value of the City of Fairwood that will provide the basis for all property taxes.

Working from King County Assessor's Office data extracts and Geographical Information Systems (GIS) digital maps of boundaries and tax parcels, Berk & Associates estimated the 2005 total assessed property of the proposed City of Fairwood is \$2.208 billion. This figure includes an estimated \$2.175 billion in taxable *real* property (land and buildings) and an additional \$33 million in *personal and intercounty utility property* (which includes certain types of equipment and the value of property and equipment in the area that is owned by utilities that have assets in more than one county).

In addition to taxable property, Fairwood also includes \$66 million in property that is exempt from taxation.⁶

Overall, in 2005, Fairwood had roughly \$85,000 of taxable assessed value for each Fairwood resident.

Projected Growth in Assessed Value

While the taxable assessed value described above provides a base on which to begin assessing the fiscal viability of the proposed City, two factors will determine growth in the taxable property of the city: 1) the increase in the value of the property associated with existing structures, and 2) the amount of new development over the period.

Based on a review of increases in assessed value that the King County Assessors Office has begun to announce from 2005 to 2006, this analysis assumes that average values of existing property in Fairwood will increase by 7% from 2005 to 2006. For 2007 and beyond, we assume that values of existing properties will increase at a rate of 5% per year (a rate we believe to be appropriately conservative given recent growth in values and given the constraints on remaining developable land in the area and in King County as a whole).

For increases in assessed value coming from new development, we assume that each new Fairwood resident will be accompanied by a \$100,000 increase in assessed value in 2005. In effect, this assumption says that, in order for new households to move to Fairwood, the area will need to build new housing. Given current conditions in the area's housing market, on average, each new person will be accompanied by \$100,000 of new housing stock. This translates to an increase of \$300,000 per

⁶ Property exempt from taxation includes property owned by senior citizens who qualify for an exemption; farm and agricultural land, timber land and other open space land; remodeling of a single-family dwelling for the three assessment years subsequent to the completion of the improvement; historic property; publicly owned property; church-owned property; and property owned by certain types of non-profit associations. More information is available at <http://www.metrokc.gov/assessor/Exemptions/Exemptions.htm>.

new 3-person household. Assumed increases for 2006 through 2012 parallel the assumed property value increases noted above: 7% for 2006 and 5% per year thereafter.

Beyond new housing, new construction value also comes from commercial development and improvements that are made to existing residential and commercial properties. Based on a review of the experiences of other cities in King County over recent years, we assume that these sources will drive additional new property value equal to 0.5% of the area’s total taxable assessed value in a given year.

**Exhibit 5
Taxable Assessed Value Estimates**

	2007	2008	2009	2010	2011	2012
Assessed Value	\$2,504 M	\$2,630 M	\$2,761 M	\$2,899 M	\$3,044 M	\$3,196 M
Assessed Value of Existing Property	\$2,481 M	\$2,605 M	\$2,735 M	\$2,872 M	\$3,015 M	\$3,166 M
Assessed Value of New Construction	\$24 M	\$25 M	\$26 M	\$27 M	\$29 M	\$30 M

Source: Berk & Associates analysis of King County Assessor data extracts.

Current Rate of Taxation

The owner of every piece of non-exempt real property within the proposed City of Fairwood currently pays property taxes according to a levy rate applied to every \$1,000 of assessed value. This total levy rate is composed of a number of elements, ranging from state taxes, to county taxes, to local school and fire district taxes. Consequently, the property tax rate paid by a potential resident of the new city varies according to the property tax levy rate area in which the resident resides. Below, we provide more detail about the current rates for one of the 19 levy areas that are part of the proposed city of Fairwood. As noted, tax rates for special districts such as fire and schools vary within the incorporation area, but the remaining levy rates are consistent for all property owners within the incorporation boundaries, and are consistent with our assumptions for the service model that would continue if the Fairwood area incorporated. These common elements appear in bold-faced type.

**Exhibit 6
Sample 2005 Levy Rates for Fairwood Property Owners**

	2005 Rate per \$1,000 of Assessed Value
King County Levy	\$1.38
Port Levy	\$0.25
State School Fund	\$2.70
King County Library District	\$0.53
County Road District Fund	\$1.83
Emergency Medical Services	\$0.23
Hospital	\$0.09
Fire	\$0.99
School Levy (Kent School District)	\$4.80
Total	\$12.80

Source: King County Assessor's Office

Of all the levies listed in Exhibit 56 and currently paid by Fairwood property owners, the only property tax that will cease upon incorporation is the \$1.83 levy for the King County Road District. This tax will be replaced by a new City levy, which would be levied for the first full year of the City's existence, which in this analysis is assumed to be 2007.

This analysis assumes that the City's 2007 property tax levy rate will be set to \$1.60 per \$1,000 of taxable assessed property. This \$1.60 is the maximum levy rate that can be guaranteed to the City in a given year. It is the maximum based on the assumption that the City will (1) continue to receive fire and emergency medical services from one or more fire districts, and (2) continue to receive library services from the King County Library System. Given that the ending Road District Levy exceeds \$1.60, virtually all newly incorporated cities set their initial property tax levy at this amount. For Fairwood, to generate the equivalent revenue to the \$1.83 in road levy (and remain consistent with the same-cost framework), the city would need to impose the assumed \$1.60 levy and identify other sources to fill the gap between \$1.83 and \$1.60.⁷ For a more in-depth discussion of statutory constraints on a City's regular levy rate, see the discussion of Property Tax – Regular Levy in the *Revenues* section of the report. For a discussion of other options that may be available to the City for securing additional levy capacity, see the *Optional Revenues* section.

Special Purpose Districts

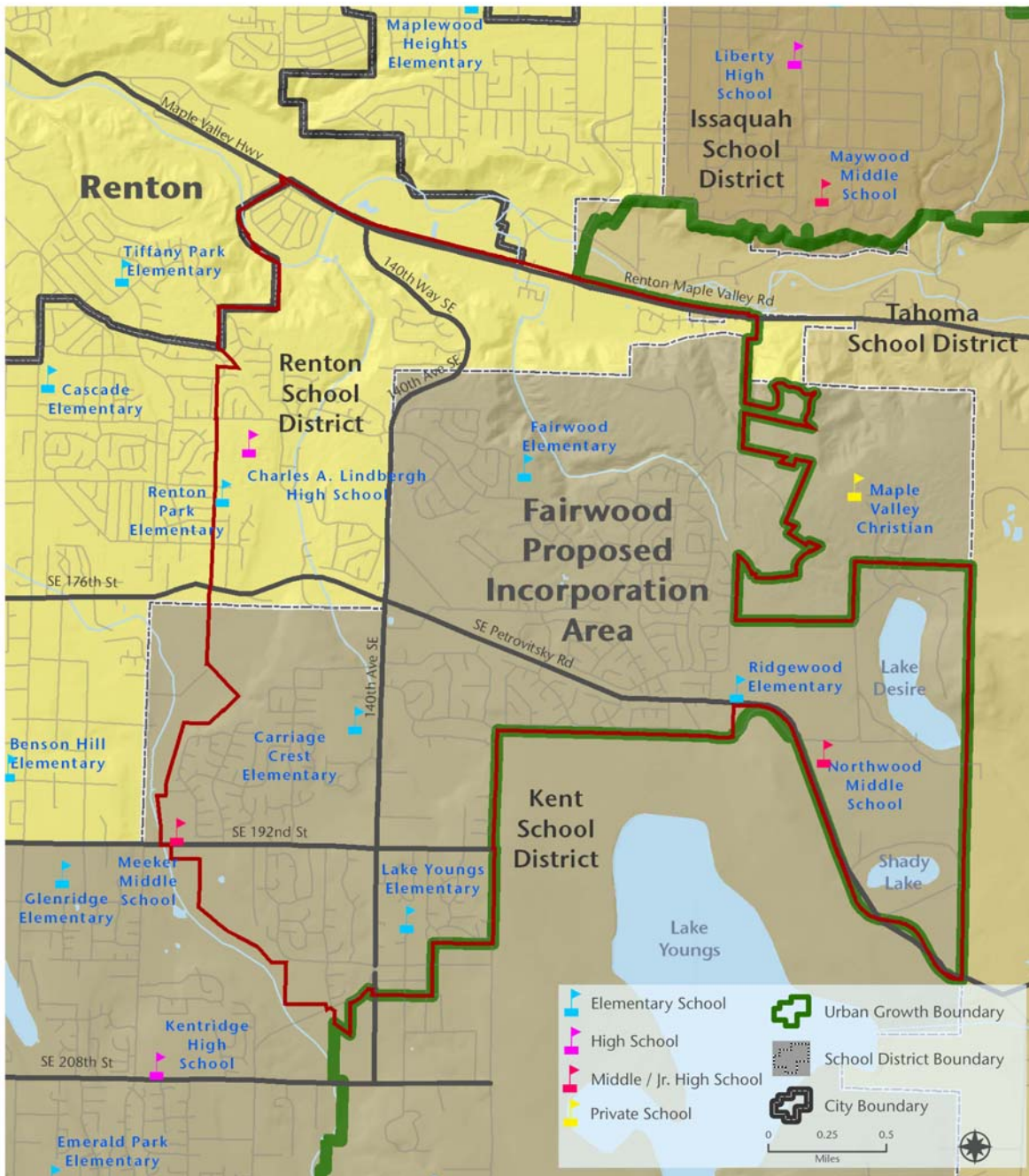
School Districts

Residents in the northeastern region of the proposed City of Fairwood would continue to be served by the Renton School District #403, which includes Lindbergh High School, Fairwood Elementary, and Renton Park Elementary located in the incorporation area. Elementary and high schools in the Renton School District are to the west of the proposed incorporation area.

The south and east areas of the new city would be served by the Kent School District, which has the following facilities in the incorporation area: Lake Youngs Elementary School; Meeker Middle School; Carriage Crest Elementary School; Ridgewood Elementary School; and Northwood Middle School.

⁷ An explanation is provided here of earlier statements which assert that the Road Levy will grow faster than I-747 limits, and likely the amount a city could generate through levy lid lifts. Since the early 1990's, King County's Road Levy has increased revenue by six percent plus new construction. Since 2001, the limit factor under Initiative 747 has been one percent; King County has used banked capacity at five percent a year. Because we know that about 40% of the Road District's property tax base is located in areas expected to transition to incorporated status over the next ten years or so, it is reasonable to assume that some or all of remaining governance transitions will happen. When they do, the Road Levy will build more banked capacity, meaning that I-747's 1% limit is not likely to apply to the Road levy on a sustained basis for many years to come. Since recent initiatives permit the same revenue from a smaller roads district, a higher rate is permitted, up to \$2.25 under state law. To the extent the county proves successful in transitioning urban unincorporated areas, the road levy tax rate will likely continue to climb toward the \$2.25 statutory maximum. Because of this, it safe to assume (as the model does) that property owners in the Road District will see average annual increases in their road district taxes equal to at least 5% per year. As long as this rate is higher than levy lid lifts needed to generate adequate property taxes for the City of Fairwood, the same cost framework holds.

Exhibit 7
Fairwood Area Schools



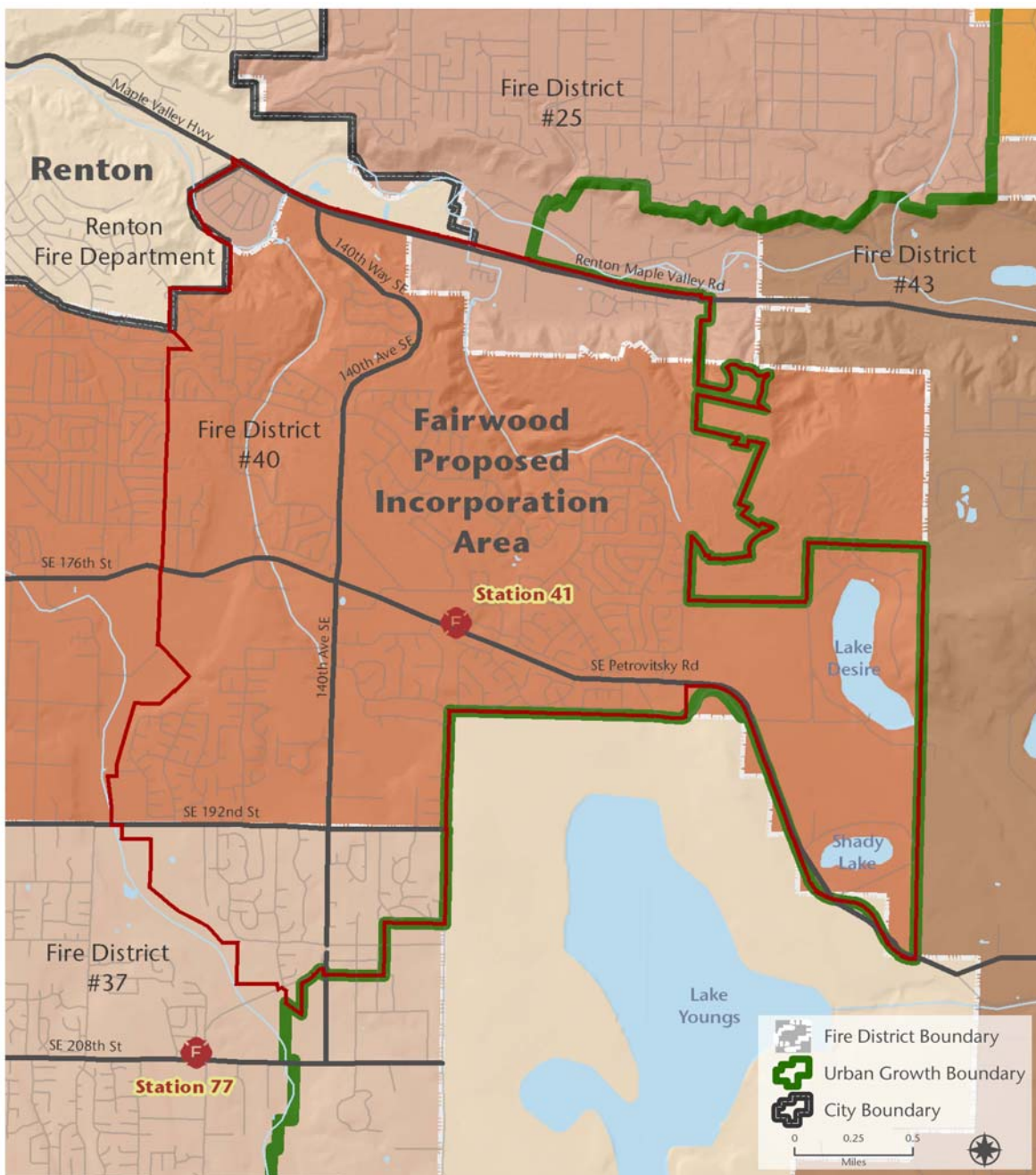
Fire Districts

Fire and *basic* life support emergency medical services are currently provided to most of the Fairwood area by Fire District 40, a full service fire district that provides its own stations, apparatus, and personnel. A small portion of the northeast part of the Fairwood study area is served by Fire District 25, which contracts with the City of Renton to provide its fire protection services, so it is already served by the City of Renton. Fire District 37 is responsible for fire protection services to the parts of the Fairwood south of SE 192nd Street. Fire District 37 contracts with the City of Kent to provide its fire and EMS protection. For purposes of assessing feasibility, this analysis assumes that the new City of Fairwood would annex to one of the fire districts to continue to provide service, most likely Fire District 40.

Advanced life support emergency medical services are currently provided to the Petrovitsky Corridor area by King County Medic One, which is a regional service that will continue to be provided by Medic One post-incorporation.

Again, our assumption is that the proposed City of Fairwood would choose to annex itself to a currently existing King County Fire Protection District. Since these districts are funded through discrete levies, under this assumed structure, the provision of fire and life safety protection will have no direct financial impact on the City's budget.

**Exhibit 8
Fairwood Area Fire Districts and Stations**



Source: Berk & Associates of King County data.

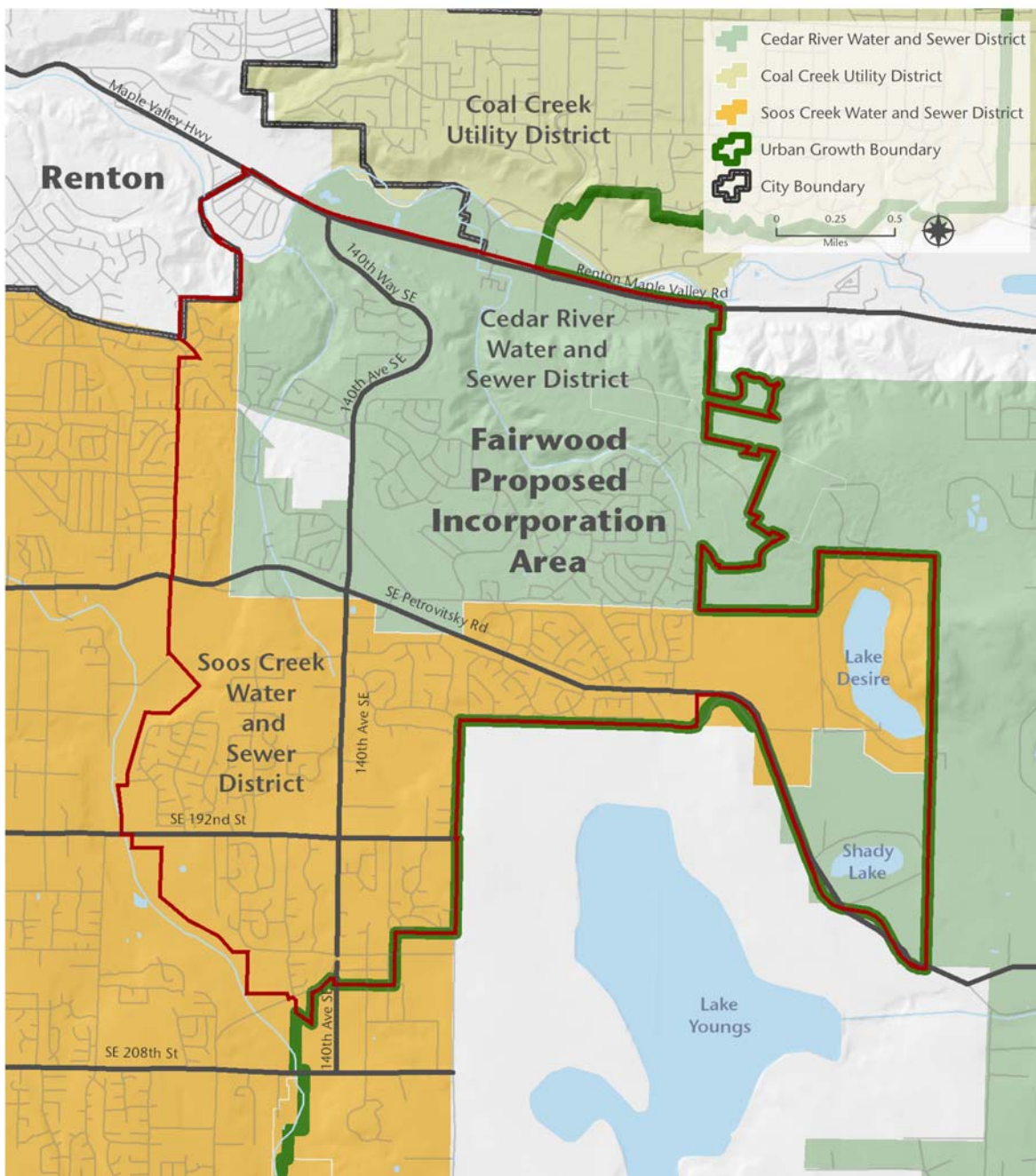
Utility Districts

This feasibility analysis assumes that, upon incorporation, residents of the newly incorporated city would continue to receive water and sewer service from two utility districts: in the northern portion of the city, Cedar River Water and Sewer District; and to the south, the Soos Creek Water and Sewer District.

The Cedar River Water and Sewer District, formed in 1960, serves the communities of Fairwood (water and sewer service) and Maple Valley (water service only). The District's area has grown today through 38 annexations to approximately 9,420 acres, or 14.5 square miles. The primary water supply for the District is a long-term water supply contract with Seattle Public Utilities from the Lake Youngs Reservoir. Lake Youngs receives potable water from the Cedar River Watershed. The watershed is a closed area of approximately 96,000 acres lying between Hobart and the crest of the Cascade Mountains.

The Soos Creek Water and Sewer District, formed in 1939, was created by a merger of Water District 58 and Cascade Sewer District in 1987. The District encompasses over 35 square miles and provides water and sewer services to almost 100,000 people in southeast King County. Water is purchased from Seattle Public Utilities and reaches the District via Lake Youngs, which is adjacent to the District's office. The sanitary sewer system, with 29 lift stations, conveys the wastewater to the King County Department of Natural Resources treatment plant in Renton for treatment and disposal.

**Exhibit 9
Fairwood Area Water and Sewer Districts**



Source: Berk & Associates analysis of King County data

Library Services

The Fairwood area currently receives library services from the King County Library System (KCLS), a district which operates the large regional Fairwood Library on 140th Avenue SE. This analysis assumes that the Fairwood community would annex to the library district after the interim period, which means that provision of library services in the proposed city will have no impact on Fairwood's city budget.

Since its opening day, the Fairwood Library has been one of the busiest branches in the King County Library System. It serves as a community center, providing meeting rooms, programs and general information. As part of KCLS's recently approved capital bond, the district plans a 5,000 sq. ft. expansion of the current 15,000 sq. ft. library to better serve patrons, including computers and wireless access, and an automated materials-handling system to speed delivery and reduce theft. The proposed start date of the expansion is 2012.

4. OVERVIEW OF REVENUES AND EXPENSES

Is a City of Fairwood Financially Feasible?

Yes. If Fairwood residents are willing to pay the *same total combined level of taxes they would pay as part of unincorporated King County*, and are willing to preserve the taxing power to purchase public services over time, then a City of Fairwood would generate enough revenues to provide a slightly higher level of service than Fairwood residents currently receive.

The margin by which the City is feasible is slim, but if the City maintains its property tax levy over time, then the City should have sufficient revenues to cover costs of service now and in the future.

Exhibit 10 summarizes projected costs and revenues for a City of Fairwood for 2007 through 2012. (See *Projected Start-Up Financing* for a month-by-month assessment of start-up cash flows from the assumed incorporation date of September 1, 2006 through the start of 2007.) Exhibit 10 summarizes what we refer to as "core" operating revenues and "core" operating costs that the City of Fairwood would face under the modeled revenue and cost structure. These core costs reflect a combination of general fund and street fund revenues and costs, and combined, they reflect the principal day-to-day costs that a City of Fairwood would have to cover from its principal sources of operating revenues.

What Exhibit 10 shows is that a City of Fairwood could (1) maintain tax burdens similar to what residents would see under King County; (2) provide levels of service similar to what King County would provide (but slightly higher in some instances); and (3) the City would have a modest level of "excess" revenues each year (generally ranging between \$500,000 and almost \$800,000). These "excess revenues" would be available to the City Council to use as they see fit, with potential uses including augmenting dedicated capital revenues for capital investments, increasing levels of service (e.g. increasing police, parks, or City Hall staffing), or to provide residents with a slight decrease in taxes.

For an in-depth discussion of what lies behind each of these identified revenues and costs, readers should see the following two major sections detailing *Revenues* and *Operating Expenses*.

In terms of capital revenues and expenses, Exhibit 10 *does* summarize estimated revenues that the City of Fairwood would expect to generate for capital investments, including Real Estate Excise Taxes, and revenues from grants, but the exhibit *does not* include any estimate of the costs of capital investments. As is discussed in the section entitled *Capital Improvements*, at this time, King County has planned very few capital investments in the Fairwood area in the years beyond 2006. Under a strict "same cost" framework, one would say that most of the estimated capital revenues represent "new" capital revenues to the City. Put another way, these revenues represent the opportunity for the City to make investments in the Fairwood area that would otherwise not happen in the coming years if the area remained unincorporated.

**Exhibit 10
Summary of Core City Costs and Revenues**

	2007	2008	2009	2010	2011	2012
Operation (non-constrained)						
Revenues						
Property taxes (Regular Levy)	\$3,970,000	\$4,049,000	\$4,129,000	\$4,592,000	\$4,684,000	\$4,776,000
Retail Sales tax	1,147,000	1,187,000	1,230,000	1,275,000	1,321,000	1,370,000
State Shared Revenues	1,022,000	1,033,000	1,043,000	1,054,000	1,064,000	1,075,000
Retail Sales Tax - Criminal Justice	576,000	606,000	636,000	669,000	702,000	738,000
Utility Tax	541,000	557,000	574,000	591,000	609,000	627,000
Permit Fees	487,000	506,000	526,000	547,000	569,000	592,000
Cable TV Franchise Fee	240,000	250,000	260,000	271,000	282,000	293,000
Community Development Block Grant	166,000	171,000	176,000	182,000	187,000	193,000
Interest Income	60,000	90,000	93,000	95,000	98,000	101,000
Gambling Taxes	41,000	42,000	43,000	45,000	46,000	48,000
Total Projected Core Revenues	\$8,251,000	\$8,492,000	\$8,712,000	\$9,320,000	\$9,563,000	\$9,813,000
Expenses						
General Government	\$2,574,000	\$2,677,000	\$2,784,000	\$2,896,000	\$3,011,000	\$3,132,000
Public Safety (Criminal Justice)	2,304,000	2,415,000	2,530,000	2,652,000	2,778,000	2,911,000
<i>Police Services</i>	<i>2,057,000</i>	<i>2,156,000</i>	<i>2,259,000</i>	<i>2,367,000</i>	<i>2,480,000</i>	<i>2,599,000</i>
<i>Jail/Court/Public Defense Services</i>	<i>243,000</i>	<i>253,000</i>	<i>263,000</i>	<i>274,000</i>	<i>285,000</i>	<i>296,000</i>
Roads Operation and Maintenance	1,088,000	1,140,000	1,195,000	1,252,000	1,312,000	1,374,000
Parks and Recreation	143,000	153,000	163,000	169,000	176,000	183,000
Planning/Permitting (Permitting and Land Use Desk)	541,000	562,000	585,000	608,000	633,000	658,000
City Attorney and Prosecution Services	412,000	424,000	437,000	450,000	464,000	478,000
Comprehensive Land Use Plan	150,000	150,000	75,000	75,000	75,000	75,000
Capital Facilities Plan	150,000	150,000	75,000	75,000	75,000	75,000
Human Services (Block Grant expenditures)	166,000	171,000	176,000	182,000	187,000	193,000
Miscellaneous	52,000	54,000	56,000	58,000	61,000	63,000
Operational Contingency	108,000	112,000	117,000	122,000	127,000	132,000
Total Projected Core Expenses	\$7,688,000	\$8,009,000	\$8,194,000	\$8,539,000	\$8,898,000	\$9,273,000
Excess Revenues	\$563,000	\$483,000	\$518,000	\$782,000	\$665,000	\$540,000
Surface Water Management						
Revenues	\$898,000	\$934,000	\$972,000	\$1,011,000	\$1,052,000	\$1,094,000
Operating expenses	\$379,000	\$394,000	\$409,000	\$426,000	\$443,000	\$461,000
Revenues available for SWM Capital Projects	\$519,000	\$540,000	\$563,000	\$585,000	\$609,000	\$633,000
Capital Revenues						
Total	\$2,436,000	\$2,551,000	\$2,672,000	\$2,798,000	\$2,931,000	\$3,069,000
<i>Real Estate Excise Tax (REET)</i>	<i>\$1,729,000</i>	<i>\$1,816,000</i>	<i>\$1,907,000</i>	<i>\$2,002,000</i>	<i>\$2,102,000</i>	<i>\$2,207,000</i>
<i>Grants</i>	<i>\$707,000</i>	<i>\$736,000</i>	<i>\$765,000</i>	<i>\$796,000</i>	<i>\$828,000</i>	<i>\$862,000</i>

Notes: Property tax revenues for 2010, 2011, and 2012 assume voter approval of a levy lid lift in 2009, which will restore the City property tax levy to \$1.60 (compared with a rate of \$1.50 in 2009).

“Non-constrained” operating revenues and expenses include day-to-day operating costs and revenues for the City’s general and street fund, including revenue streams that are statutorily constrained in their use, but for which those legal constraints are not binding. For example, by statute, cities must use gas tax revenues to fund road operation, maintenance, or improvement. In practice, cities set up a separate road or street fund to which gas tax revenues accrue. Revenues from this road fund are then used to fund road maintenance. As it turns out, however, estimated “restricted” gas tax revenues that accrue to the city are less than the estimated cost of road maintenance, so the restriction is non-binding. In the above summary, all such functionally unconstrained revenues and costs are grouped together to give readers a bottom-line picture of operating revenue-sufficiency.

Source: Berk & Associates analysis

As a residential city, the City of Fairwood would generate roughly half of its revenues from property taxes, with retail sales taxes and state revenue distributions also serving as important contributors. City expenses will be dominated by public safety, roads operation and maintenance, and the cost of general government (City Hall staffing), where 25 staff positions will cover the City’s legislative and administrative functions as well as the highest-level City staff in planning, parks and recreation, public

works, and the City engineer. As discussed in the *Expenditures* section and the *Projected Start-Up Financing* section, staffing levels are assumed to take a “go-slow approach” that will allow the City to build up financial reserves , and are consistent with actual staffing approaches employed in recently incorporated cities such as Maple Valley and Kenmore.

This analysis assumes that, as a City that contracts for key services like police, roads maintenance, and surface water maintenance, the City will be able to operate on a relatively lean City Hall staff.

Key Issues Related to Feasibility

Although the proposed City is primarily residential with a weak commercial tax base, the combination of relatively high residential property values and a modest level of existing public services makes the proposed City financially feasible.

In terms of sales tax revenues per resident, we project that Fairwood would generate roughly \$38 per resident in 2005, which would rank the lowest of all cities in King County (Exhibit 11).

Exhibit 11
Regular Sales Tax Revenues per City Resident (King County Cities)

	Sales Tax Revenues	Population	Sales Tax per Resident
Tukwila	16,111,783	17,240	\$935
Issaquah	9,270,674	15,510	\$598
Woodinville	5,205,442	9,915	\$525
Medina	1,226,415	2,955	\$415
Skykomish	81,677	210	\$389
Redmond	16,418,571	46,900	\$350
SeaTac	8,217,417	25,130	\$327
Bellevue	37,173,969	116,500	\$319
Auburn	14,294,011	46,135	\$310
Renton	16,653,825	55,360	\$301
North Bend	1,398,183	4,660	\$300
Kirkland	12,703,978	45,800	\$277
Bothell	7,604,654	30,930	\$246
Kent	20,102,888	84,560	\$238
Snoqualmie	1,159,174	5,110	\$227
Seattle	116,278,663	572,600	\$203
Enumclaw	1,784,913	11,160	\$160
Hunts Point	70,608	450	\$157
Carnation	291,811	1,895	\$154
Burien	4,050,601	31,130	\$130
Federal Way	10,536,298	83,590	\$126
Milton	682,683	6,025	\$113
Shoreline	5,744,116	52,740	\$109
Maple Valley	1,704,386	16,280	\$105
Newcastle	868,597	8,375	\$104
Covington	1,524,899	15,190	\$100
Mercer Island	2,179,712	21,830	\$100
Algona	253,787	2,605	\$97
Beaux Arts	28,649	300	\$95
Yarrow Point	93,741	990	\$95
Duvall	516,390	5,545	\$93
Clyde Hill	234,258	2,790	\$84
Kenmore	1,425,462	19,170	\$74
Sammamish	2,274,117	36,560	\$62
Des Moines	1,715,690	29,020	\$59
Black Diamond	230,263	4,000	\$58
Normandy Park	306,916	6,400	\$48
Lake Forest Park	515,579	12,770	\$40
Fairwood	1,000,000	26,100	\$38

Source: Municipal Research & Services Center and Berk & Associates

Note: For a detailed discussion of estimated sales tax revenues for the proposed City of Fairwood, see the discussion of *Sales Taxes – Regular* in the following section of the report.

In terms of assessed value per resident, Fairwood would rank close to Maple Valley, higher than six other cities in King County (Exhibit 12)

**Exhibit 12
Taxable Property Value per City Resident (King County Cities)**

	Taxable Assessed Value	Population	Assessed Value per Resident
Hunts Point	593,456,567	450	\$ 1,319,000
Medina	1,979,552,449	2,955	\$ 670,000
Yarrow Point	523,297,996	990	\$ 529,000
Clyde Hill	994,149,235	2,790	\$ 356,000
Mercer Island	6,345,660,937	21,830	\$ 291,000
Beaux Arts	70,753,648	300	\$ 236,000
Tukwila	3,373,231,785	17,240	\$ 196,000
Issaquah	3,026,104,987	15,510	\$ 195,000
Redmond	8,787,158,266	46,900	\$ 187,000
Bellevue	21,209,960,837	116,500	\$ 182,000
Woodinville	1,769,120,872	9,915	\$ 178,000
Kirkland	7,422,139,375	45,800	\$ 162,000
Sammamish	5,912,313,518	36,560	\$ 162,000
Snoqualmie	820,409,120	5,110	\$ 161,000
Newcastle	1,288,048,148	8,375	\$ 154,000
Seattle	83,480,019,346	572,600	\$ 146,000
Normandy Park	910,982,746	6,400	\$ 142,000
Bothell	4,195,710,134	30,930	\$ 136,000
SeaTac	3,274,008,104	25,130	\$ 130,000
Lake Forest Park	1,618,292,987	12,770	\$ 127,000
Algona	299,327,957	2,605	\$ 115,000
Renton	6,344,519,649	55,360	\$ 115,000
North Bend	524,048,214	4,660	\$ 112,000
Duvall	584,187,844	5,545	\$ 105,000
Kenmore	1,984,768,702	19,170	\$ 104,000
Black Diamond	403,441,518	4,000	\$ 101,000
Shoreline	5,290,466,808	52,740	\$ 100,000
Kent	8,449,061,721	84,560	\$ 100,000
Auburn	4,495,617,693	46,135	\$ 97,000
Skykomish	19,881,724	210	\$ 95,000
Burien	2,766,091,483	31,130	\$ 89,000
Maple Valley	1,407,088,460	16,280	\$ 86,000
Fairwood (2005)	2,208,000,000	26,100	\$ 85,000
Carnation	151,163,978	1,895	\$ 80,000
Covington	1,188,347,421	15,190	\$ 78,000
Federal Way	6,262,874,389	83,590	\$ 75,000
Milton	444,167,578	6,025	\$ 74,000
Des Moines	2,085,218,819	29,020	\$ 72,000
Enumclaw	766,585,951	11,160	\$ 69,000

Source: Municipal Research & Services Center and Berk & Associates

The Importance of Maintaining the City's Property Tax Levy Rate

The passage of I-747 by Washington voters means that, absent positive action, most cities should expect the value of their property tax base to erode over time. Under I-747, absent a public vote to increase a city's levy, the revenues a city is allowed to collect from property taxes cannot grow by more than 1% per year (excluding the effects of new construction).

At the same time that I-747 limits the growth of a city's core property tax base, cities face rapidly increasing costs of doing business. Personnel costs (the principal cost of providing city services) are growing at a rate that exceeds inflation. These costs are driven by 1) large annual increases in the costs of health care and 2) wage increases that exceed the rate of general inflation (driven by long-run increases in worker productivity in the private sector).

Due to compounding effects, the gap between cost and revenue growth can easily erode a city's ability to maintain public services. For example, if the costs of serving a given population increase at a rate of 4% per year, while property taxes revenues increase at only 1% per year, over a period of ten years, a city's property tax base would fall 33% short of being able to cover costs of service. This represents a level of revenue erosion that many cities, particularly residential cities, cannot afford. What this means is that in future years, many, if not most, Washington cities will need to seek regular public votes to maintain their property tax levy rates.

Residential cities across Washington State rely on property taxes and utility taxes to make up the large majority of their total revenues. Faced with the prospect of compounding erosion of property tax revenues, many residential cities are beginning to take a cue from fire districts, asking residents to periodically approve levy lid lifts that increase or maintain their levy rate. Recent examples of cities pursuing levy lid lifts include the City of Duvall, which recently won voter approval of a six-year lid lift, and the City of Des Moines, which recently saw a levy lid lift vote fail.

A lesson learned from the Duvall and Des Moines experiences is that cities are better positioned to succeed in passage of a levy lid lift if they are seeking to *maintain* city levy rates rather than *raise* them. Duvall's successful lid lift maintained the City's levy rate at \$1.60 per \$1,000, while Des Moines failed (55% to 45%) to *raise* its levy rate from what would be less than \$1.50 in 2006 to \$1.60. Fire districts already know, and many cities are now learning, that it is very important not to let the city levy rate drop because of the implications for level of service.

While utility taxes may represent short-term relief from the eroding effects of Initiative 747 that can be authorized by the city council instead of requiring voter approval, the long-term effects of allowing the property tax rate to erode without rate capacity could create a very difficult long-term financial situation for a city, without a variable revenue source such as the property tax to rely on.

The Washington State Legislature recently provided cities with much-needed relief by allowing cities to pursue levy lid lifts that apply for multiple years (up to six years at a time). This is an important tool for cities that one would expect to see used in coming years.

For a city like the proposed City of Fairwood, which will always rely on property taxes to provide city services, it will be particularly important for the City to maintain its levy rate.

5. REVENUES

If Fairwood residents vote for incorporation, the new City of Fairwood will have at its disposal a range of revenue options and potential tax and fee structures. The hypothetical revenues summarized in the preceding *Overview of Revenues and Expenses* presents revenues that the City could reasonably expect to generate under one available structure. As discussed previously, the modeled revenue structure was explicitly designed to maintain tax burdens on Fairwood households that are in line with what those households would expect to pay if they remained part of unincorporated King County ("same cost" framework).

All revenues included in the preceding summary are revenues that a Fairwood City Council would have authority to tap or pursue under existing statutes. As noted throughout this report, however, the modeled revenue structure *does* assume that the City of Fairwood would seek voter approval for a levy lid lift that would allow the City to maintain its regular property tax levy rate over the long term.

Fortunately, as a newly incorporating City, the City of Fairwood would have a number of options for protecting itself from the eroding effects of I-747. The most transparent of these options is to ask voters to approve periodic levy lid lifts to maintain the City's property tax levy. Berk & Associates used this assumption to model financial feasibility because (1) it is transparent, and (2) it sends a clear message to voters that, if they vote for incorporation, they should do so with a commitment to maintaining the City's property tax levy rate.

Building Reserves

Another key to a strong financial footing for Fairwood will be a "go-slow" approach to hiring permanent full-time staff for City Hall. Two recently incorporated cities, Kenmore and Edgewood, made a conscious decision to draw out their hiring of full-time City Hall staff for as long as possible. As a result, both cities quickly repaid short-term debt they incurred during incorporation start-up, and in fact, both cities went on to create healthy financial reserves that have served the two cities well as they face current fiscal challenges.

If Fairwood follows a similar "go-slow" approach to staffing City Hall, then the City should be able to adapt flexibly to changes in the fiscal environment and build up substantial operating reserves. Because the goal of a feasibility assessment is to investigate whether annual revenues are sufficient to cover annual costs, these operating reserves do not show up in the annual figures (except in calculations of interest income).

Revenue Growth over Time

For the six-year period of the feasibility analysis, each estimated revenue source will change over time according to its own unique conditions. In some instances, revenues will grow with general increases in prices (e.g. sales taxes and utility taxes). In other instances, the manner in which revenues change from year to year is more complex. In the case of property taxes, for example, the tension between I-747 limits, assumptions about a voter-approved levy lid lift, and assumptions about new construction activity translate into a very specific prescription for property tax revenue growth.

In all instances, Berk & Associates' assumptions that drive modeled changes in revenue over time are documented in each description and section of each revenue source.

Property Tax – Regular Levy

For a residential city like the proposed City of Fairwood, one of the largest sources of annual revenue is property tax. The property tax levy rate is set annually by a jurisdiction's legislative body (the City Council, school board, etc.) and is generally applied uniformly to all taxable property within the boundaries of the jurisdiction.

Many taxing jurisdictions, like school or fire districts, have boundaries that cut through the proposed incorporation area, and as a result, different areas of Fairwood are, and will continue to be, subject to different levy rates. The levy for the proposed City, however, will apply to all taxable property within the city boundaries.

State law delineates what types of property are and are not subject to property taxes. Those properties subject to taxation include "real" property (land, structures, and specific equipment affixed to structures) and some forms of personal property (some types of mobile homes, business related machinery, and supplies). While all of these types of property within a city's jurisdiction are assessed, some are exempt from taxation. These exemptions generally apply to properties owned by government, schools, churches, or property with other uses that provide public benefits.

Title 84 of the Revised Code of Washington (RCW) focuses on property taxes. RCW 84.52.043 establishes the authority for cities to levy regular property taxes; special levies are authorized by RCW 84.52.052 and .056; and RCW 84.55.050 allows for jurisdictions to seek levy lid lifts from residents. According to state law, the levy a city can apply is constrained according to the services the city provides. If a city delivers its own fire and library services, it is allowed a maximum levy of \$3.60 per \$1,000 of assessed value. If a city does not provide either of these two services, state law generally restricts the maximum levy to \$1.60 per \$1,000 assessed value (while the fire district and the library districts are allowed to levy \$1.50 and \$0.50 respectively).⁸ The working assumption of this feasibility study is that the proposed City of Fairwood will not provide either fire protection or library services, so the \$1.60 maximum levy rate will apply.

This analysis assumes that the City will assess \$1.60 per \$1,000 AV. This leaves a shortfall of \$0.23 per thousand between what households paid in property taxes in 2005 and what they will be paying upon incorporation. In order to maintain the existing tax burden, we assume that these revenues are exactly "made up" through some form of new utility taxes. This assumption will be discussed further in the section entitled *Utility Taxes*.

Of course, the simple levying of a tax does not guarantee full and immediate payment by all households. In any city, there will be some taxes that are due but go unpaid. Fortunately for the City's

⁸ Example: If no fire district serving the city levies more than \$1.40, the \$0.10 that the districts are not currently using is available to the city. However, if one fire district changes their levy in a subsequent year, the city loses its ability to levy anything more than \$1.60. Fire district property tax levies are authorized by RCW 52.16.130 and library district levies are authorized by RCW 27.12.050.

finances, however, when it comes to property taxes, sooner or later almost all taxes that are levied are paid in full. Property tax estimates included in Exhibit 10 assume that, in any given year, the City will receive property tax revenues equal to 99% of the City levy.

I-747 Limits and a Levy Lid Lift

As noted in the Overview of Revenues and Expenses, I-747 limitations on the growth of property tax are a challenge to many cities across the state. In particular, I-747 poses the largest challenges to residential cities like Fairwood, where property taxes are *the* big source of city revenues.

Based on estimated taxable assessed value summarized earlier, we forecast City property tax revenues of \$3.97 million in 2007, growing to \$4.78 million in 2012 (Exhibit 12). This assumes that in 2009, three years after incorporation, City residents will approve a levy lid lift that will reset the City’s property tax levy to its original \$1.60. We would expect that, absent a windfall of revenue from another source, as long as I-747 limits are in effect, levy lid lifts will be required on a three- or four-year rotating basis.

**Exhibit 13
Fairwood Property Tax Revenues and Assessed Values by Year**

	2007	2008	2009	2010	2011	2012
Property taxes (Regular Levy)	\$3.97 M	\$4.05 M	\$4.13 M	\$4.59 M	\$4.68 M	\$4.78 M
Assessed Value	\$2,504 M	\$2,630 M	\$2,761 M	\$2,899 M	\$3,044 M	\$3,196 M
<i>Assessed Value of Existing Property</i>	<i>\$2,481 M</i>	<i>\$2,605 M</i>	<i>\$2,735 M</i>	<i>\$2,872 M</i>	<i>\$3,015 M</i>	<i>\$3,166 M</i>
<i>Assessed Value of New Construction</i>	<i>\$24 M</i>	<i>\$25 M</i>	<i>\$26 M</i>	<i>\$27 M</i>	<i>\$29 M</i>	<i>\$30 M</i>
Levy Rate	1.6000	1.5398	1.4955	1.6000	1.5386	1.4944

Source: King County Assessor and Berk & Associates

Based on a review of increases in assessed value that the King County Assessors Office has begun to announce from 2005 to 2006, the analysis assumes that average values of existing property in Fairwood will increase by 7% from 2005 to 2006. For 2007 and beyond, we assume that values of existing properties will increase at a rate of 5% per year (a rate we believe to be appropriately conservative given recent growth in values, and constraints on remaining developable land in the area, and in King County as a whole).

For increases in assessed value coming from new development, we assume that each new Fairwood resident will be accompanied by a \$100,000 increase in assessed value in 2005. In effect, this assumption says that, in order for new households to move to Fairwood, the area will need to build new housing. Given current conditions in the area’s housing market, on average, each new person will be accompanied by \$100,000 of new housing stock. This translates to an increase of \$300,000 per new 3-person household, which based on an analysis of assessed values and recent transactions in the Fairwood area, is consistent with the market for new housing in the area. (Berk & Associates analysis of King County Assessor database extracts finds that houses constructed in Fairwood between 2000 and 2005 have an average current value of \$315,000). Assumed increases for 2006 through 2012 parallel the assumed property value increases noted above: 7% for 2006 and 5% per year thereafter.

Beyond new housing, new construction value also comes from commercial development and improvements made to existing residential and commercial stock. Based on a review of the experiences of other cities in King County over recent years, we assume that these sources will drive additional new property value equal to 0.5% of the area's total taxable assessed value in a given year.

Sales Taxes - Regular

Retail sales tax is added on a percentage basis to the sale price of tangible personal property (with the exception of groceries and prescription medicine) and to many services purchased by consumers. Beyond its application to tangible personal property, sales tax is also applied to things like telephone service; the installation, repair, or cleaning of tangible personal property; and to the construction or improvement of new or existing buildings (including labor and services provided throughout the process, under RCW 82.04.050).

According to state law (RCW 82.08, 82.14, 81.104.170), a city's maximum sales tax rate is set at 1%, which is the same rate that King County currently collects in the planned incorporation area. Of this 1%, Washington State's Department of Revenue (DOR) receives 1%. (That is, the DOR retains 1% of 1%, or 0.01% of the purchase price.) Beyond the small portion retained by the DOR, by state law, a county is eligible to receive 15% of the city's 1%. The City of Fairwood, thus, receives roughly 84% of its 1% sales tax.

The City's 1% sales tax is split into two halves: a base half and an optional second half which a city could choose not to levy if it so desired. Since King County currently levies both halves, and since, if the City of Fairwood were to choose not to levy the second half the funds would accrue to King County anyway, we have assumed that the full one percent will be levied by the City of Fairwood.

Both Berk & Associates and King County staff at the Office of Management & Budget analyzed sales tax revenues in Fairwood and arrived at similar revenue estimates. King County invested substantial effort in a top-down estimate of sales taxes in unincorporated areas, starting with the entire pot of taxable sales in the unincorporated county and allocating all of those sales to sub-areas like the Fairwood incorporation area. To achieve this, County staff needed to (1) identify the location of every business in the unincorporated area and (2) identify and allocate contributions made by construction and other contracting activities, and (3) identify and allocate contributions made by households and businesses for expenditures like vehicle purchases (between individuals and monthly leases) and sales taxes on things like telephone services or computers.

We approached our analysis using a similar framework, identifying retail outlets in Fairwood, estimating construction expenditures in the area (based on our assumptions about residential growth) and estimating sales tax revenues generated by household and business purchases.

Our analysis suggests that, in 2005, roughly \$500,000 of Fairwood's sales tax revenues are generated by retail activity in commercial spaces, including the area's commercial center and the Fairwood Golf Course and Country Club. Based on our assumptions about housing growth and other development in Fairwood, we project that, under our growth scenarios, construction in Fairwood would generate an additional \$160,000 in sales tax revenues. Finally, we estimate that a remaining \$340,000 in revenues is generated through resident and business purchases of goods or services [e.g. new carpets

or floors, house or yard maintenance, landscaping, telephone services, or computer purchases (Dell computers pays sales taxes to virtually every local jurisdiction in Washington State)].

Growth in sales tax revenues is driven by:

1. **Growth in retail square footage:** Currently, a new drug store and a new auto parts store are under construction, which should add an additional 20,000 square feet of retail space to Fairwood's commercial center. Given the size of the property under development, it would be reasonable to expect an additional 20,000 square feet of retail on the same site as the property builds out. The analysis assumes the first 20,000 square feet will be added by 2006, and the second 20,000 square feet will be added by 2007. Given that Fairwood's commercial center is largely built out after this latest development, the analysis assumes that retail square footage will not grow from 2007 through 2012. (There are policy choices a city can make to influence private investment, so the statement that the commercial center is built out is true only barring 1) a more intense redevelopment of the center or 2) potential zoning changes to provide more retail land.)
2. **Growth in sales at existing retail outlets:** Given a lack of immediate options for more retail development, and given typical growth in retail spending, we project 5% annual growth in sales per square foot for retail space in Fairwood. Given the combination of (1) growing population in the market served by the Fairwood commercial centers; (2) limited opportunities to expand retail square footage in the area; and (3) opportunities to "upgrade" the mix of retailers in the center, Berk & Associates believes that annual per-square-foot retail growth of 5% is a reasonable (and perhaps conservative) estimate of growth over the period of the analysis.
3. **Growth in direct expenditures by households and businesses:** We project that households and businesses in the Fairwood area will increase their purchases of delivered goods and services that are subject to taxable retail sales by 3% annually (as a contributor to total retail tax revenue)—a rate that reflects the overall rate of inflation. Under current law, home-based taxable activities include, among other things, construction/renovation activities, (e.g. remodel construction, carpet or floor installation, and landscaping); expenditures for telephone services, interstate purchases of most computers, and automobile lease payments. In effect, our assumption of increases that equal the assumed rate of general inflation means that households and businesses will make no shift in their direct purchasing habits..
4. **Growth in value of new construction:** As the value of new construction increases, the taxable sales associated with the construction increase as well. Assumptions of the value of new construction mirror the assumptions about new construction used in calculating new assessed value (7% increase from 2005 to 2006 and 5% per year thereafter).

One issue that many cities face in collection of sales taxes is the difficulty of having zip codes that do not coincide with city boundaries.

Because certain taxable sales (like an internet purchase of a computer) are allocated to cities based on the location of the delivery, in order for the sale to accrue to the correct jurisdiction, the Washington State Department of Revenue must know, with accuracy, the jurisdiction of the delivery. Unfortunately, in many instances, it is difficult for the Department of Revenue to know this information. The most reliable information the Department has about the sale is the zip code where the delivery was made. However, in instances where zip codes cross jurisdictional boundaries, the possibility exists for errors to be made in allocating sales tax revenues to the proper jurisdiction.

An example of an instance where sharing zip codes may be advantageous for one city and disadvantageous for another is the case of zip code 98056. This zip code encompasses a large part of the City of Newcastle, but the majority of the zip code covers areas of the City of Renton, a larger and more established city. The City of Newcastle believe that this circumstance leads to Newcastle receiving fewer allocations of sales tax dollars than they would receive if all sales were perfectly tracked to the correct jurisdiction. (Note that, if Newcastle is correct in their assessment, then that means that the City of Renton is benefiting from sharing the zip code 98056 with Newcastle.)

As it happens, a City of Fairwood may actually benefit from being in a zip code that extends outside of city boundaries. If it incorporated, Fairwood would be the principle population center, the principle commercial center, and virtually the only city to which zip code 98058 applies (the zip code extends into rural areas to the west, and includes a slice of the Cascade area to the east). As a result, if any errors are made regarding the allocation of sales to addresses in the 98058 zip code, one might expect a City of Fairwood to benefit.

Retail Sales Tax – Criminal Justice

RCW 82.14.320 and 82.14.330 authorize a dedicated sales tax to support criminal justice expenditures. In 1992, voters in King County approved a one-tenth of one percent sales tax levy specifically for the purpose of raising revenue to support criminal justice expenditures. This 0.1% sales tax is collected by the state's Department of Revenue and is distributed, through them, to the county, which in turn passes 90% on to cities on a per capita basis. The county retains 10% for its criminal justice function.

From 1994 to 1999, criminal justice sales tax revenues were increasing rapidly, growing from about \$14 per resident in 1994 to \$23 per resident in 1999. Since 1999, distributions have generally hovered around \$20 per resident. Estimates of criminal justice sales taxes used in this analysis assume a distribution of \$20 per resident in 2005, with future distributions growing at a rate of 4% per year thereafter. Because criminal justice sales tax revenues are generated countywide, a 4% per-capita increase means that taxable sales in King County are assumed to grow by 4% per resident, which is slightly less than historical averages.

State-Shared Revenues

All cities and towns in Washington State are eligible to receive certain "shared" revenues on the basis of their population. These state-collected revenues derive from liquor receipts (both profits from liquor sales and liquor taxes and from the Motor Vehicle Fuel Tax (the gas tax). As a group, Washington cities and towns receive a fixed percentage of these source revenues, and that fixed percentage is then allocated to the individual cities on a per capita basis. (For shared profits from liquor sales, as an example, Washington cities and towns as a group receive 40% of the total profits. This lump of money is then distributed to the individual municipalities according to their respective populations.)

Shared revenue sources include:

- Liquor Excise Tax
- Liquor Profit

- Unrestricted Gas Tax
- Criminal Justice Revenues – General

Estimates of state-shared revenues in 2006 and 2007 are based on projections published by the Municipal Research & Services Center in their publication *Budget Suggestions for 2006* (recognizing a slight dilution effect on allocations from the addition of Fairwood to the distribution pool). Future year revenues assume no growth in per-resident distributions.

Certainly, an assumption of no growth in revenues will not turn out to be strictly accurate; there will doubtless be some variation in each of the per capita funding levels from year to year. However, historical trends suggest that, on net, per resident distributions have grown little, if at all.

Liquor Excise Tax

According to Washington State law, a share of the state collected excise tax on liquor is distributed directly to cities on a per capita basis. In order to receive both liquor excise tax distributions as well as liquor profit distributions, a city is required to spend at least 2% of those distributions to support an approved alcoholism or drug addiction program. We have provided for this required expenditure in our projected miscellaneous expenditures. Liquor excise tax distributions are made on a quarterly basis, on the last day of January, April, July, and October. Currently the consultants at the Municipal Research and Services Center (MRSC) project the per capita distributions for liquor excise taxes to be \$3.93 in 2006 and \$4.13 in 2007. Accounting for the dilution effect of adding Fairwood to the distribution pool, we estimate distributions of \$3.90 and \$4.10 for 2006 and 2007, respectively. We then assume distributions of \$4.10 per resident for years 2008 through 2012.

Liquor Profits

Revenues Like liquor excise tax distributions, liquor profit distributions are made to cities on a quarterly basis. Liquor profits, however, are distributed in different months. Specifically, they are distributed on the last day of March, June, September, and December. The MRSC currently projects liquor profits distribution of \$7.41 in 2006 and \$8.06 in 2007. Accounting for the dilution effect on allocations from the addition of Fairwood to the distribution pool, we estimate distributions of \$7.36 and \$8.00 for 2006 and 2007, and \$8.00 for 2008 through 2012.

Motor Vehicle Fuel (Gas) Tax

A portion of the state-collected gas tax is shared directly with municipalities which bear a substantial portion of the overall costs of road maintenance and construction. The gasoline and diesel tax is a flat amount levied per gallon (rather than a percentage of the price at the pump), so even with increasing fuel prices, the state distributions may decrease if the number of gallons sold is decreasing by a greater percentage amount.

Prior to 2005, gas taxes were distributed in two parts: an “unrestricted” portion of these funds was disbursed to help defray the costs of street maintenance and a “restricted” portion was distributed to cities to maintain an “arterial” fund. However, with the passage of SB 5969 in 2005, all gas tax funds are now “unrestricted” for all cities, and beginning with September 2005 distributions, cities will receive only a single distribution. Cities with a population of 15,000 or more no longer have to spend

a portion of their gas tax on capital expenditures and can spend any portion on maintenance (of course, all the gas tax monies must still be spent for street purposes).

With the passage of the statewide 9-cent gas tax by the State Legislature in 2005, one penny of the gas tax increase will be split between cities and counties and will be phased in with a ½ cent in 2005-2006, and the second ½ cent in 2006-2007. This means a ¼ cent to cities the first year and a ¼ cent the second year. Cities can expect new distributions beginning at the end of September 2005.

Based on these changes to the law, MRSC estimates per-capita distributions of the gas tax for cities to be \$23.69 in 2006 and \$25.44 in 2007. Accounting for the dilution effect on allocations from the addition of Fairwood to the distribution pool, we estimate distributions of \$23.53 for 2006 and \$25.27 for 2007 and beyond.

Criminal Justice Revenues

With the repeal of the Motor Vehicle Excise Tax, the only city distributions for criminal justice come from portions of proceeds of revenues collected under state statutes RCW 82.14.320 and 82.14.330. Seventy percent of revenues under RCW 82.14.330 are distributed on a per-capita basis, distributed under two headings: (1) Criminal Justice – Former CTED Programs and (2) Criminal Justice – Population Based. Although the names of the distributions suggest that only the latter is distributed on a per capita basis, in fact, state law dictates that funds under both headings be distributed to cities on a per-resident basis. Municipal Research & Services estimates that these distributions will sum to \$0.97 per resident in 2006 and \$0.99 in 2007. Accounting for dilution effects on allocations from the addition of Fairwood to the distribution pool, we estimate distributions of \$0.96 in 2006 and \$0.98 for 2007 and beyond.

Summary of State Shared Revenues

Applying the above estimated distribution levels to our baseline population estimates, we have arrived at the following projections for State Shared Revenues:

Exhibit 14 Projected Per-Resident Distributions of State-Shared Revenues

	2006	2007	2008	2009	2010	2011	2012
New Unrestricted Gas Tax	\$23.53	\$25.27	\$25.27	\$25.27	\$25.27	\$25.27	\$25.27
Liquor Excise Taxes	\$3.90	\$4.10	\$4.10	\$4.10	\$4.10	\$4.10	\$4.10
Liquor Profits	\$7.36	\$8.00	\$8.00	\$8.00	\$8.00	\$8.00	\$8.00
Criminal Justice Revenues - General	\$0.96	\$0.98	\$0.98	\$0.98	\$0.98	\$0.98	\$0.98
Total	\$35.75	\$38.35	\$38.35	\$38.35	\$38.35	\$38.35	\$38.35

Source: Municipal Research & Services Center and Berk & Associates

Utility Taxes

Unlike counties in Washington State, cities are allowed to impose taxes on many of the utility services provided within the city boundaries. According to statute (RCW 35.21.870), cities in Washington State are allowed to tax private utilities such as telephone, natural gas, water, sewer, storm water, and

electricity, by action of the city council, up to a rate of six percent. This rate can be exceeded upon voter approval. No such statutory maximum applies to taxes/franchise fees on cable television, although cable television does enjoy certain protections against "discrimination" under current Federal statute. (King County currently imposes a 5% cable television franchise fee, and as we will outline later, we have assumed the City will continue this levy.)

For residential cities like Fairwood, utility taxes are generally the first or second most important revenue source, generating more revenue than retail sales tax. In King County, roughly 80% of all cities imposed a utility tax of some form in 2004, and across Washington State, more than 85% of cities who reported costs and revenues to the Washington State Auditor's Office levied such taxes. The list of cities levying utility taxes has grown in recent years, and given current fiscal pressures on many cities, one can expect that the list will continue to grow in years to come.

City administrations have a great deal of flexibility in how they levy utility taxes. A city council can choose structures ranging from the imposition of a single tax on a single utility, to the imposition of different tax rates on all qualifying utilities. In general, however, the two largest sources of utility revenues to cities in Washington State are electricity and telephone taxes.

The City of Normandy Park serves as a good example to envision the level of utility tax revenues the City of Fairwood might expect to generate if the City was to take full advantage of its default utility tax authority (see Exhibit 17).

**Exhibit 15
Utility Taxes Per Capita in Normandy Park, 2003**

	Revenues Per Capita
Phone	\$27
Electricity	\$25
Cable TV	\$14
Gas	\$11
Garbage	\$6
Water/Sewer/ Storm Drainage	\$4
Total	\$88

Source: Washington State Auditor Office

Normandy Park levies a 6% utility tax on telephone, cell phones/pagers, electricity, natural gas, garbage, cable TV, sewer, and recycling services. In 2003, the City of Normandy Park generated slightly less than \$90 per resident from these taxes, which would translate to roughly \$100 per resident in 2006. Since Fairwood has a similar level of commercial activity to Normandy Park (on a per-resident basis), one could expect that Fairwood could generate similar revenues per resident, although revenues will be affected by things like the rates the City negotiates with garbage collectors.⁹

⁹ A City of Fairwood would be required to honor the existing garbage contract for a period of seven years after incorporation, but at the end of that period, would be free to negotiate a new contract.

In order to maintain our baseline of using current tax burdens to assess feasibility (creating a balanced “same cost” framework), we assume that a new Fairwood City Council will impose utility taxes at a rate of 1.1% to make up the difference between the disappearing road tax levy and the new City property tax that is limited by state law. As we outlined in prior sections, the 2005 King County road tax levy for is \$1.83 per \$1,000 of assessed value, while our assumed City levy is set at \$1.60. In 2005, this difference of \$0.23 between the two levies translates into taxes of \$510,000. Based on our estimates of taxable utility revenues in Fairwood, we project that a tax of 1.1% on all taxable utilities would generate the \$510,000 necessary to “make up” the reduction in property taxes.¹⁰ For 2006 through 2012, we project that utility taxes that are levied at a given rate will increase at a rate of 3% per year—which, based on Berk & Associates’ review of State Auditor’s Office records, is consistent with the recent experiences of other cities.

The City of Fairwood will have the option of imposing utility taxes that would generate more revenues than assumed above. In fact, as we noted above, many cities in King County do raise substantial revenues through utility taxes. We estimate that, if Fairwood chose to levy the full 6% on all utilities then the City would generate roughly \$2.75 million in utility tax revenues in 2006. Since the feasibility model only assumes a 1.1% levy, enough to generate slightly more than \$500,000 per year, this means that the City of Fairwood would have a “cushion” of utility tax capacity in excess of \$2 million.

¹¹

Cable Television Franchise Fees

While Washington State counties are not allowed to impose utility taxes, they are allowed to impose franchise fees, and at the present time, King County does impose such a fee on cable television [authorized by the Cable Communications Policy Act of 1984, §622(a),(b) 47 U.S.C. §542 (a),(b)]. Currently, residents of unincorporated King County pay a 5% franchise fee as part of their charge for cable service. We have assumed that a newly incorporated City of Fairwood would replace King County’s franchise fee on cable television with a 5% fee of its own. Based on current and projected receipts in other cities, as reported by the Washington State Auditor’s Office, we project that Fairwood will generate cable franchise fee revenues of \$8.50 per resident in 2005. For 2006, through 2012, we project that per-resident revenues will grow at a rate of 3%, resulting in an estimated \$10.45 per resident in 2012.

¹⁰ Berk & Associates’ estimate of the necessary utility tax rate to generate the desired revenues is based on a series of multi-factor regression analysis of many cities in King County and across Washington State. The goal of the regression analysis is to identify how the unique characteristics of each city contributes to the generation of taxable utility revenues.

¹¹ Berk & Associates’ analysis relies on property tax levy lid increases rather than utilizing a maximum 6% utility tax, because addressing the property tax issue directly leaves more future revenue options open to a future city, and because a utility tax strategy alone does nothing to protect a city from an eroding property tax base, and once the maximum utility tax amount is levied, that tax option is at capacity.

Taking into account assumed population growth, cable franchise fee revenues are expected to equal \$240,000 in 2007, growing to \$293,000 in 2012.

Community Development Block Grants

If residents of the Fairwood area choose to incorporate in 2006, the new City of Fairwood will be invited to join the King County Community Development Block Grant (CDBG) and HOME Investment Partnerships Consortia as a “pass-through” city. This would entitle the City to receive a direct share of the federal CDBG funds to allocate to local needs, which primarily benefit low and moderate-income persons.

In 2007, in order to qualify as a pass-through city, the City will need to develop a strategic plan, which meets HUD requirements and an allocation process for distribution of their anticipated CDBG funds. The Plan will include an assessment of the City’s housing and community development needs and adopted strategies for addressing those needs.

If the City becomes a pass-through city in 2007, based on an analysis of the pattern of receipts of other cities, as reported by the Washington State Auditor’s Office, we estimate that the City would receive distributions equal to \$6 per resident. To balance these estimated revenues, we include an equivalent City expense for provision of human services. Given the required uses of these revenues, an increase or decrease in Block Grant revenues would not affect other portions of the City’s general fund budget.

Since the working assumption is that the City’s Human Services expenditures represent the City’s use of CDBG revenues, if CDBG revenues are higher or lower than estimated, the only financial effect the difference will have on the City will be a reduction in the City’s Human Services expenditures.

Building Permit Revenues

Upon incorporation, the responsibility to provide land and building regulation within the boundaries of the City of Fairwood will transfer from the County to the new City. Coincident with this new responsibility, the City will be the recipient of all new revenues generated through the issuance of building and land use permits.

At that time, the new City will have to establish its own fee structure for building and land regulation. As a matter of policy, King County has adopted a “full cost recovery” model, meaning that the County’s goal is to cover the costs of regulation through the revenues generated by its permitting and inspection activities. Of course, whether or not the City of Fairwood will choose to work from the same philosophical basis is ultimately a question of policy for the new City Council to decide.

Over years of working with Washington cities, Berk & Associates has talked with more than a dozen different cities about their experience regarding cost-recovery of permitting. The experience of other recently incorporated cities in King and other counties has been that they have been able to cover their full costs of staffing a building and land use desk through permit revenues. For this assessment, we use a slightly more conservative assumption that 90% of the costs of planning and permitting will be recovered through permit revenues. However, this cost recovery does not include the City’s senior planner, whose cost is included in the costs of City Hall staffing.

Based on an assumption of modest housing and commercial development during the period, and based on comparisons with fees generated in other jurisdictions like Sammamish, Newcastle, Covington, Maple Valley, and King County, we estimate permit revenues of slightly less than \$470,000 in 2006. Given our assumed 90% cost recovery rate, this level of activity would drive planning and permitting costs of \$520,000 for the same year. For future years, we permit revenue increases of 4% per year—a rate of increase that parallels growth in permit revenues.

Interest Income

Estimates of interest income are based on an assumption that, in 2007, the City of Fairwood will generate a 3% return on average interest-earning funds of \$2 million, and by 2008, the City will have accumulated interest-earning revenues averaging \$3 million. From 2008 through 2012, the model assumes modest annual growth in interest income of 3%.

As discussed previously, we recommend that, if incorporation should occur, the City of Fairwood would be well served to examine the experiences of the cities of Kenmore and Edgewood in city start-up. Both of these cities followed a “go-slow” approach that allowed them to build millions of dollars of revenue reserves. For example, in its first few years of incorporation, Edgewood, a much smaller city than Fairwood, with a more modest tax base, accumulated in excess of \$4 million of reserves. Given that experience, one might expect the City of Fairwood to be able to build reserves of much more than \$3 million in its first few years of operation.

The analysis of start-up revenue and expenses suggests that, by January of 2007, the City of Fairwood should have an accumulated cash position of \$1.5 million and, by December 2007, that figure will grow to more than \$2.5 million. By mid-2008, if Fairwood carries out a go-slow start-up strategy, the City should be able to achieve an accumulated cash position well in excess of \$3 million.

Gambling Taxes

State statute provides that cities and towns that choose to allow gambling activities within their boundaries may tax the revenues generated by those activities. Based on data provided by King County, establishments within Fairwood currently generate slightly less than \$40,000 in gambling taxes. Based on the “same cost” framework, the model used for assessment of feasibility assumes that the Fairwood City Council would levy gambling tax rates that are line with what King County currently levies. As a result, the model estimates the similar levels of gambling tax revenues. Based on analyses of gambling tax revenues in cities across Washington State, projections of gambling tax revenues assume 3% annual growth.

Revenues Not Included in Core Operating Costs and Revenue Projections

Beyond the City's core operating revenues, which cover the costs of providing most of the City's day-to-day provision of services, the City of Fairwood will also generate dedicated revenues to fund operating and capital costs for surface water management (SWM) and revenues that will be available to fund capital investments [real estate excise taxes (REET)]. Another revenue source that is included in virtually every city's capital investment planning process are state and federal grants.

Surface Water Management Fees

Under the system currently in place, King County's Water and Land Resources Division administers the surface water management (SWM) program in portions of King County in pursuit of dual goals: the preservation, protection and enhancement of surface water resources such as streams, lakes, and wetlands; and the management of the impacts of flooding on persons and property. The County funds these activities through fees that are imposed on all developed property within the designated SWM Program services area (unincorporated King County). For single family residences, the fee is currently a flat rate of \$102, collected as a distinct line item on property tax bills.

Currently, \$10.57 of the \$102 total is dedicated to repayment of debt service on SWM bonds in the urban portion of the service area. By statute, when a portion of the SWM service area is incorporated, the properties within the incorporation area continue to pay to King County the debt service portion of the service charge until the debt is retired. Cities can choose to pay the debt service by interlocal agreement, rather than direct residential billings from King County.

Upon incorporation, the City of Fairwood will have the option of entering into an interlocal agreement with King County for continuation of day-to-day SWM services. Alternatively, the City government could choose to operate the program on its own. We assume that the City will contract with King County for SWM services, and that, as part of its start-up, the City Council will enact fee structures consistent with those currently in place. Based upon an incorporation date of September 1, 2006, the City of Fairwood is currently slated to receive SWM fee revenues for the final quarter of the year. By statute, although the City would be in existence throughout the month of September (which falls in the third quarter), King County maintains the right to receive all third quarter revenues. Assuming that the City will want to enter into an interlocal agreement with the County, however, receipt of these revenues may be subject to negotiation.

King County has provided revenue information for the proposed City of Fairwood indicating imputed SWM revenues in 2006 of \$1,094,418. This figure represents the sum of collections from private entities together with collections from the State and County for their transportation facilities. The figure also excludes the portion of SWM revenues that is dedicated to bond repayment.

Projected SWM revenues assume an annual growth rate of 3% for existing properties plus 1% growth associated with assumed new development. In fact, Surface Water fees do not increase at a regular rate. Rather, they change based on policies that are set by King County or the City Council. However, since it is difficult to forecast when the County will again raise surface water fees, and by how much, we opted for an assumption that surface water fees will increase at roughly the rate of general inflation.

Surface water management revenues must be used by a city for specific purposes. First among those purposes, of course, are the day-to-day costs of providing of a range of surface water program services. Once these day-to-day costs have been subtracted from net revenues, however, there should still be a substantial sum of money available. These funds can be used for two purposes: First and foremost, funds should be used to pay for surface water management capital investments; secondarily, however, remaining SWM funds can legitimately be used to defray the cost of maintenance or construction for roads that relate directly to the surface water management system.

For purposes of this assessment, however, we have not assumed any transfer of SWM revenues for roads maintenance expenditures.

Real Estate Excise Taxes

The Real Estate Excise Tax (REET) is levied on all sales of real estate, applied to the full sale price of the property in question. According to state law (RCW 82.45, 82.46), a city that is required to plan under the Growth Management Act can levy a Real Estate Excise Tax totaling 0.5% of the selling price of the property. The first 0.25% of the Real Estate Excise Tax must be used to fund capital facilities expenditures that have been identified in the city's comprehensive plan. The second 0.25% REET revenues must also be used to fund capital facilities, with the added stipulation that they cannot be used for the acquisition of land for parks.

Projections of the REET revenues that would be generated in Fairwood are split into two components:

1. Revenues that accrue from the sale of existing property and non-residential development; and
2. Revenues that are tied to assumed population and housing growth.

Berk & Associates' analysis of property transactions in Fairwood finds that, from 2000 through 2004, the average value of transactions for existing property in Fairwood approached trended up each year, reaching \$300 million in 2004. This estimate excludes the value of new housing that was constructed in each year, which averaged roughly \$50 million per year over the same period. This estimate also converts sales prices for 2000 through 2004 to 2006 dollars based on assumed 7% annual growth in values of real property between 2000 and 2006.

Given this analysis, and given the increase in housing prices in the past year, the revenue model assumes that, in 2006, REET revenues from resale of existing properties in Fairwood will generate \$1.5 million. REET revenues from new housing construction are based on assumed population growth (275 people per year) and assumed assessed value per new resident (\$100,000 in 2005, assumed to grow by 7% in 2006, and then by 5% annually from 2007 through 2012). Reflecting market expectations for housing price growth in coming years, REET revenues are projected to grow by 5% each year from 2006 through 2012.

In total, we project REET revenues of roughly \$1.65 million in 2006, growing to \$2.21 million by 2012.

Bonds

Another option that cities have for raising capital revenues is through the issuing of municipal bonds. In effect, the city takes out a loan for a lump-sum of capital revenues and agrees to repay that loan over an extended period (often a period of 20 years). If Fairwood were to issue a bond with the expectation that it would use \$1 million of REET revenues to repay that bond, then at current bond rates, the City could expect to generate more than \$11 million. (At a bond rate of 6.0%, sale of a 20-year bond with an annual service payment of \$1 million would generate about \$11.5 million).

It is important to note that bond revenues do not represent "new money" to a city. Rather, bonds allow cities to access funds today, to cover the costs of an immediate need, at the cost of handing over a set amount of future revenues.

State and Federal Grants

Most cities in Washington State seek to leverage their existing capital dollars by pursuing grants from Washington State and from the federal government. Success in competing for grant revenues is hit-and-miss, which means that grant revenues tend to fluctuate wildly from year to year. However, based on historical analysis of cities between 20,000 and 35,000 people in Washington State, we estimate that, on average, Fairwood will garner grant revenues equal to \$25 per city resident. Looking to future years, we assume that these per-resident revenues will grow at a rate of 3% per year, reflecting the rate of general inflation.

Transportation Impact Fees

To mitigate the increased demand on transportation networks accompanying development, cities can impose transportation impact fees under RCW 82.02.050. In order to do this, however, a new city must have a comprehensive plan which includes, among other things, assessments of the current transportation system, projected transportation facilities needs, and projections of the costs of addressing developmental impacts in specific areas.

When considering impact fees, the City of Fairwood will have a choice between participating in King County's Mitigation Payment System, or creating its own impact fee system. Given the time it takes to develop a city Comprehensive Plan, however, the latter path will take some time to implement.

This analysis does not include estimates of impact fees, but depending on how the City chooses to proceed, such fees may be available to defray costs of transportation investments.

Optional Revenues

In the previous section, we have examined the revenues we would expect the City of Fairwood to receive if the City were to pursue a policy of maintaining taxes at their current rates. This does not mean, however, that the City of Fairwood could not choose to increase its revenues. If the City desired to raise additional revenues, it could do so through, among other means, a property tax – excess levy, additional utility taxes, business and occupations taxes, or, potentially, a gambling tax. For a complete discussion of revenue mechanisms available to cities, the Municipal Research and Services Center (MRSC) has a useful revenue guide and website available to cities as a resource.

Property Tax – Excess Levy

As a newly incorporated city, the proposed City of Fairwood would not have any excess levy upon incorporation, and would probably not seek one within the horizon of this analysis. State law, however, does provide room for excess levies approved by the voters within the city.

A city can present a ballot measure to voters for the approval of an excess levy under two conditions: for a special purpose, or for general government purposes with the stipulation that the approved excess levy must be limited to one year. For the latter, it is not necessary for the city to specifically identify the proposed use or uses of the excess funds. In order for excess levies to be accepted, however, the ballot must be approved by sixty percent of the total votes cast, and there must be a voter turnout of at least forty percent of the last general election.

With the passage of Initiative 747, there are only two ways for a jurisdiction to increase property taxes by more than one percent. Some jurisdictions have taken less than the maximum increase they could have in the past and have "banked" capacity that they can use. The other way to increase property taxes by more than this amount is to do a levy lid lift under RCW 84.55.050. During the 2003 legislative session, that statute was amended to allow a lid lift for multiple years.¹² Cities now have the option of seeking a voted lid lift that applies for six years. Under such a multi-year lid lift, cities can design a lift that will inflate each year, thereby counteracting the eroding effects of I-747.

If it so desired, a city with an initial levy rate of \$1.60 could pass a multi-year lid lift that would hold its levy at that same \$1.60 for six years. Given new authority to pursue multi-year lid lifts, most cities in Washington that seek levy lid lifts now pursue such six-year lifts. Given the practical benefits, we expect that, in reality, Fairwood would also pursue six-year lid lifts (perhaps beginning the first year after incorporation to ensure that the City would be able to maintain its \$1.60 rate). This reality notwithstanding, however, for our modeling of feasibility, we assume a one year lift, voted on in 2009, which allows us (1) to clearly demonstrate the eroding effects of I-747 and (2) to highlight how a lid lift works as a fiscal instrument.

Property Tax – Levy Capacity from Fire District Annexation

In the event of incorporation, the most likely scenario and most financially feasible for the new City of Fairwood would be to annex to one of the fire districts to continue to provide service, most likely Fire District 40.

By annexing to a fire district, the new City of Fairwood would be making essentially a long-term decision by the city not to provide its own fire protection services. The city would annex to a district through an election as outlined in the fire expenses section, above. If the city annexes to a fire district, the annual property tax imposed by the district would apply throughout the district, including the city. Fire District 40's 2005 levy rate is \$0.99 per thousand AV, and the maximum regular levy that a district may impose is \$1.50 per one thousand dollars of assessed value.

Recall that the maximum levy that a city may impose, which is \$3.60 per thousand dollars of assessed value when a city is annexed to a fire district, is reduced by the amount of the fire district levy, which commonly is the entire \$1.50 that could be levied. The shift in financing and responsibility for fire protection from the city to the fire protection district that comes from annexing to a fire district can be viewed as a potential benefit. This is because remaining fire district levy capacity can then be made available in future years for fire services with voter approval. In effect, by annexing to the fire district, the new city would create the property tax capacity to increase their levy to \$2.10 with voter approval, and with the caveat that if Fire District 40 were to end its benefit charge, that levy capacity would not be available to the City of Fairwood.

¹² Municipal Research & Services Center has more information about multiple year levy lid lifts which can be found at their website: <http://www.mrsc.org/subjects/finance/levyliftbudsugg.pdf>.

Additional Utility Revenues

For our baseline analysis, we have anticipated that the City of Fairwood would levy a small utility tax to make up the difference between the existing King County Road levy and the City property tax levy that would replace it. If the City chose to do so, however, it could increase utility taxes above the level we have anticipated. In fact, residents of many other cities do pay substantially higher utility taxes per person than we have projected for Fairwood.

Business and Occupation Taxes

While King County does not have the legal authority to impose business and occupation (B&O) taxes, the City of Fairwood could impose a variety of such taxes. As a Washington State city, the City of Fairwood would have the authority to impose a tax of up to 0.2% on the gross receipts of all businesses located within its boundaries (RCW 35.21.710). Most cities in King County choose not to impose this tax. As an alternative, the City has the option of developing some form of business licensing program. Such a licensing program might require all businesses to register with the City, whether as a one-time event or on an annual basis. As part of this registration process, the City could then impose a licensing fee.

Gambling Taxes

State statute (RCW 9.46.110) provides that cities and towns that choose to allow gambling activities within their boundaries may tax the revenues generated by those activities. To the best of our knowledge, there are currently not major gambling establishments within the proposed boundaries of the City of Fairwood, but a small amount of revenue would be available from punch-cards and pull-tabs based in current County revenues from gambling taxes in the incorporation area and *is* estimated in the baseline financial plan for the proposed City.

The State of Washington regulates and licenses gambling, and a city's role is limited to allowing or banning social card game rooms. Some cities have placed moratoria on social card game rooms, but recent court cases concerning the status of card rooms in Kenmore and Edmonds will probably force all cities with moratoria to either ban or allow gambling in their cities. Ultimately the choice to allow or ban gambling activities in the City will be a policy choice of the City Council. If gambling were to be allowed, however, it would continue to be a potential source of revenue for the City.

6. OPERATING EXPENSES

Given the revenues that the proposed City of Fairwood could generate, and assuming the same tax burdens as residents face today, the following section reviews in detail the assumptions we made for the complement of municipal services that city would provide. As discussed throughout this report, modeled service levels, and therefore costs of service, were driven by a desire to remain consistent with the “same cost” framework. In other words, modeled costs reflect the costs of providing levels of services that are consistent with what Fairwood residents would receive if they remained part of unincorporated King County.

There are many ways that a City of Fairwood could structure the services Fairwood residents receive. For this analysis, the analysis team has assumed that, like many recently incorporated cities, the City of Fairwood would choose to annex to existing special service districts for provision of fire and emergency medical services, water and sewer services, and library services. The analysis assumes that remaining city services would be provided by the City of Fairwood, either directly or through contracts with other service providers such as King County. In particular, this analysis models feasibility under an assumption that the City would contract with King County for police and jail services, municipal courts, roads operation and maintenance, and surface water management.

In some instances, estimates of costs are based directly on cost data that have been provided by the King County departments that the model assumes will be the provider of the service, through contract with the City. In other cases, estimates of costs are built from the ground up, based on variables like the acreage of parks that will require maintenance.

For future-year estimates, the model assumes that the core costs of providing a set level of services will increase by 4% per year. This is a rate that exceeds the rate of general inflation, reflecting the fact that most city services are labor-intensive, and due to efficiency gains in the private sector, the costs of labor tends to increase at a rate that exceeds inflation. Another factor that drives escalation in city costs is the growing cost of health insurance. On the other hand, it is also true that technological innovation and emerging efficiencies in service provision serve to mitigate some of the labor cost increases.

Given all of the forces at work, and based on our work with dozens of cities, we believe that a core cost-escalation assumption of 4% is most reflective of the reality of what cities face. Our assessment that a core 4% cost escalation for city services is appropriate is the result of *many* conversations with city managers, finance directors, city council members, budget analysts, and members of the public. In the wake of all of those debates, Berk & Associates has found that a core escalation rate of 4% is the rate that best stands up to critiques from both sides of the issue.

In addition to cost escalation for providing a given level of service, in a few instances, the model also assumes that certain services will grow at a rate in excess of 4%, with that growth being driven by increases in City population. Due to varying economies of scale, the *incremental* costs of serving, say, an additional 100 residents is generally less than the city's *average* cost per 100 residents. For services like Police and Road Operation and Maintenance, the model assumes a growth driven elasticity of 0.75. This means that, for every 1% growth in the City's population, the cost of those services increases by 0.75%.

In a year when Fairwood is expected to grow in population by 1%, then, the costs of providing police services is projected to increase by slightly more than 4.75% (the combined effect of 4% growth in core costs and the 0.75% increase in costs due to growth). As with the estimated rate of core costs, the model's estimates of cost-escalation from population growth are based on Berk & Associates' work with cities across Washington State.

General Administration

One of the single largest expenses the City of Fairwood would face upon incorporation is the cost of administering the City. With salaries to be paid and benefits to be provided, along with all of the costs of facilities, supplies, and equipment, the administration of a city meeting various service demands will come with associated costs.

Other recent incorporations in King County are instructive about the costs of administration. In practically every case, when we compare the costs of administration as projected by the feasibility study with the costs actually incurred by the cities after they incorporate, the actual costs exceed the analysts' forecasts by a substantial margin. Of course, having noted this discrepancy, we need to remember that the goal of this feasibility analysis is not to predict what the City of Fairwood might *choose* to spend on administration, but rather, to estimate the level of expenditures that would be consistent with providing a level of service equal to, or slightly greater than, that which residents of the area are currently receiving.

Estimates of salaries for specific positions were generated by taking the 85th percentile of the actual salary range as reported by the Association of Washington Cities' Salary Survey and then rounding the number *up* to the nearest \$5,000. City Hall staffing includes 25 staff positions that will cover the City's legislative and administrative functions as well as the highest-level City staff positions in planning, parks and recreation, public works, and the City engineer. As discussed below, we explain that a "go-slow" approach to hiring will allow the City to build up financial reserves; and our aim to develop City Hall staffing levels that best approximate the level of local government services the Fairwood area would see if it remained unincorporated (under the "same cost" framework).

City Council

Assuming that the City of Fairwood chooses to incorporate as a Council/City Manager government, the City will have a seven-member Council elected by voters living within the boundaries of the newly incorporated City. We have assumed that the members of the Council and the Mayor will serve part-time. The Mayor would be elected by the Council as directed under 35A.13.030 RCW. Upon election, the Mayor will preside over Meetings of the Council, and serve as the ceremonial leader of the City. By statute, upon incorporation the City of Fairwood will be required to compensate the members of the Council at a rate of \$5,400 per year and the Mayor at a rate of \$6,000 per year. For our analysis, we have assumed these salary rates.

City Manager's Office and General Administration

In the Council/City Manager form of government, it is assumed that the City Council has only one employee: the City Manager. The City Manager, then, is ultimately responsible for hiring, supervising, and the dismissal of all further staff. We have projected staffing for the administration of the City of 25

full time employees in the base year. This staffing level, as outlined in the following table, includes staffing for the City Manager's Office, for the City Clerk's Office, Finance, Engineering, Planning, Information Systems, and for oversight of Parks and Recreation.

As discussed in the examination of *Start-Up Financing* (Chapter 8), we envision that a new City of Fairwood would be deliberate in its hiring of City staff. Such a go-slow approach will allow the City to build up a reserve to serve as a financial cushion in years to come. This means that, although the baseline assessment of feasibility estimates general government costs of nearly \$2.5 million, the City could (and perhaps should) see costs that are significantly lower than that as it slowly ramps up.

While staffing levels for the proposed city are lower than levels in many existing cities, it is important to note that under a "same cost" framework, the goal of this assessment is not to model staffing levels of one or another existing city, but rather, to develop City Hall staffing levels that best approximate the level of local government services the Fairwood area would see if it remained unincorporated.

Clearly, it is difficult to estimate what level of City Hall staffing would provide the levels of local governance services that Fairwood residents now receive. The analysis team has modeled a relatively bare-bones level of City Hall staffing, reflecting the reality that, although County staff do their best to provide responsive service to all of the County's residents, Fairwood residents do not typically expect a great deal of County attention to be focused on local governance issues in Fairwood, especially given the County's Annexation Initiative and messages to unincorporated communities of recent years. This bare-bones staffing level is somewhat higher than assumed staffing levels in prior incorporation analyses, and higher than staffing levels that might be found at some poorer cities across the state. Overall, however, this staffing level is less than one would observe at many cities. Based on our experience working with unincorporated area residents in Fairwood and many other unincorporated areas across the state, we believe that even this minimal staffing level would represent an increased level of service in terms of the amount of undivided attention that is spent on issues of local governance in Fairwood.

In addition, the expense estimates include in other expenditure categories a number of additional staff who might be considered City Hall staff in some cities (for example, estimated expenditures in excess of \$500,000 for Permitting and Land Use would fund a number of staff positions that might be considered general government staff in some cities).

Exhibit 16 summarizes estimated staffing for a base year, with costs estimates that are consistent with 2005 costs. For future years, general government costs are assumed to grow at a rate of 4% per year.

**Exhibit 16
Staffing and Cost Assumptions for City Hall Staffing (Base Year)**

Staffing Levels and Salaries

	Monthly Salary Range		Full-Time Equivalent (FTE) positions	Annual Salary	Total
	Low	High			
	City Manager	7,177			
Management Assistant	6,354	8,253	1	\$100,000	\$100,000
Director of Administration & Finance	5,946	7,428	1	\$90,000	\$90,000
Accountant - Senior	3,747	4,662	1	\$55,000	\$55,000
Accounting Clerk	2,883	3,607	1	\$45,000	\$45,000
City Engineer	5,532	7,007	1	\$85,000	\$85,000
Engineer Tech	3,297	4,120	2	\$50,000	\$100,000
Public Works Director	6,140	7,688	1	\$90,000	\$90,000
Community Development Director	5,651	7,081	1	\$85,000	\$85,000
Computer Support Specialist	3,101	3,849	1	\$45,000	\$45,000
City Clerk	3,868	4,845	1	\$60,000	\$60,000
Legal Secretary	2,928	3,587	1	\$45,000	\$45,000
Administrative Secretary	2,918	3,636	2	\$45,000	\$90,000
Receptionist	2,330	2,846	1	\$35,000	\$35,000
Senior Planner	4,246	5,383	1	\$65,000	\$65,000
Parks Maintenance Supervisor	3,764	4,692	1	\$55,000	\$55,000
Recreation Coordinator	3,066	3,833	1	\$45,000	\$45,000
Miscellaneous FTEs			6	\$50,000	\$300,000
<i>Council Members</i>	<i>6</i>			\$5,400	\$32,400
<i>Mayor</i>	<i>1</i>			\$6,000	\$6,000
Total			25		\$1,533,400
Benefits					\$460,020
Benefits as % of Salaries			30%		
Facility Costs					\$106,250
Cost per square foot			\$17		
Square Feet per FTE			250		
Operating Supplies					\$153,340
Supplies as % of Salaries			10%		
Phone Expenses					\$25,000
Cost of phone per FTE			\$1,000		
Computers					\$33,213
Computer cost per FTE per year			\$1,329		
Furniture					\$18,292
Furniture cost per FTE per year			\$732		
Vehicle Lease					\$30,000
Number of vehicles			5		
Cost per vehicle per year			\$6,000		
Vehicle Operation & Maintenance					\$20,000
Number of vehicles			5		
Vehicle O&M cost per year			\$4,000		
TOTAL COSTS OF GENERAL ADMINISTRATION					\$2,379,515

As shown in Exhibit 16, we have included 6 full-time equivalent (FTE) positions designated only as "Miscellaneous FTEs," compensated at a rate of \$50,000. Clearly, the new City Manager will have his or her own ideas about appropriate City Hall staffing levels. Our intention here is only to estimate a reasonable headcount that slightly exceeds current levels of services Fairwood residents receive as an unincorporated area in King County, and is adequate to provide a baseline level of services assumed under a contract city model.

Salaries and Benefits

We arrived at the above salary assumptions, first by calculating the 85th percentile of the salary range reported in the Association of Washington Cities' Salary Survey for each position, and then, by rounding that figure *up* to the nearest \$5,000. Our projected total cost of salaries in the first full year of incorporation comes to slightly more than \$1.5 million. We assume that the cost of benefits will be equal to 30% of salaries based on a review of the Washington State Auditor's Office records, which show that for cities within King County, the weighted average ratio of general fund benefits to salaries was 25% in 2004 (excluding Seattle).¹³

Supplies and Equipment

Estimated costs for supplies and equipment are based on Berk & Associates' analysis and experience, and based on our work with cities across Washington State. For costs associated with phones, office furniture, and computers, we have derived projected expenses on an annual per-employee basis. For phone expenses we have estimated annual costs of \$1,000 per FTE. For furniture, we assume an annualized cost of \$732 per year. This figure was arrived at, first, by estimating furniture costs of \$3,000 per employee, and second, by assuming that the useful life of this furniture would be five years. Given these figures, we annualized the costs by amortizing the \$3,000 over 5 years at a 7% interest rate. For computers, we estimated annual costs per full time employee of \$1,329. This figure assumes computer costs of \$4,500 per employee and an average useful life of computers of 4 years. On top of the projected costs of phones, furniture, and computers, we added an expense category for general supplies. We estimate supply costs equal to 10% of salary costs.

Vehicles

For many of the positions identified in our administration staffing, an integral part of their job will require at least the part-time use of a vehicle. We project that the City will want to lease five vehicles, at an annual cost of \$6,000 per vehicle. For operation and maintenance of the vehicles, we estimate annual expenses of \$4,000, each. The total costs of having a vehicle at the City's disposal is then \$10,000 per year.

Facilities

Projections of the costs of City Administration facilities have been directly tied to our estimates of staffing levels. We have assumed that the City will need 250 square feet of office space for each full

¹³ If one includes Seattle in the analysis, the weighted average is much lower, but the figures reported in the State Auditor's database for Seattle appear to be suspiciously low.

time employee it hires. We have also assumed an annual lease rate of \$17 per square foot, which is consistent with the going rate in the area. Given our staffing projections, we have therefore estimated facilities costs of about \$106,000 per year. Of course, if the members of the City Council saw fit, they could choose at some point to purchase land and construct a new City Hall. If they were to take this step, then the above funds could be viewed as expenditures to cover debt service on City bonds.

City Attorney and Prosecution Services

The City of Fairwood would likely contract with local firms for City Attorney services and prosecution services. Estimated costs of City Attorney services are based on comparisons with the cities of Kenmore and Sammamish, which currently contract for City Attorney services, and bear annual cost of \$400,000 and \$425,000, respectively.

The actual costs the City will bear will depend heavily on the level of services the City requires. If the City wishes to have an attorney present at meetings every night of the week, then the costs of these services would be greater than if the attorney's services were only required a few days a week. Law firms indicate that the City will need to contract for City Attorney services at least four or five months prior to the official date of incorporation to help with the drawing up of the interlocal agreements needed upon start-up.

Future-year costs assume 3% annual growth in the City Attorney contract.

Public Safety

Police

The second largest line item listed in our projection of expenses is for Public Safety. The costs of providing this service represent a little more than one quarter of the entire costs of running the City of Fairwood.

Certainly, among residents of Fairwood, there will be differing opinions on what would be the optimal level of public safety services provided. As with all other services, however, our goal here is not to recommend an optimal level of service, but rather to estimate the costs the proposed City could expect to incur were it to provide the same, or slightly higher, level of service than currently prevails in the area. From this baseline level, given the available funds, a City of Fairwood might choose to expand and extend its public safety services. In our estimates of public safety expenses, we assumed that the City of Fairwood will contract with King County for all service areas. At some point in the future, the Fairwood City Council might weigh the benefits and costs of having the City provide its own Public Safety services, but presumably they would only do so if they believed that the move would *improve* the City's position. Therefore, our contract assumption remains a reasonable baseline from which to work.

As a municipality, the proposed City of Fairwood would be required to provide for the protection of people and property within the City boundaries. Currently, as part of unincorporated King County, Fairwood receives its police services from the King County Sheriff's Office. As part of the County's larger cooperative effort for this analysis, King County Sheriff's Office has provided us with examples of different contracting options might look like for the City of Fairwood.

Given the variety of contracting options available, upon annexation the Sheriff would be willing to negotiate with Fairwood for the provision of a wide range of service options. To inform this assessment of fiscal feasibility, the Sheriff's Office provided examples of what a contract might look like given alternative levels of service.

Exhibit 17 summarizes four representative contracts that are based on current service levels in the proposed incorporation area. The status quo option attempts to reflect existing service levels, with the addition of a City Police Chief. Alternatives A, B, and C provide alternative approaches to staffing, including dedicated patrols for the City. The examples retain all services currently being provided, including those that are optional under the contract. An explanation of the contract program and terms follows the chart. The city may choose not to purchase some optional services, and use the savings elsewhere in the budget or to purchase different police services such as additional patrol staffing.

Please note that these examples are provided as a point of reference only based on current interlocal agreements. Sheriff's Office police contracts are developed through lengthy discussions with city officials about the needs of the community and their vision of police service. For further explanation of differences between alternatives and other considerations surrounding police contracts, please see Appendix 1.

All four representative contracts summarized in Exhibit 17 include a City Police Chief. We believe that inclusion of a chief represents an increased level of service over what Fairwood currently receives, and therefore, a departure from our "same cost" baseline. However, we also believe that is not realistic to assume that a City like Fairwood could operate without having a Police Chief. Having the chief allows the City to secure grants, establish City police priorities (with the city council and manager), work on mandated plans such as emergency operations protocols, act as department head accountable to the City and its citizens, and ensure local representation in decision making. The chief can also help the City determine the appropriate staffing levels once the city is up and running.

Given our goal of assessing feasibility based on current tax burdens and existing or slightly improved levels of service, our cost estimates are based on the Status Quo alternative, with estimated costs of \$1.87 million. For 2006 through 2012, baseline costs are assumed to grow at a rate of 4%. In addition, police service costs are assumed to grow with population growth, under the assumption that 25% of the cost is independent of population growth. This suggests that, as population in Fairwood slowly increases over time, certain core functions will remain relatively stable.

Exhibit 17
Representative Alternative Contracts for Provision of Police Services

Model Examples (2005 figures)	Status Quo with City Chief		Example A		Example B		Example C	
	FTE	Cost	FTE	Cost	FTE	Cost	FTE	Cost
Required Services								
Shared Major	0.1	\$17,384	0.1	\$17,384	0.1	\$17,384	0.1	\$17,384
City Chief (Captain)	1	\$160,883	1	\$160,883	1	\$160,883	1	\$160,883
Shared Captains	0.2	\$32,092	0.2	\$32,092	0.2	\$32,092	0.2	\$32,092
Sergeants	0		1	\$137,129	1	\$137,129	1	\$137,129
Shared Sergeants	0.9	\$126,359	0.72	\$101,030	0.72	\$101,030	0.72	\$101,030
Patrol Deputies	0		6	\$742,663	9	\$1,113,994	12	\$1,485,326
Shared Patrol Deputies	6.44	\$796,661	2.15	\$265,554	0		0	
Detective Units	0.87	\$106,858	0.87	\$106,858	0.87	\$106,858	0.87	\$106,858
Precinct Facility		\$25,865		\$25,865		\$25,865		\$25,865
Major Crimes Unit	0.58	\$96,746	0.58	\$96,746	0.58	\$96,746	0.58	\$96,746
Communications (E-911)	2.29	\$236,357	2.29	\$236,357	2.29	\$236,357	2.29	\$236,357
Tactical Unit	0	\$0	0	\$0	0	\$0	0	\$0
Subtotal, Required Services	12.38	\$1,599,204	14.91	\$1,922,559	15.76	\$2,028,336	18.76	\$2,399,668
Services that are required, but cities choose whether to pay up front or per use								
K-9	0.34	\$52,696	0.34	\$52,696	0.34	\$52,696	0.34	\$52,696
Hostage Negotiation	0	\$0	0	\$0	0	\$0	0	\$0
Major Accident Response Unit	0.09	\$8,491	0.09	\$8,491	0.09	\$8,491	0.09	\$8,491
Subtotal, Other Required Services	0.43	\$61,187	0.43	\$61,187	0.43	\$61,187	0.43	\$61,187
Optional Services (represents current service level; other services are available)								
Storefront Officers	1	\$123,777	1	\$123,777	1	\$123,777	1	\$123,777
Domestic Violence Intervention Unit	0.28	\$48,287	0.28	\$48,287	0.28	\$48,287	0.28	\$48,287
Fraud, Forgery, Organized Crime	0.23	\$39,543	0.23	\$39,543	0.23	\$39,543	0.23	\$39,543
Subtotal, Optional Services	1.51	\$211,607	1.51	\$211,607	1.51	\$211,607	1.51	\$211,607
Total Staff/Cost (2005 Figures)	14.3	\$1,871,997	16.9	\$2,195,352	17.7	\$2,301,130	20.7	\$2,672,461
Population: 26,000								
Sworn per Thousand		0.4		0.5		0.6		0.7
Cost per Capita		\$72		\$84		\$89		\$103
Calls per Patrol Deputy		620.55		490.34		443.78		332.83
Minimum staffing per shift (assumes 3 shifts/day, 365 days a year)		n/a		1		1.5		2

Source: King County Sheriff

If the City chooses to contract with the County for police services, the County has indicated that the first two months of that service will be provided without charge. This assumption is included in estimates of start-up financing in the discussion to come.

Court Services, Public Defense, and Jail Costs

Cost estimates for court services, public defense, and jail costs are based on a review of costs incurred by other cities. Based on Berk & Associates' detailed modeling of demand for law enforcement services in Fairwood, we find that the City of Fairwood would generate demand for law enforcement that is most similar to the City of Kenmore.

This assessment is based on Berk & Associates' statistical analysis of the experiences of more than 170 cities across Washington State regarding demand for police services. Berk & Associates' proprietary model explains the variation in demand for criminal justices services among based on the

fundamental characteristics of each city, including characteristics like housing type and tenure, levels of commercial activity, density of population, and proximity to state highways. After analyzing all of the pertinent factors in Fairwood, we estimate that a City of Fairwood would generate overall demands for criminal justice services that are very similar to those experienced by the City of Kenmore.

In 2004, Kenmore paid court services, public defense, and jail costs of roughly \$180,000. Growth rates for these costs are expected to mirror growth in police services, in effect, growing at a base rate of 4% per year (to cover core increases in costs of services) and also growing with increases in City population. Overall, we estimate 2007 courts, public defense, and jail costs of \$234,000, growing to \$296,000 by 2012.

Fire and Life Safety Protection

Our assumption is that the proposed City of Fairwood would choose to annex itself to the currently existing King County Fire Protection Districts. Since these three districts are funded through discrete levies, the provision of fire and life safety protection will have no direct financial impact on the City's budget.

Road Maintenance and Operation

RCW 35.02.220 provides for the provision of road, library, and fire district during the transition period at pre-incorporation levels. In particular, the law states that "road maintenance shall be for a period not to exceed sixty days from the official date of the incorporation or until forty percent of the anticipated annual tax distribution from the road district tax levy is made to the newly incorporated city or town pursuant to RCW 35.02.140, whichever is the shorter time period."

After incorporation and the interim period, the new City of Fairwood will take over responsibility for the maintenance and improvement of public rights-of-way. For our analysis, we have assumed that the City will contract with the County for provision of these services. This assumption is based on a recognition that most recently-incorporated cities chose to contract with the County for continued provision of road maintenance services. Given the challenges of purchasing equipment, building facilities, and staffing road maintenance crews, most new cities find it much easier to contract for provision of maintenance services.

King County reports that the current estimated cost of maintaining current levels of roads and traffic maintenance in Fairwood would be roughly \$986,000 in 2005. Of this total, \$885,000 would cover roads maintenance and the remaining \$101,000 would cover costs of engineering, signage, and traffic signals. It is important to note that these represent current *estimates* of road maintenance.

For 2006 through 2012, baseline costs are assumed to grow at a rate of 4%. In addition, a portion of roads service costs are assumed to grow with population growth, under the assumption that new development will introduce new streets and new infrastructure. Recognizing that much of the City's road system is already set, however, we assume that a 1% increase in population will result in only a 0.75% increase in costs of roads maintenance. The underlying rationale for this assumption is that, although new development in Fairwood will certainly bring with it new traffic and new public roadways, a 1% growth in population is unlikely to be accompanied by a full 1% growth in roadway mileage.

King County Roads Services Division notes that, as submitted, the proposed boundaries of the City of Fairwood exclude certain road segments that fall within the urban growth boundary. Roads Services believes that minor adjustments to the boundaries will need to be made. Estimates of roads maintenance costs reflect an assumption that those recommended adjustments will be made.

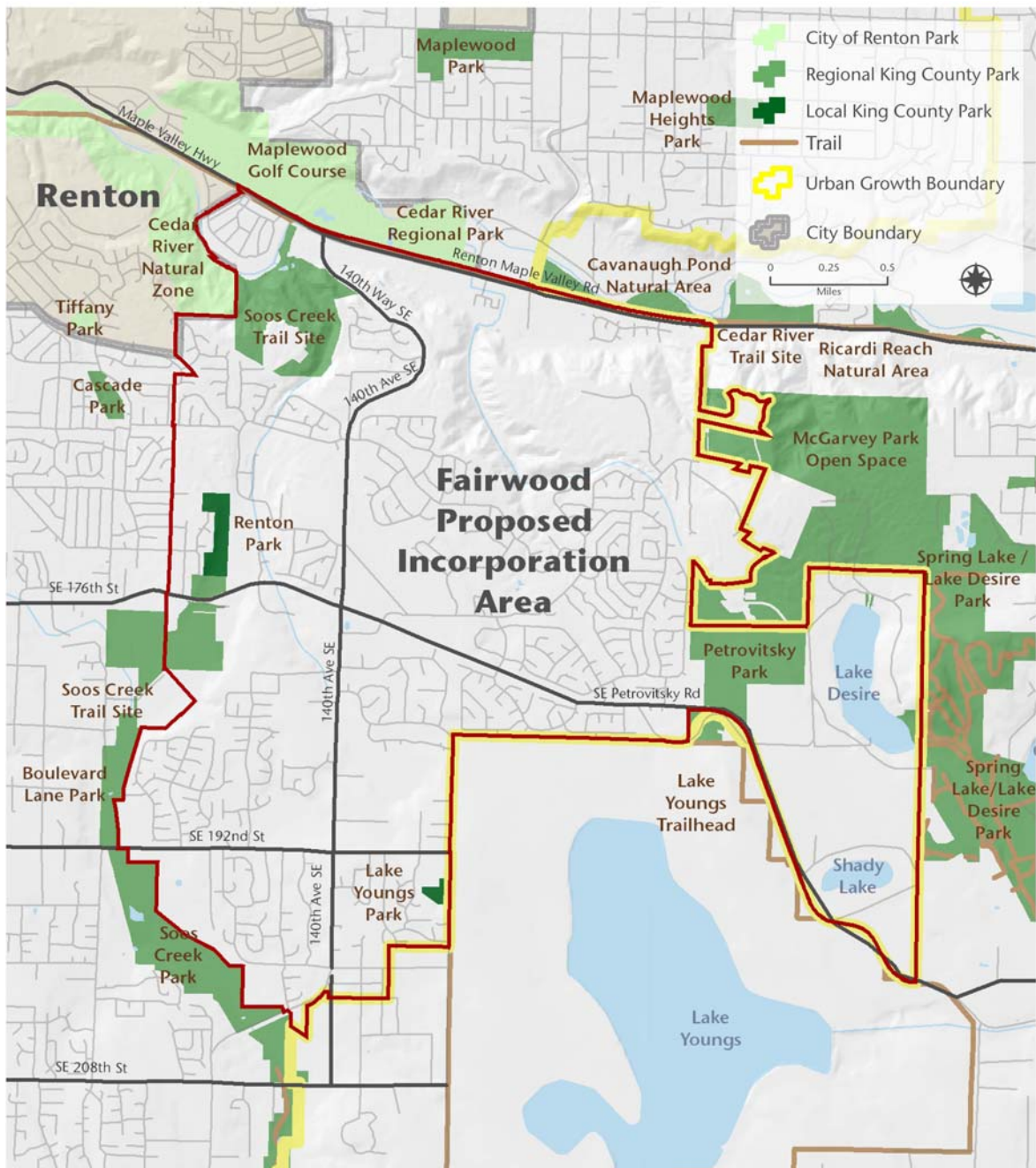
Parks and Recreation

Currently, the public parks and parklands in the Fairwood area are owned, maintained, and improved by King County Division of Parks and Recreation. According to County policy, upon incorporation, facilities defined as local parks by the *Parks, Recreation, and Open Space Plan* could be transferred immediately to the newly incorporated City. King County expects that, under the above policy, two parks and one facility currently within the proposed City of Fairwood would transfer to the City: Renton Park (19.09 acres), Lake Youngs Park (4.81 acres), and Renton Pool (0.88 acres). The Spring Lake, Lake Desire, McGarvey Open Space, Soos Creek Trail Sites, and Petrovitsky Parks, which are classified as regional county parks, would continue to be owned and maintained by King County. While these parks are currently classified as regional, these classifications have shifted historically, and it is possible that more parks could be considered "local" in the future.

By law, the new city is not mandated to accept the parks and pools, but if they do not take them, King County would "mothball" the facilities, or conduct only minimal safety-related maintenance. It is unclear whether the facilities would remain open to the public..

It is worth noting that, while the City of Fairwood could acquire responsibility for a relatively few acres of local parks, residents of the area will have these other regional parks and open space at their disposal. In or adjacent to the proposed City are the 500-acre Soos Creek Park; Petrovitsky Park (nearly 100 acres including sports fields) the Lake Youngs Reservoir, trailhead and trail site; and Spring Lake and Lake Desire, all of which King County will maintain as regional facilities. These facilities will allow Fairwood residents to enjoy recreation opportunities and pristine areas just outside the urban growth boundary. In addition to regional parks, there are privately owned and maintained parks that are restricted in use to residents of the Fairwood Crest and Fairwood Greens neighborhoods, which represent parkland that would be counted as part of the inventory of park acreage in the future city's capital facilities plan.

**Exhibit 18
Fairwood Area Parks and Open Space**



Source: Berk & Associates

Should the new city opt to take the King County Parks, our estimates of parks and recreation expenses are broken into three components: (1) park maintenance, (2) recreation, and (3) expenditures for operation of Renton Pool.

Park Maintenance

Estimates of park maintenance costs are based on experiences of other cities and counties. Cities we have worked with in the past estimate that passive parks like Renton Park and Lake Youngs Park cost relatively little to maintain on a per-acre basis (often less than \$100 per acre per year). However, given the few acres that the City of Fairwood would take on, we assume maintenance costs of \$420 per acre. On a per-acre basis, this is a much higher cost than most cities see, reflecting the reality that, with very few park acres to maintain, the City of Fairwood would have very few opportunities to achieve economies of scale, even if contracting with a private vendor for maintenance services.

Combined, Renton Park and Lake Youngs Park encompass almost 24 acres of passive parkland, resulting in estimated maintenance costs of \$10,000 per year. Estimates of future-years expenditures assume 4% annual growth in maintenance costs per acre and do not include the regional or private park acreage noted above.

Recreation

Although King County does not currently provide recreation services in Fairwood area parks, the analysis *does* include modest recreation expenses for the City. Recreational programming could be done through a partnership with King County, with the city funding recreational programming and utilizing the County's regional facilities in the City (such as Petrovitsky park fields, or similar to the County's agreement with the City of Enumclaw). Recreation activities could include summer day camps, youth basketball (using school facilities) or sports leagues or instruction. Like the creation of a City Police Chief, we believe it is difficult to envision a City of Fairwood that did not provide *some* level of recreation services, even though it is not a service that a city must provide. In addition to a recreation coordinator position, which is included in City Hall staffing, we assume net recreation expenditures of roughly \$80,000 in 2005 (excluding the cost of the Renton Pool). This net cost reflects the cost to the City of recreation services after accounting for recreational fees.

We assume that recreation expenditures will begin in 2007, and since the services will be new services to the City, the full cost of recreation services will be born by the City of Fairwood. As with park maintenance, we assume that net recreation costs will increase at an annual rate of 4%.

Renton Pool

The passage of the 1968 Forward Thrust capital improvement bond initiative by Seattle and King County voters placed an emphasis on acquisition of park sites and construction of facilities, particularly swimming pools. This included the construction of the Renton Pool, which is part of the Lindbergh High School campus and currently in County ownership. Currently, King County has a lease with the Renton School District to operate the pool. Both the lease agreement and Forward Thrust bond covenants end in May, 2010.

Since 2001, King County has endeavored to transfer all Forward Thrust pools to assist with the future financial and operational stability of King County Parks. Following the recommendations of the Metropolitan Parks Task Force, King County refocused its mission to limit its role as a local service provider and concentrate on regional assets, while preserving local assets for public use. And further due to its on-going fiscal crisis, King County undertook an initiative to transfer ten local, in-city pools to cities or other entities. By the end of 2002, King County reached operating or transfer agreements

regarding eight pools, keeping seven open and mothballing one until the local jurisdiction could ask voters to approve funds that would support the pool.

- The cities of Kent, Enumclaw, Federal Way, Tukwila, and Covington took over ownership of pools within their jurisdiction.
- The Mt. Rainier Swimming Pool is operated by the non-profit Aquatics Management Group for the Cities of Des Moines, Normandy Park, Sea Tac and the Highline School District. The cities are joint owners of the pool, and along with the City of SeaTac and the Highline School District, will contribute financially to pool operations for three years until a new sub-regional pool is built.
- The non-profit organization Northwest Center operates the Mercer Island (Mary Wayte) Pool on Mercer Island, the Northshore (Ruiz-Costie) Pool in Bothell, the Redmond Hartman Pool in Redmond, the Si View Park Pool in North Bend, and the St. Edward Park Pool and gymnasium in Kenmore.
- King County recently completed an agreement with the Auburn School District that allows the pool to reopen for school district use. Under the terms of the agreement between King County and the Auburn School District, the District will be solely responsible for staffing, operating and maintaining the pool over the next five years. After King County's one-time expenditure of \$65,000 for improvements, which is consistent with other pool deals, the District will be responsible for all capital improvements during the lease term. The District also assumes all liability. The lease allows King County and the District to continue seeking new ownership for the pool so it can transfer.

Five pools remain in King County ownership: Weyerhaeuser Aquatic Center, a regional facility; two indoor pools (Evergreen Pool and Renton Pool); and two outdoor pools (Cottage Lake Pool and Vashon Pool). The County will continue to work to transfer local pools to cities or other entities with governance transfers. As long as King County satisfies the bond covenants for the Renton Pool, it can convey the pool to another owner and operator at any time.

If Fairwood incorporates, the City could negotiate with King County for any of the above options related to the ownership and management of the Renton Pool, with the caveat that the pool "deals" related to the ten pools listed above may no longer apply to the four remaining local pools that King County operates. If the City does nothing, the pool would continue in County ownership and is likely to be "mothballed" until another owner and operator can be found. Likewise, the City could take ownership of the Renton Pool, with city staff operating it as part of the complement of city parks and recreation services, or could take ownership of the pool, with a contractor operating it.

The proposed City of Fairwood, if incorporated, will acquire local parklands and facilities at its discretion. For the purposes of this study, we assume based on conversations with other cities, that the Renton Pool will be operated and maintained by a non-profit organization such as the Northwest Center, and that the new City of Fairwood will make some financial contribution (\$50,000 per year in 2005 dollars) towards its operation. The minimum subsidy that King County Parks requires for a pool operated by the Northwest Center is in the range of \$100,000. Therefore, if the City of Fairwood were to take over responsibility for the Renton Pool, and if the City were shoulder the *full* public cost of the pool, pool operating costs would be in the range of \$100,000.

Because it is possible that the new city could share the subsidy costs with a neighboring city who may also value the pool, we assume that Fairwood's estimated partial contribution of \$50,000 will begin in 2007 and the cost will grow at an annual rate of 4%. Even if the new city chose not to own the pool, the assumption that the City would provide some financial contribution toward its operation, in partnership with others, is consistent with agreements that other cities in King County have developed with King County, recognizing that the pool is a community resource and service that current residents value.

Building Permit and Land Use Desk

As we indicated in our analysis of projected building permit revenues, we have assumed that the City of Fairwood will have a building permit and land use desk that will recover 90% of its costs through fees. Given assumptions about City growth, we assume permit fee revenues of \$450,000 and, therefore, building and land use desk costs of \$500,000. We assume that both costs and revenues will grow by 4% per year, which translates into a cost of \$541,000 in 2007, growing to \$658,000 in 2012.

Based on the experiences of other recently-incorporated cities, we believe a 90% cost-recovery assumption is conservative. The experience of most new cities is that permit revenues more than cover city costs.

Policymakers should be aware that there is likely to be some degree of pent-up demand among residents for permitting issuance and advice from the permit office. Officials at other recently incorporated cities advise that the City may want to recruit a highly experienced building permit official early in the formation of the new City.

Comprehensive Land Use and Capital Facilities Plan

According to the Washington State Growth Management Act, soon after the City of Fairwood incorporates, it will need to begin the process of developing a comprehensive land use plan and a capital facilities plan. The manner in which the City approaches this process, of course, will be a policy decision. In theory, the City could contract with consultants who would develop a package of plans consistent with requirements of the Growth Management Act for two or three hundred thousand dollars. In practice, however, the experience of other recently incorporated cities has been that, by the time the plan is adopted, these plans cost a great deal more. Most cities spend well over \$1 million developing their comprehensive and capital facilities plan. Given the experiences of other cities, we have allocated \$1.2 million, over a period of six years for development of a comprehensive land use plan and a capital facilities plan. Of this total figure, we project expenditures of \$300,000 per year for the first two full years after incorporation on the two plans, and \$150,000 per year for the four years thereafter.

Upon incorporation, the City of Fairwood will be required to plan under the State's Growth Management Act (GMA) (RCW 36.70A), and adopt a comprehensive plan and its associated elements. A comprehensive plan is a land use document that provides the framework and policy direction for land use decisions. City comprehensive plans contain chapters regulating: land use, transportation, housing, capital facilities, and utilities. Chapters that are focused on economic development and parks and recreation are required if the city receives state funding. Optional

chapters may be included such as: conservation, energy, recreation, and sub-area plans where appropriate.

GMA requirements include the adoption of county-wide planning policies and adoption of county and city comprehensive plans and development regulations to implement the plan. Each city, after adopting its comprehensive plan, also adopts associated regulations to govern: zoning; plats and subdivisions, concurrency (ensuring that public facilities are in place to meet development demands); critical areas; levying impact fees; siting public facilities; and any other regulations that will implement the plan policies.

The required capital facilities element of the comprehensive plan guides the development of public land, structures, street or utility system improvements, or other long-lasting city assets (and other public facilities in the area as well). Capital facility planning in cities is usually done for streets, roads, highways, sidewalks, street and road lighting systems, traffic signals, domestic water systems, storm and sanitary sewer systems, parks and recreation facilities, schools, and police and fire protection facilities.

RCW 36.70A.070 states that a capital facilities plan element must consist of:

- (a) An inventory of existing capital facilities owned by public entities, showing the locations and capacities of the capital facilities;*
- (b) A forecast of the future needs of such capital facilities;*
- (c) The proposed locations and capacities of expanded or new capital facilities;*
- (d) At least a six-year plan that will finance such capital facilities within projected funding capacities and will clearly identify sources of public money for such purposes; and*
- (e) A requirement to reassess the land use element if probable funding falls short of meeting existing needs and to ensure that the land use element, capital facilities plan element, and financing plan within the capital facilities plan element are coordinated and consistent.¹⁴*

Human Services

The King County Department of Human Services (DHS) reports that the major service areas using County funds in the Community Services Division are regional, and most of the non-county funded services are also regional services. From the Department's perspective, the impact of incorporation of Fairwood on CSD services is minimal. Only local services in the Executive budget were included in the analysis. The vast majority of the approximately \$670,000 that CSD directs to human services in the Fairwood area will not be affected by a change in governance, and all regional services and state or federal flow-through funding will be maintained at King County as in the past.

¹⁴ Information presented in this section is drawn from Washington State Department of Community, Trade and Economic Development publications, Municipal Research and Services Center, and RCW 36.70A.070.

The Community Services Division appropriation unit in the Children and Family Services fund is the only one of the divisions that uses county funds for local services. These local services provided with County funds by the Community Services Division are for the senior center and adult day health for the aging and prevention services for youth. Both are currently targeted to unincorporated area populations.

- The Fairwood annexation will not impact any of the youth prevention services which are targeted to the Snoqualmie Valley, West Hill and North Highline.
- Fairwood is in the catchment area of the Kent and Renton Senior Centers. The current funding policy for senior centers provides funding to a historical set of senior centers. Kent and Renton Senior Centers are not included in the current funding policy and, therefore, would not be affected by the Fairwood incorporation.
- There is no Adult Day Health program serving Fairwood.
- One local service contract that would be reduced is Pacific Science Center reduced admissions for disabled and elderly. The population targeted is county-wide and data is not available on a geographic basis. The reduction is based on Fairwood as a prorated portion of total county population. Reduction in number of admission would be approximately 84.
- The second is Community Voice Mail a service provided to low income, frequently homeless populations county wide. While Fairwood is a relatively middle-class area, the assumption that there are homeless in all areas of the county was used. Fairwood costs were derived using Fairwood as a percent of total population. Reduction in numbers served would be eight.

Having noted minimal impact on the County's provision of human services, this analysis *does* assume that Fairwood *would* become a pass-through city for Community Development Block Grants. Estimated expenditures for human services reflect those estimated Block Grant revenues.

Miscellaneous Non-Departmental Services

When the City incorporates in 2006, we estimate that the City will face miscellaneous costs for insurance, association dues, and contributions to a chemical dependency program. The latter chemical dependency expense is a requirement that cities face in order to be eligible for receipt of state-shared liquor profits and liquor taxes.

Included in miscellaneous costs is a small cost for insurance. Estimated insurance costs are based on interviews with cities, a review of adopted city budgets, and interviews with the Washington Cities Insurance Authority. All lines of liability insurance plus property and crime fidelity insurance would be needed, at an initial annual cost of \$5,000-\$7,000. Association of Washington Cities' Insurance Authority is another possible insurer.

Post-incorporation, coverage is given through a rating system based on the number of city worker hours and historic losses. If there are few staff (which would be the case with a City of Fairwood that would contract for many of its services), and there is no loss rating, insurance is low-cost and would only increase based on city workers' compensation claims, the land use hearings process, and whether public safety functions (fire and police) are provided directly by the city. Losses are attributed and assessed to cities through premiums, based on a complex actuarial formula. Most cities will not pay very high premiums even after 5-10 years.

Operational Contingency

No matter how thoroughly a city plans, there will always be unanticipated events requiring discretionary funds. To meet these unforeseen needs, we have anticipated an annual allocation of \$100,000 (in 2005 dollars), which the City administration would be free to spend at its discretion. The Municipal Research and Services Center has a variety of inquiry topics discussing how much constitutes an adequate range of contingency and reserve allocations for a city. Based on this, and our professional judgment based on prior city finance projects, we assume contingency funding will increase at a rate of 4% per year.

Surface Water Management

Upon incorporation, the new City of Fairwood will take over the responsibility of surface water management within City boundaries. Because there are certain binding constraints on how SWM revenues can be spent, we separate this fund from our core operating costs and revenues throughout the analysis. As indicated previously, the three categories of legitimate SWM expenditures are: 1) day-to-day costs of surface water program services; 2) capital investment in SWM facilities; and 3) transfers to the Street Fund for roads expenses directly related to surface water management.

For this analysis, we have not assumed any transfer of SWM revenues to the City's Street Fund. In terms of operating costs, we estimate that, in 2005, a City of Fairwood would spend \$350,000 to operate and maintain its existing SWM facilities. This estimate is based on per-acre SWM expenditures that the City of Sammamish plans for 2005. Sammamish is a newly-incorporated city that, given its geographic location on the Sammamish Plateau, has significant surface water and drainage issues that Fairwood also faces. SWM operating and maintenance expenditures are expected to grow by 4% per year.

7. CAPITAL IMPROVEMENTS

Capital improvements are investments that a city makes in its physical infrastructure that allow a city to improve its overall position for the future. These improvements could include the repair and construction of road, acquisition and development of parklands, or development of structures to enhance surface water management. For a city like Fairwood, these physical investments are just as important as day-to-day city operations. Because the returns on capital improvements are generally received over a long period, and because the costs of improvements are substantial, it is important to plan carefully for, and phase, capital investments. As a city that will prepare a comprehensive plan under the State’s Growth Management Act, Fairwood will be required to adopt and fund a six-year capital improvement plan (CIP) that conforms to the policies outlined in its comprehensive plan.

There is no way to know today what the composition of Fairwood’s comprehensive plan will be, but current King County investments are inventoried in this section, and no future capital investments by King County are anticipated to carry into the period after annexation (2007 through 2010). The City of Fairwood will need a capital facilities assessment very soon after incorporation in order to understand the City’s future capital needs.

Surface Water Management

According to data provided to us by King County’s Department of Water and Land Resources, from 2001 to the present, King County will have invested more than \$3.6 million in surface water capital facilities within the proposed incorporation area, primarily for drainage issues in the Madsen Creek area. (A detailed description of investments is provided as an appendix to this report.) Today, the Water and Land Resources Division has no projects planned for construction past 2006 (through 2010), aside from completing the six capital projects identified in the list below.

**Exhibit 19
Surface Water Capital Projects in the Fairwood Area, 1999-2006**

Project Name	Year Started	Year Completed	Est. Project Cost
Madsen Creek R/D Pond	1999	2005-06	\$ 2,200,000
Madsen Creek East Wetland overflow	1999	2001	\$ 350,000
Madsen Creek - Bell Diversion Modification	1999	2001	\$ 1,000
Madsen Creek LWD/Boulder Placement	1999	2003	\$ 740,000
Madsen Creek Drainage Conveyance Improvement to West Trib	1999	2003	\$ 350,000
Madsen Creek Northwest Tributary Stabilization (same as LWD)	1999	2004	
Total			\$ 3,641,000

Source: King County Water and Land Resources Division, Berk & Associates

Roads Construction

Exhibit 20 below details nearly \$16 million in Fairwood roads projects included in King County’s 2004 Transportation Needs Report (TNR). The TNR is intended to be a list of all identified transportation needs that have not yet (and in some cases, may never be) included in the County’s Capital Improvement Program (CIP), subject to need and funding. There is a single project, related to

improvements to 140th Avenue SE, which makes up the largest share of future transportation needs that could be phased over time. It should also be noted that this list includes projects that, at least in part, fall within the incorporation boundary or run along the boundary. However, some portions of a given project may extend beyond the study boundary.

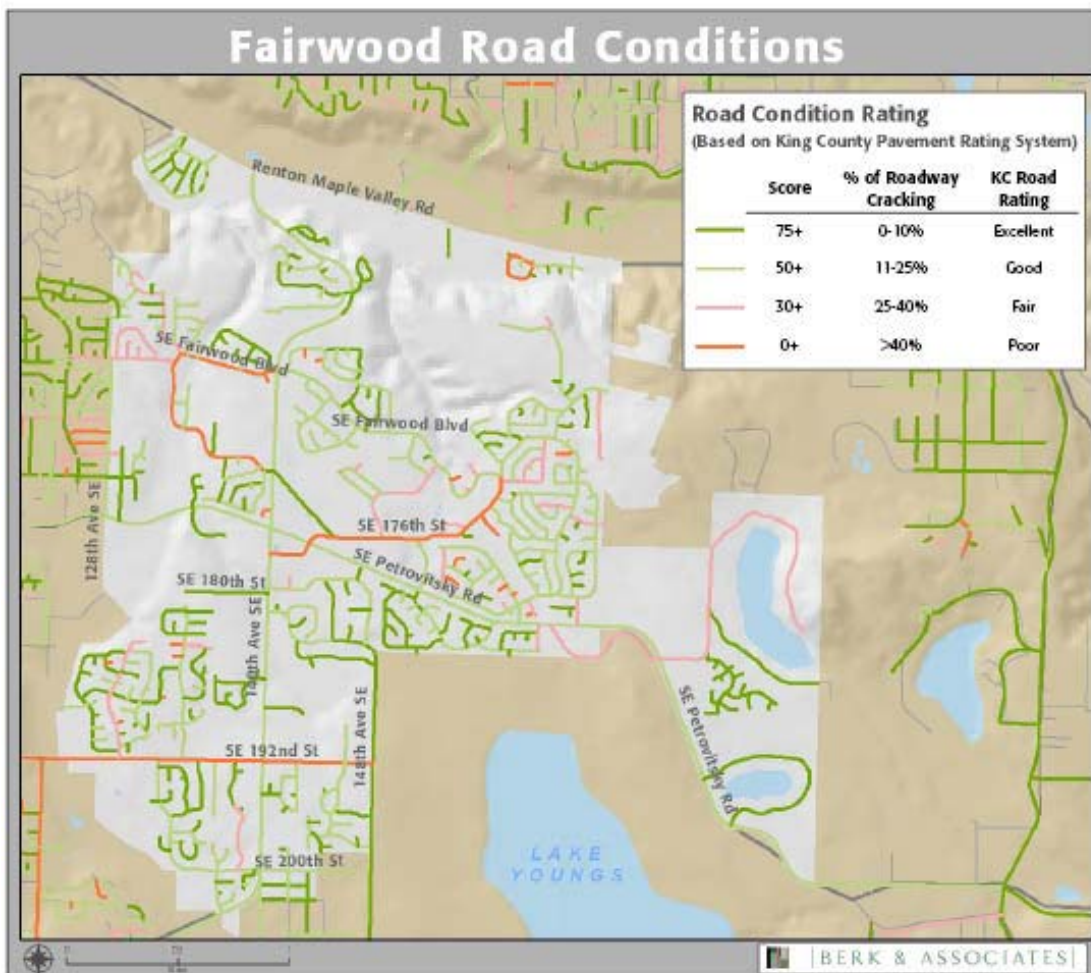
**Exhibit 20
Transportation Needs in the Fairwood Area, 2004**

King County Project #	Location	Category of Need	TNR Priority	Cost (\$000)
GR-20	Petrovitsky Rd from 108th Ave SE to SE 184th St	Safety	High	\$69
SIG-41	140th Way SE/140th St SE from SR-169 to SE Petrovitsky Rd	Operations	High	\$133
HARS-21	140th Ave SE from SE 177th St to SE 180th St	Safety	High	\$316
SPP-4016	Fairwood Blvd from @ 148th Ave SE	Nonmotorized	Low	\$25
3P-9966	Lake Youngs Pipeline Pathway from vicinity of 155th Pl SE	Nonmotorized	Low	\$30
SPP-4035	SE 184th St from SE Petrovitsky Rd east to crosswalk	Nonmotorized	Low	\$55
3P-9956	SE 176th St from 147th Ave SE to 152nd Pl SE	Nonmotorized	Low	\$185
3P-9965	SE 183rd St from 142nd Ave SE to 147th Ave SE	Nonmotorized	Low	\$190
GR-51	SE 192nd St from SR 515 to 148th Ave SE	Safety	Medium	\$28
HARS-17	140th Ave SE from SE 188 Wy to SE 190 St	Safety	Medium	\$663
ITS-1	SR 169 from I-405 to 140th Way SE	Operations	Medium	
401195	140th Ave SE from SE 177 to SE 197	Capacity Major	Medium	
SC-55.22	140/132 Ave SE Ph II @ from SE 196 St to SE 208th St	Nonmotorized	TBD	\$408
Recon-3	Petrovitsky Rd from 128th Ave SE to 143rd Ave SE	Reconstruction	TBD	\$2,006
400197	140th Ave SE @ Petrovitsky Rd	Operations	TBD	\$11,750
SC-202	140th Ave SE @ SE 181 St	Operations	TBD	
Future Road Projects - Estimated Need				\$15,858

Source: King County Roads Division, Department of Transportation, Berk & Associates

In addition, upon incorporation, the City of Fairwood would be newly responsible for just over 73 road miles of streets, including several streets which today have a poor pavement condition rating (below a score of 20, meaning that over 40% of the roadway has cracking). The map below shows the pavement condition of Fairwood Roads. Each City sets different standards for the pavement condition rating (King County's standards are outlined within Exhibit 21, so the City of Fairwood would need, in its initial capital assessment, to determine the appropriate standards for these roads through the City's overlay program).

**Exhibit 21
Fairwood Area Pavement Condition (King County Road Condition Ratings)**



Source: King County Roads Division, Department of Transportation, and Berk & Associates GIS analysis

According to King County Roads Services Division, prior investments in road design and construction Capital Improvement Program (CIP) projects in Fairwood have totaled over \$40 million over the last six years, with nearly \$400,000 in projects to be completed this year in the incorporation area. Between the years 2006-2010, no further capital expenditures are planned.

**Exhibit 22
King County Road Construction Projects in the Fairwood Area, 1999-2006**

Project Name	Location	Prior Years	2005 Budget	Planned through 2010	Total
140th Way SE	Petrovitsky Rd to SR-169	\$19,829,986	\$0	\$0	\$19,829,985
140th Ave SE	SE 177th St to SE 197th St	\$20,275,523	\$291,202	\$0	\$20,566,726
140th Ave SE - ITS	Petrovitsky Rd to SE 192nd St	\$1,932	\$98,068	\$0	\$100,000
Total		\$40,107,441	\$389,270	\$0	\$40,496,711

Source: King County Roads Division, Berk & Associates

If a city incorporates in the middle of a given year, the County's policy is to complete road construction, design or other improvement projects programmed for that year, by either actually finishing the project or providing funds to the city for transportation purposes. Based on an incorporation date of September 1, 2006, the County would finance all construction and design planned for 2005 and 2006. Because these projects are anticipated to be completed prior to 2007, we do not have a reliable estimate of future annual expenses for construction of roads in the City of Fairwood.

Parks Capital Improvements

The King County Parks & Recreation Division reports three locally-classified King County facilities which could become part of the City of Fairwood at the City's option (see Exhibit 23). Among the five listed parks, King County would seek to transfer the three local parks to the City: Renton Park, Lake Youngs Park, and Renton Pool.

King County has not made any recent capital investments in any of the parks within the incorporation area, nor are any investments planned for the future. The two local parks, Lake Youngs and Renton Parks, have few facilities, and we assume that the Renton Pool would be operated and maintained by a non-profit provider, so the most likely capital investments that may be needed in the future would be upgrades or additions to the City's limited stock of local parks.

**Exhibit 23
Existing King County Park Facilities in the Fairwood Area**

Park Facility	Classification	Acres	Field/ Court	Picnic/ BBQ	Play Equip	Rest- room	Address
Renton Park	Local	19.09		No facilities			130th Place SE and SE 172nd
Renton Pool	Local	0.88					16740 128th Ave SE
Lake Youngs Park	Local	4.81	1	1			SE 200th and 148th Ave SE
Soos Creek Trail Site	Regional	203.02		No facilities			SE 184th St and 124th Ave SE to 140th Wy SE and Hwy 169
Petrovitsky Park	Regional	92.66	7	1	1	1	16400 Petrovitsky Rd SE
Total		320.46	8	2	1	1	

Source: King County Parks, Berk & Associates

Estimating Capital Improvement Expenses

While the County has generated no future-year projections for countywide project investments, Road Services Division has provided us with a detailed list of capital investments that were made on the Petrovitsky Corridor from 1995 through 1999. The prior governance study estimated that countywide project expenditures over these years averaged roughly \$135,000 per year.

Municipalities use a number of strategies for financing capital investments. Which strategy they choose is often based on their assessment of the city's long-term capital needs. For instance, if a city believes that it needs to make substantial investments in the near-term, but once those needs have been met, it will face fewer needs in the future, that city could issue bonds and effectively spread the near-term costs out over a longer period of time. If, however, a city expects that it will need to make a steady stream of investments over the both the near- and long-term, it will ultimately need to be able to finance a given year's investments with that same given year's revenues.

We do not estimate an average annual level of capital improvement expenses because, given King County's recent funding constraints and recent historic investment in parks, surface water management, and roads, the anticipated capital facility needs in the Fairwood area would tend to be understated and not reflective of an urban level of service for capital investment. In addition, the fact that King County estimates no projected capital improvements for roads, parks or surface water management facilities in the near future means that the best predictor of capital expenses for Fairwood will be the on-site assessments that the new City would undertake when it created its capital facilities plan.

Estimated capital revenues, as noted above in the revenue section, are likely to equal roughly \$2.9 million in 2007, stemming from real estate excise tax (REET) (\$1.7 million); from Surface Water Management (SWM) (\$520,000); and from various state and federal grant sources, which could average roughly \$700,000 per year if the City of Fairwood enjoys success in obtaining those grants that is in line with what similar sized cities have achieved across the state. These dedicated sources for capital will assist the new City in addressing future capital needs.

8. PROJECTED START-UP FINANCING

As part of the creation of the new city, the interim staff at the City of Fairwood will need to contact a local lending institution to set up a line of credit to tide the City over until substantial revenues begin to flow in. Flows of the various sources of revenues outlined in earlier sections will depend on both the speed with which the City is able to implement its projected fees and the ease with which the City handles its transition period. Policymakers at the City should contact the Municipal Research and Services Center as early as possible, and they should also obtain copies of the MRSC's *The New City Guide* and *A Revenue Guide for Washington's Cities and Towns*.

On the following page, we provide a general overview of the monthly revenues and expenses the City can expect. While some categories may look like they represent a smooth flow of funds, the reality of revenues and expenses is much "lumpier" by nature.

The exact amount of debt the City will incur depends on how the City approaches its start-up. Governing factors include how quickly staff is hired (or not hired), the furniture, computer systems and supplies that purchased by interim staff, and the choice to buy or lease vehicles. We have assumed a level of spending on pre-incorporation administrative overhead that includes the lease of a facility (6,000 sq ft at \$17/sq ft), and the purchase of computers and supplies for three interim staffers (at \$8,000 per staffer). Because these persons will be serving in interim roles, we assume that those 3 staffers will be paid towards the higher end of the salary range for 4 months.

Once Fairwood is incorporated, we assume that City Hall will be staffed with 8 full-time employees for its first year of existence (similar to Kenmore's start-up staffing model), and that those employees will also initially need supplies and computers at the rate of \$8,000 per staffer. Finally, we have assumed that the City will lease its vehicles, leading to expenses that are spread throughout the year.

It is instructive to reflect on the experience of two cities, Kenmore and Edgewood, in their choice to defer or delay hiring permanent full-time staff for City Hall. In both cases, the choice to begin with a very small City Hall staff, and increase staffing costs slowly and in partial positions or on a contract basis (based only on increased service demands), allowed each City to establish significant cash reserves in the first few years. This go-slow approach placed the cities on sound financial footing.

- As noted in the expense section, above, the City of Kenmore incorporated in 1998 with a complement of eight staff positions, including the City Manager, Assistant City Manager, Senior Planner, Community Development Director, Receptionist, Administrative Assistant, Accounting Tech, and City Clerk. Today, the City has 16 staff: a Street/Storm/Public Works Superintendent, City Clerk, Office Assistant, City Engineer, City Manager, Assistant City Manager, two Administrative Assistants, Director of Community Development, Code Compliance Officer, Building Inspector, Senior Planner, Associate Planner, Permit Technician, Finance Account Technician, and Finance Director.
- The City of Edgewood (Pierce County, population 9,405) incorporated in 1999 and staffed City Hall with just under 11 positions: 0.8 FTE City Manager, 1.75 Finance staff, 1 City Clerk, 1.9 Central Services staff, 2.925 City Planning staff, 1.775 Building Office staff, 0.538 Street Maintenance staff, and 0.638 Surface Water Management staff. Today, five years later, only partial

staff positions in planning, parks, street maintenance and surface water management have been added, bringing 2004 City Hall staffing levels to 13 FTE.

After the initial start-up period, the City should expect to see a somewhat more even flow of revenues and expenses. Some revenues are distributed quarterly, and for some revenues, there is a substantial delay before collection. Half of annual property tax revenues, for instance, are due on April 30. Some of those revenues accrue to the City in March, April, and May, but a large portion of those revenues will not accrue until June or later.

For the City's expenses, we have estimated monthly payments by simply dividing yearly expenses into 12 equal monthly payments, and for many of the larger expenses (e.g. road maintenance and public safety contract payments) this estimation really does reflect the way outflows will occur. For other expenses, like parks and recreation, costs arising from one month to the next are not so easily predicted. For these smaller outflows, then, our monthly estimates should be viewed only as a general indicator of the kinds of expenses the City will face.

Fairwood should count on accumulating debt in its early stages as it absorbs the costs associated with incorporation and start-up (attorney fees, interim staffing, purchase of facility and supplies). In mid-November, Fairwood will receive its first large revenue receipt in the form of road levy revenues from King County (the City should contact King County Finance well ahead of mid-November to work out the details of the fund transfer). By statute, these revenues must ultimately be dedicated to roads maintenance and construction, but the City is allowed to borrow against this fund as long as the loan is paid back, with interest, within 3 years.

If the City follows the go-slow staffing ramp-up strategy that is reflected in Exhibit 24, then the City will incur relatively little debt. In terms of an accumulated cash position, the low water mark for the City would come in the month of September, when the City would accumulate debt of nearly \$500,000. The City will be in a position to pay off that debt when it receives its road fund distribution from King County in November. From November on, however, the City's accumulated cash position never drops below \$1.3 million. This means that the City will borrow, at most, \$600,000 to \$800,000 from Road Levy distribution to fund general operations.

Since estimated operation and maintenance costs for roads far exceed the gas tax distributions the City will receive, as modeled, the City will transfer more than \$500,000 from its General Fund to its Road Fund to cover road maintenance costs. This means that the "repayment" of the Road Levy funds will not represent any burden at all to the City. Rather, the "repayment" will happen automatically, as the City regularly uses General Fund revenues to cover the costs of road maintenance.

The modeled start-up anticipates that after November, 2006 the city will maintain a positive overall cash position. The road funds received from King County in November will tide the City over until May, when it receives its first substantial influx of property tax revenue. Contingent upon the policy decisions of Fairwood's administration, and in light of the overall finding of feasibility, we expect the City's cash position to remain positive into the future.

Exhibit 24
Proposed City of Fairwood Cash Flows for First Year
(Not Including SWM or REET Revenues)

Inflows (In Thousands)	2006					2007							
	Pre-Incorp.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun	Jul	Aug.
Road Tax	-	-	-	2,010	-	-	-	-	-	-	-	-	-
Property taxes (Regular Levy)	-	-	-	-	-	-	-	29	89	987	979	19	12
State Shared Revenues	-	-	187	-	49	202	-	53	202	-	53	202	-
Unrestricted Gas Tax	-	-	155	-	-	168	-	-	168	-	-	168	-
Liquor Excise Taxes	-	-	26	-	-	27	-	-	27	-	-	27	-
Liquor Profits	-	-	-	-	49	-	-	53	-	-	53	-	-
Criminal Justice Revenues - General	-	-	6	-	-	7	-	-	7	-	-	7	-
Retail Sales Tax	-	-	-	-	90	90	90	96	96	96	96	96	96
Retail Sales Tax - Criminal Justice	-	-	-	137	46	48	48	48	48	48	48	48	48
Utility Tax	-	-	-	-	-	45	45	45	45	45	45	45	45
Cable TV Franchise Fee	-	-	19	19	19	20	20	20	20	20	20	20	20
TOTAL	-	-	206	2,166	203	405	203	291	500	1,196	1,241	430	221

Outflows (In Thousands)	2006					2007							
	Pre-Incorp.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun	Jul	Aug.
Public Safety (Criminal Justice)	-	-	-	183	183	-	-	-	-	-	1,152	192	192
General Government	234	108	87	87	87	87	87	87	87	87	87	87	87
Salaries and Benefits	-	63	63	63	63	63	63	63	63	63	63	63	63
Administration Overhead	126	42	20	20	20	20	20	20	20	20	20	20	20
Interim Staffing	108	-	-	-	-	-	-	-	-	-	-	-	-
Vehicle Lease and Operation	-	4	4	4	4	4	4	4	4	4	4	4	4
Roads Operation and Maintenance	-	-	-	86	86	91	91	91	91	91	91	91	91
City Attorney and Prosecution Services	56	19	19	19	19	34	34	34	34	34	34	34	34
Parks and Recreation	-	-	-	3	3	12	12	12	12	12	12	12	12
Comprehensive Land Use Plan	-	-	-	-	-	13	13	13	13	13	13	13	13
Capital Facilities Plan	-	-	-	-	-	13	13	13	13	13	13	13	13
Miscellaneous	-	4	4	4	4	4	4	4	4	4	4	4	4
Operational Contingency	-	-	-	-	-	9	9	9	9	9	9	9	9
TOTAL	289	132	110	383	383	262	262	262	262	262	1,414	454	454

(In Thousands)	2006					2007							
	Pre-Incorp.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun	Jul	Aug.
Cash Inflows - Cash Outflows	(289)	(132)	96	1,784	(179)	143	(59)	30	238	934	(173)	(23)	(233)
Accumulated Cash Position	(289)	(421)	(325)	1,458	1,279	1,422	1,363	1,393	1,631	2,565	2,392	2,368	2,136

Capital Inflows (In Thousands)	2006					2007							
	Pre-Incorp.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun	Jul	Aug.
Real Estate Excise Tax	-	-	146	146	146	153	153	153	153	153	153	153	153

Startup Financing Assumptions

The timing and amount of revenue inflows summarized in Exhibit 24 are based on information about the timing and nature of revenue distributions identified by King County, the Washington State Department of Revenue, and Municipal Research & Services Center.

Estimated outflows or revenue are based on estimated costs of services, modeled staffing levels, and information received from King County regarding the timing of contract payments for things like Public Safety contracts.

Following are brief summaries of the factors that drive estimated monthly inflows and outflows.

Inflows

- Road Tax: Assessed value times the King County levy rate of 1.832 times 46%, which is historically the proportion received in September-December.
- Property taxes (Regular Levy): None collected in 2006. In 2007, total yearly times historical distribution for each month.
- Unrestricted Gas Tax: Quarterly payout, so Fairwood receives 1/4 of the 2006 total amount and 3/4 of the 2007 total amount.
- Liquor Excise Taxes: Quarterly payout, so Fairwood receives 1/4 of the 2006 total amount and 3/4 of the 2007 total amount.
- Liquor Profits: Quarterly payout, so Fairwood receives 1/4 of the 2006 total amount and 3/4 of the 2007 total amount.
- Criminal Justice Revenues – General: Quarterly payout, so Fairwood receives 1/4 of the 2006 total amount and 3/4 of the 2007 total amount.
- Retail Sales Tax: Two-month lag between levy and collection, then an even monthly payout after that.
- Retail Sales Tax - Criminal Justice: Two-month lag between levy and first collection leads to payout of 3-month's-worth in November 2006. After that, even monthly payouts.
- Utility Tax: Not levied until January 2007, then even monthly inflows.
- Cable TV Franchise Fee: Part of "Permit Fees" in yearly summary. Even monthly inflows beginning in October.

Outflows

- Public Safety (Police): Two months free service from King County. Because the King County contract states that cities get billed based on the lower of the two cost books, the first bills don't generally go out until May of each year (budget has to be finalized first). So, the cities have that money from January to May. After May, assumed costs reflect a lump sum payment for the first half of the year and equal monthly payouts for the latter half.

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- General Government: Yearly summary includes fully staffed city hall, does not include interim staffing costs for 2006.
- Salaries and Benefits: Eight employees (City Manager, Assistant City Manager, Senior Planner, Community Development Director, Receptionist, Admin Asst, Accounting Tech, City Clerk) + 6-person council + a mayor for the first year, paid out in even monthly outflows.
- Administration Overhead: Pre-Incorporation costs of 6,000 sq ft * \$17/sq ft, as well as \$8,000/interim FTE * 3 interim FTEs. Initial costs (in September 2006) include \$8,000/FTE and 5 additional FTEs, as well as costs of \$20,000/month for supplies, phones, insurance.
- Interim Staffing: Three interim employees (City Manager, Asst City Manager, Administrative Assistant) at high pay scales for four months (September-December).
- Vehicle Lease and Operation: Five vehicles in the first year, at a cost of \$6,000/year to lease and \$4,000/year for operation and maintenance.
- Roads Operation and Maintenance: Two months free service from King County, followed by even monthly outflows.
- City Attorney and Prosecution Services: Paying a total of 1/3 of full year in 2006, spread more in pre-incorporation time than in subsequent incorporated months. In 2007, even monthly outflows.
- Parks and Recreation: City pays \$5,000 per month in 2005, assumed to begin in November 2006. The City then fully funds park maintenance, recreation, and a \$50,000 annual contribution to pool operation in equal monthly payments through 2007.
- Comprehensive Land Use Plan: No outflows in 2006, followed by even monthly outflows in 2007.
- Capital Facilities Plan: No outflows in 2006, followed by even monthly outflows in 2007.
- Miscellaneous: Even monthly outflows beginning in September 2006.
- Operational Contingency: No outflows in 2006, followed by even monthly outflows in 2007.

9. RELATED FACTORS

In addition to the core question of fiscal feasibility, the King County Boundary Review Board has asked for information regarding two fiscal questions related to incorporation:

1. What impact, if any, would the incorporation of Fairwood have on the governance prospects for the Cascade area?
2. What impact would exclusion of the Maplewood Addition have on the financial position of the City of Fairwood?

Impacts on Governance of the Cascade Area

The proposed incorporation area comprises only a part of the City of Renton's existing Fairwood potential annexation area (PAA). The remainder of Renton's Fairwood PAA lies to the west of the incorporation area. This "remainder" area, referred to here as the "Cascade Area," has an estimated 2005 population of 16,100 persons.¹⁵

It has been suggested that the incorporation of the Fairwood area would represent a loss of a relatively attractive portion of Renton's Fairwood PAA, and as a result, the fiscal costs associated with annexing the remaining Cascade area could be large enough to discourage annexation. To address this question, King County contracted with Berk & Associates to assess the implications that Fairwood incorporation would have on the desired governance transition of the Cascade area.

Since Cascade is part of Renton's established Potential Annexation Area, the specific analysis that King County commissioned was an assessment of the fiscal cost that the City of Renton would face if it annexed the Cascade area (the area was defined as the area of Renton's Fairwood PAA not included in the proposed incorporation boundaries). The result of that assessment was a report entitled *King County Annexation Analysis: Fiscal Impact of Renton's Annexation of the Cascade Area*.

In developing the report, Berk & Associates worked with King County and the City of Renton to estimate revenues and costs of services that the City of Renton would face if it was to annex the Cascade area. **What our analysis found was that, in comparison with the cost of annexing most of the large unincorporated areas remaining in King County, the City of Renton would face relatively modest net costs if the City was to annex the Cascade area.**

Specifically, the annexation assessment found that, in terms of steady-state day-to-day operating expenditures, annexation of the Cascade area would impose a net cost on the City of between \$340,000 and \$681,000 (depending on what costs are included in the definition of day-to-day

¹⁵ The methodology to derive the population of this area is identical to the estimation of Fairwood population: analyses of (1) U.S. Census Bureau 2000 census data; (2) King County Assessor's database extract data describing the distribution of current housing units in the Fairwood Area; (3) Puget Sound Regional Council data describing recently permitted housing units; and (4) review of King County Annual Growth Reports. Using these data sources, Berk & Associates used spatial analysis to develop current estimates of population in the Fairwood and Cascade unincorporated areas in consultation with King County's Chief Demographer.

operating costs). While this is not an insignificant sum, as a point of comparison, a similar assessment of the costs of annexing West Hill found that the annual operating cost to Renton of that annexation would exceed \$2.5 million (for an area with a smaller population than Cascade).

A principal reason behind the finding of relatively modest costs associated with Renton's annexation of Cascade was that, if Renton pursued annexation, the City would be able to take advantage of some key service efficiencies. In particular, because Renton already has a fire station located in the heart of the Cascade area, the costs of extending fire and EMS services to Cascade are more than \$1 million less than they would be if the City had to establish, and staff, an entirely new station.

When thinking about the costs of any annexation, it is important to bear in mind that, in addition to annual operating costs, the City of Renton would also face potential investments in capital infrastructure upon annexation (e.g. parks and recreation improvements), and the City would also certainly face at least a million dollars in one-time transition costs. Counterbalancing some of these one-time costs, the City of Renton might be able to negotiate a payment from King County as a part of King County's broader Annexation Initiative (designed to help persuade cities like Renton to pursue annexation of remaining urban islands).

Having noted real, but not overwhelming fiscal hurdles to Renton's annexation of Cascade, it is also important to note that the fiscal costs of annexation are only one factor in determining if, when, and how an annexation may occur.

Maplewood Addition

The Maplewood Addition is a small residential area in the northwestern-most corner of the proposed City of Fairwood. The area is bordered on the north, west, and south by the City of Renton, and is somewhat isolated from the main center of Fairwood by power lines, a steep hill, and by the Cedar River, which bounds Maplewood Addition on the south and east sides.

In addition to being included in the proposed incorporation area boundaries, the City of Renton has also asked that the King County Boundary Review Board consider the Maplewood Addition for potential annexation by the City, in response to a petition for annexation to Renton by Maplewood Addition residents. Given this request, the Boundary Review Board has asked for information on what impact residents of Maplewood Addition would see if the area was excluded from the incorporation.

In response to the Boundary Review Board's request for information, the analysis team performed a post-analysis assessment of the Maplewood Addition. Our analysis of census data, housing unit data, and 2005 assessed values finds that the Maplewood Addition has the following characteristics:

- Estimated 2005 population: 350
- Estimated taxable property value: \$32 million.¹⁶

¹⁶ The above estimates of population and taxable property are based on the same analytic approach used to estimate the population and taxable property of the City of Fairwood (see discussion of Population on page 27).

These figures suggest that the Maplewood Addition has a similar assessed value per resident to the proposed City of Fairwood as a whole (roughly \$90,000 per resident).

As a single family residential area, demands for services in the Maplewood Addition are likely to be relatively modest. Also, as a result of the loss of some small economies of scale, if the Maplewood Addition was excluded from the proposed incorporation area, Berk & Associates' assessment is that the proposed City of Fairwood would probably see a small negative impact.

Although we have not had an opportunity to perform an in-depth analysis of how exclusion of Maplewood Addition would affect costs of services, Berk & Associates does perform similar analyses on a regular basis. Based on our experience and a high-level analysis, we believe that exclusion of Maplewood Addition would result in a net reduction of perhaps \$20,000 to \$40,000 in "excess revenues" for the proposed City of Fairwood.

Our high-level analysis finds that a City of Fairwood without Maplewood Addition would generate roughly \$85,000 less in taxes and state-shared revenue distributions [including property taxes (\$50,000); sales taxes (\$5,000 to \$7,000); criminal justice sales taxes (\$7,000); utility taxes (\$7,000); and state distributions of gas taxes, liquor taxes, and liquor profits (\$13,000)]. However, the elimination of Maplewood Addition would also reduce costs of services for services like road maintenance and law and justice services.

Absent a full-scale analysis of how service costs would change with exclusion of Maplewood Addition, we based our estimate of net fiscal impacts on general information provided by the King County Sheriff's Office, plus an assessment of how a modest reduction in the City of Fairwood's size would translate to reductions in citywide service costs. For example, given the relatively bare-bones City Hall staffing that is included in the model, we do not believe the City of Fairwood would be in a position to reduce City Hall staffing in response to exclusion of Maplewood Addition. Based on conversations with the King County Sheriff's Office, however, we *do* believe that police service contract costs could be reduced by a small amount if Maplewood Addition was excluded from the contracted service area. Overall, we believe that, given the characteristics of the proposed City of Fairwood as it exists today, reductions in the city's size would result in diminished economies of scale for things like police services, City Hall staffing, and large-scale planning activities like development of Fairwood's Comprehensive Plan.

From Maplewood Addition's perspective, we believe one could make the case that either Renton or Fairwood could provide services to the area in an efficient manner. As a City with a strong tax base, Renton would be in a position to commit more resources to the area. On the other hand, as a smaller city, being part of the City of Fairwood would give Maplewood Addition residents a larger voice in determining how a City of Fairwood was governed.

From a geographical logistics perspective, the most important service considerations revolve around fire and EMS services and police services. For fire and EMS services, Maplewood Addition currently receives services from the City of Renton (through the City's contract to provide services for Fire District 25). Given the distribution of fire stations in the area, however, it appears that Maplewood Addition is equidistant from three different stations, two stations operated by the City of Renton (in downtown Renton and in the unincorporated area of the East Plateau) and Fire District 40's station on Petrovitsky Road in Fairwood.

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In terms of police services, if Fairwood incorporates, it is clear that Maplewood Addition would be on the edge of a police service area regardless of whether it annexed to Renton or was included in the City of Fairwood. One could argue, however, that with higher concentrations of patrol officers nearby (compared with the King County Sheriff's Office), the City of Renton would have the greater capability to respond to Maplewood Addition with initial responders and with backup.

10. MARKET ASSESSMENT

What Will Fairwood Look Like in the Future?

In negotiating the scope of the feasibility study with King County, Berk & Associates was asked to provide a market assessment of the City of Fairwood's economic position, an assessment not included in prior incorporation analyses, but which Berk & Associates has provided to a variety of cities over the past five years related to annexation. A market assessment provides a picture of what the city might become. If one looks at the cities in King County that have incorporated over the past decade, it is clear that many of those cities look vastly different today compared to what they looked like at the time of incorporation. Cities that have seen some significant level of transformation include Covington, Woodinville, Newcastle, and Sammamish.

The maturation of a city offers city residents and city government two opportunities:

- It offers City residents and businesses a chance to achieve their vision of the place they want Fairwood to be; and
- It offers the City, as provider of local governance, a path to long-term fiscal sustainability.

Questions about what Fairwood's commercial center might look like ten or twenty years from now, or about what the City's mix of housing and residents might be, both speak to residents' quality of life and the City's relative fiscal strength.

Overall, Fairwood is likely to remain a primarily residential city, growing slowly and relying on a solid base of residential property as its principal source of City revenues. With its existing commercial center, the City may have opportunities to develop a more vibrant city center, with long-run potential for redevelopment of the center into a mix of retail, residential and/or office uses that (1) could serve as an attractive center of focus for the community and (2) provide a modest boost to the prospective City's tax base.

Commercial Development

As a residential area close to the cities of Renton, Tukwila, and Kent, commerce in Fairwood is likely to continue to remain community-oriented. As is typical of most community retail centers, activity in Fairwood's center is dominated by convenience-oriented retail and consumer services. These uses include grocery stores, banks, convenience restaurants, video stores, dry cleaners, drug stores, and a variety of other small retail and service outlets.

In many ways, Fairwood is similar to the recently-incorporated City of Newcastle. Newcastle is sandwiched between Bellevue and Renton, and is dominated by regional retail centers in Downtown Bellevue, Factoria, Renton, and Tukwila. For a visual comparison of the two areas, see Exhibits 28 and 29 on the following pages.

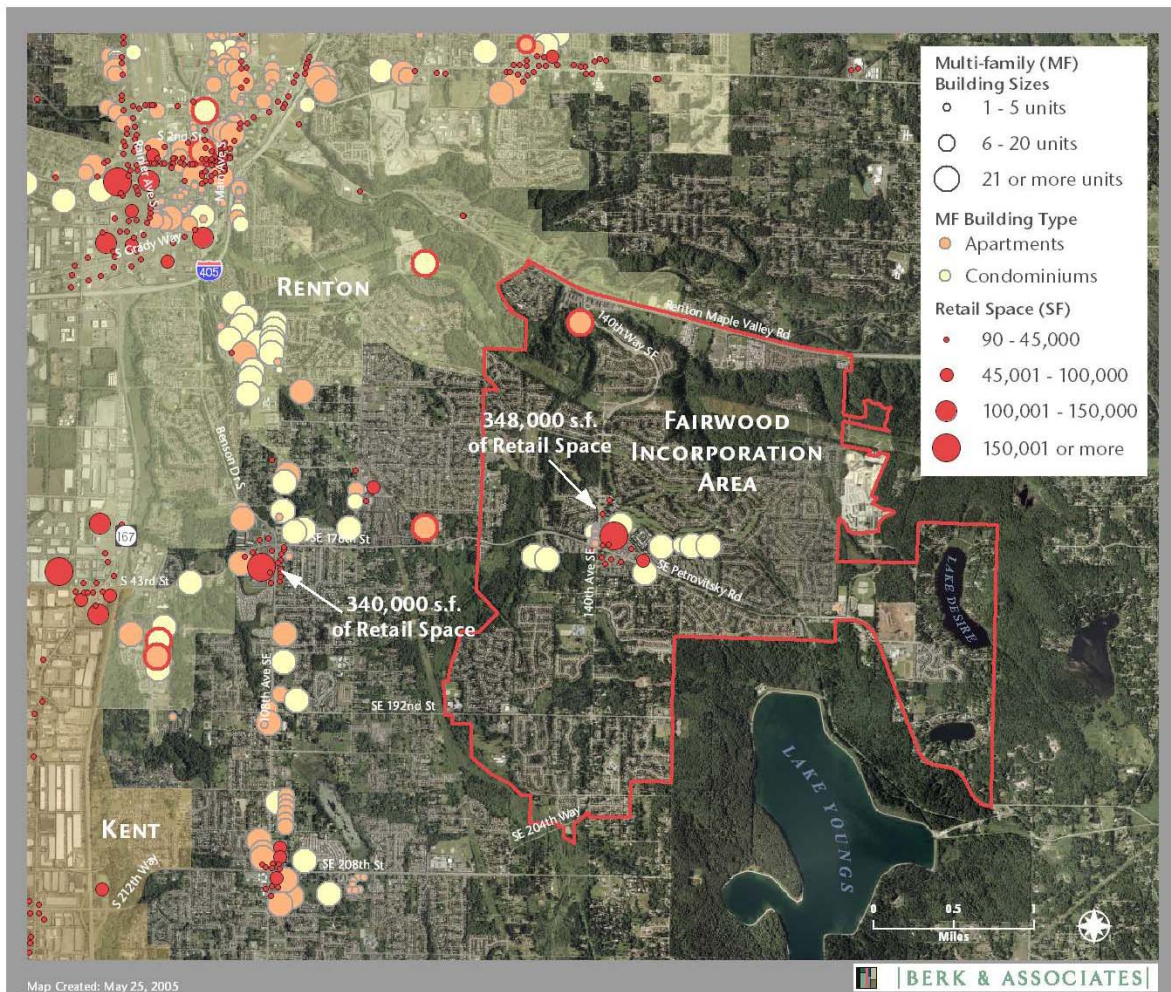
Newcastle's community retail center includes about 150,000 square feet of retail space, and in terms of its convenience-oriented uses, serves a population of about 10,000 people. Fairwood's community retail center is larger (roughly 350,000 square feet of retail) and serves a larger population, but it includes many of the same categories of retail and service uses.

Existing commercially-zoned land in Fairwood is largely built out. This means that any expansion of commercial activity in the proposed city would require:

1. Rezoning to provide additional commercial land; and/or
2. Increased intensity of use for the area’s existing commercial center.

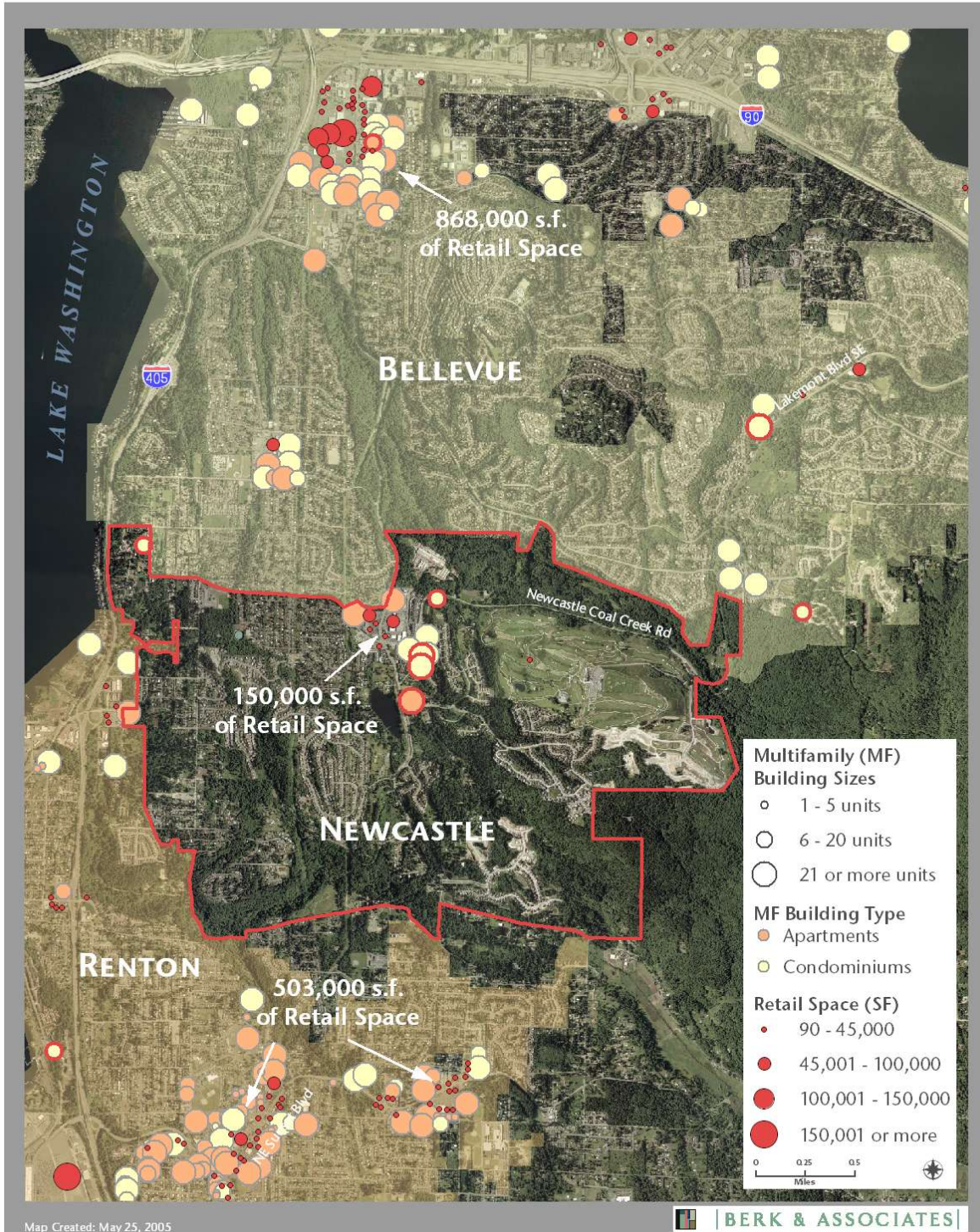
Fairwood’s two major retail centers, anchored by Safeway, QFC, and Albertson’s grocery stores, comprise roughly 30 acres of land. At their existing suburban density, these areas support roughly 300,000 square feet of retail space. With more intense development patterns, these properties could support perhaps twice as much commercial space, or they could offer opportunities for redevelopment in the form of a mix of uses—combining a mix of retail, residential, and/or office uses.

Exhibit 25
Retail Square Footage and Multi-Family Housing in Fairwood
and Adjoining Centers



Source: King County Assessor data extracts and Berk & Associates

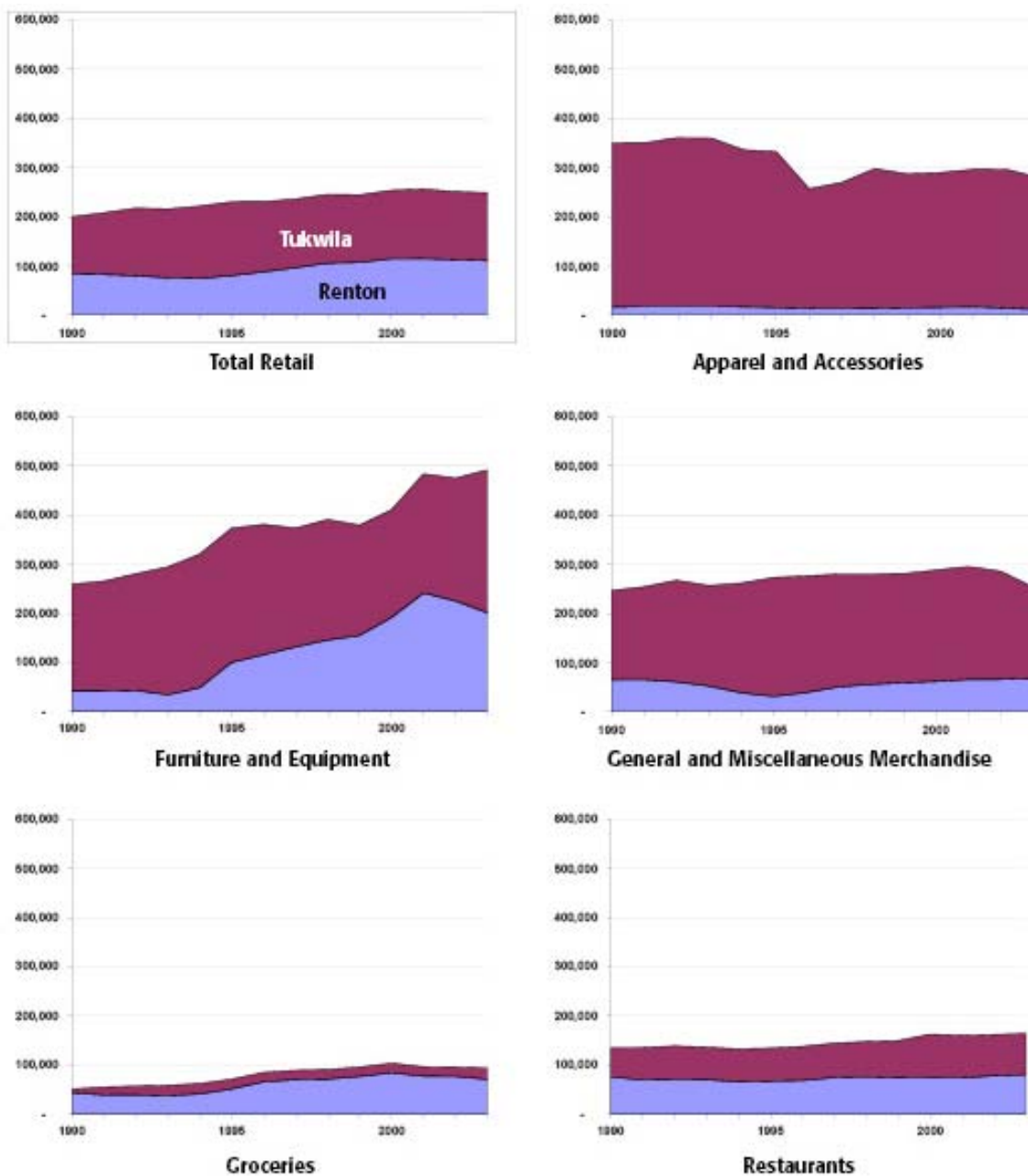
**Exhibit 26
Retail Square Footage and Multi-Family Housing in Newcastle
and Adjoining Centers**



Source: King County Assessor data extracts and Berk & Associates

Just as Newcastle is dominated by regional retail centers in Bellevue, Renton, and Tukwila, Fairwood is dominated by Renton and Tukwila. For all retail categories combined, Renton and Tukwila combine to capture expenditures from a large portion of south King County—capturing sales equal to the total spending of 250,000 people. Exhibit 27 summarizes Tukwila and Renton’s market capture (in terms of the number of typical people’s 2004 expenditures, in total sales or by retail category).

Exhibit 27
Historical Retail Capture Rates for Tukwila and Renton
(annual 2004 person-expenditures captured by retail category)



Source: Washington State Department of Revenue, Washington State Office of Financial Management, and Berk & Associates

Exhibit 27 summarizes capture rates for Renton and Tukwila (1) for all retail categories combined and (2) for selected categories of retail sales. What Exhibit 9 shows is that Renton and Tukwila dominate the market in categories like *apparel and accessories*, *furniture and equipment*, and *general and miscellaneous merchandise*—retail categories that are typically dominated by so-called regional or

super-regional retail centers. (As the largest mall in the Puget Sound region, Southcenter Mall is categorized as a super-regional center.)

What Exhibit 27 also shows, however, is that Renton and Tukwila are far less dominant in other categories of retail, including categories like *grocery stores* and *restaurants*. These categories, other convenience uses, and targeted categories like bookstores and pet stores are likely to offer a City of Fairwood the greatest opportunity to develop a vibrant commercial center. If developed, such a city center will (1) offer Fairwood residents an attractive central *place* that will provide a center of focus for the community and (2) offer opportunities to modestly expand the City's retail tax base.

If Fairwood's ultimate goal is to foster a higher-amenity center with a mix of retail, office, and residential uses, then the area's limited supply of commercial land could serve as an advantage. All else being equal, a constrained supply of commercial and mixed use land will tend to increase the value of the commercial land that now exists. These higher values, in turn, will give property owners and developers an incentive to make more intense use of Fairwood's existing center.

As Fairwood's retail market matures, one possible scenario would be that Fairwood would *not* see a net increase in its square footage of grocery stores, but would see some shifting towards higher-end retail outlets over time. Redevelopment of the commercial center in a mixed-use town-center style might bring a combination of a slight increase in retail square footage, an increase in sales volumes per square foot, and additional uses like residential and office uses to the area that will support the overall level of activity in the center.

If the City wanted to go in another direction—one of trying to maximize retail development in a more traditional suburban style—City decision makers could consider creating additional commercial land through rezoning.

If Fairwood residents vote in favor of incorporation, at some point after the City is established, and after the City government gains solid footing, the City would then be in a position to evaluate what efforts the City can take to focus and encourage development in the commercial center in a manner that helps achieve the City's long-term goals.

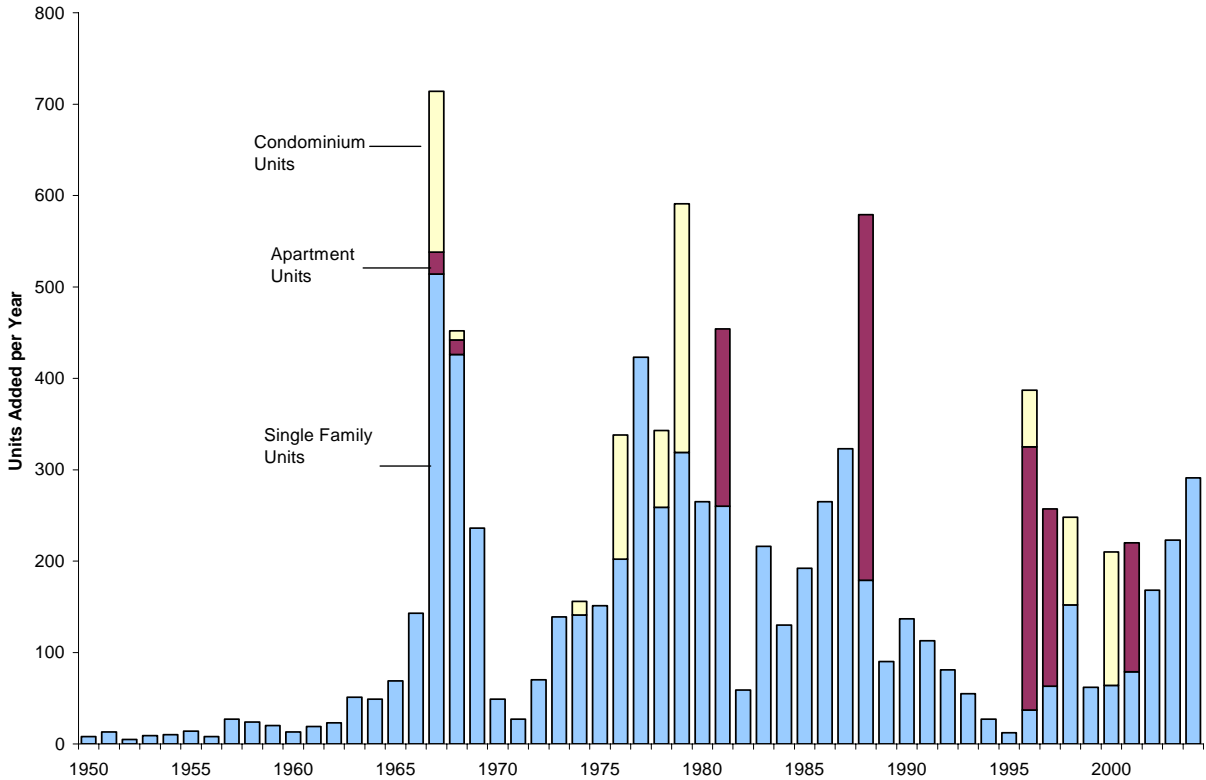
Housing

In its early years of development, Fairwood represented an outlying residential area in the region. In current terms, however, with residential development extending deep into Pierce and Snohomish counties, Fairwood can be viewed almost as a close-in community, with driving distances of 18 miles or less to the region's largest employment centers.

Fairwood's housing stock is dominated by single family housing—representing a little more than 70% of the area's total housing. Almost all of Fairwood's housing was built over the last 40 years, with construction booms in the late 1960s, the late 1970s to about 1990, and the late 1990s to the present (see Exhibit 28).

In broad terms, Fairwood appears to be approaching build-out—at least in terms of large-scale, greenfield development. Few large, developable properties still exist within the boundaries of the proposed city. Some of the larger developable properties are located relatively close to Fairwood's commercial center and are zoned for housing at a density of six dwelling units per acre.

Exhibit 28 Fairwood Area Housing Construction



Source: King County Assessor data extracts and Berk & Associates

On average, the type of housing that is being developed in Fairwood now is consistent with what has been built in the area for the last 20 years. Developers are building a mix of single family and multi-family housing, and within multi-family housing stock the area is seeing the addition of both apartments and condominiums.

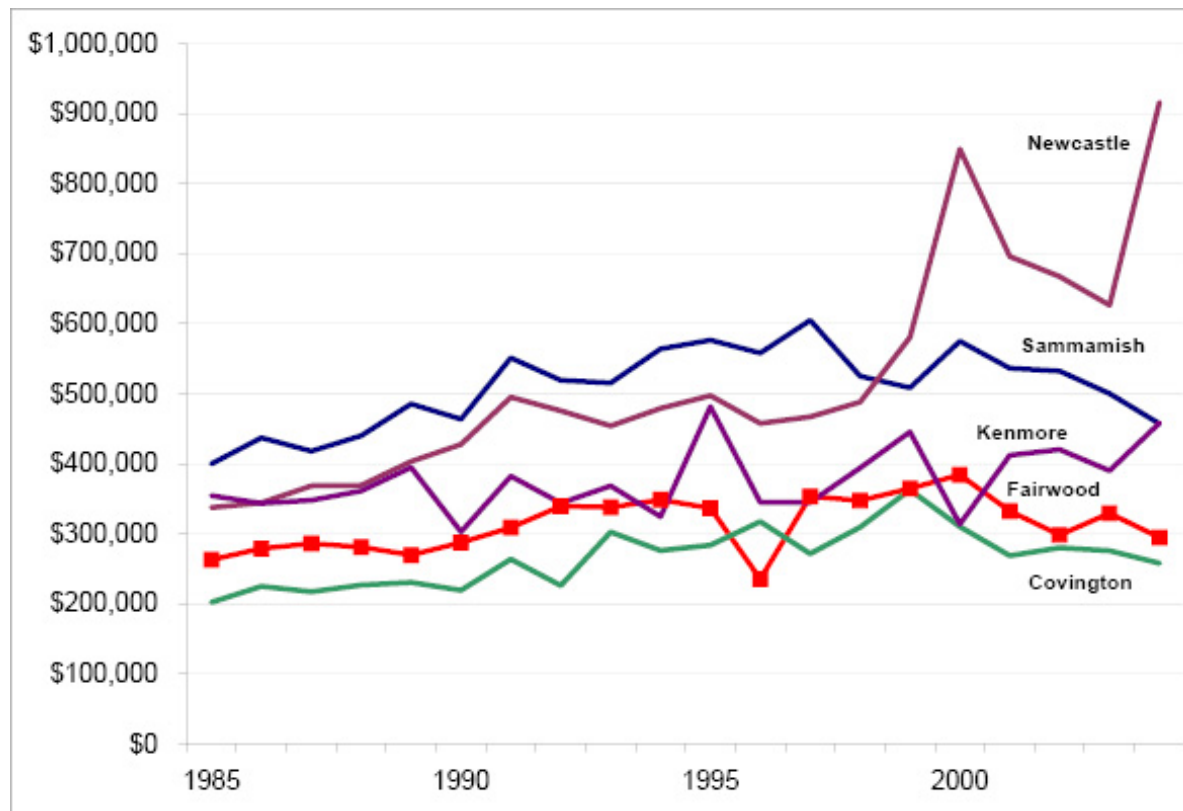
Within the single family category, new housing in Fairwood is of slightly higher value than housing built in the 1980s. The average single family house built from 2000 through 2004 in Fairwood is currently valued at \$315,000. For houses built in 1985 through 1989, the average current value is roughly \$275,000.

Exhibit 29 shows how values of houses change in Fairwood and recently incorporated cities depending on the year when the house was built. All values in the exhibit reflect current values of houses (2005 assessed values), sorted by the year the houses were built. What Exhibit 11 shows is that one city, Newcastle, has seen dramatic increases in the values of new housing since the City's incorporation. Other cities, including Sammamish and Kenmore, have seen marked swings in values

depending on the year and, presumably, depending on the specific developments under way in a given year.

Fairwood, by contrast, has seen relatively stable housing values, with values of new housing that are consistently greater than those of Covington.

Exhibit 29
Housing Construction Trends for Fairwood and Other Recently Incorporated Cities
(Average House Value in 2005 by Year of Construction)



Source: King County Assessor’s data extracts and Berk & Associates

The reason that trends in housing values matter to a city is because, particularly for residential cities, a city’s housing stock is the principal source of city tax base.

11. POTENTIAL ADDITIONAL REVENUE SOURCE

Sales Tax Streamlining

Because the Washington State Legislature is expected to consider actions to address changes in sales tax sourcing rules in the coming legislative session, it is possible that by the time Fairwood residents vote on incorporation, new “sales tax streamlining” rules may be in place. If enacted, these rule changes would have a modest positive impact on a City of Fairwood’s revenues.

In the preceding feasibility assessment, the model did not assume any revenues from sales tax streamlining. However, to ensure that Fairwood residents have information available to them should the legislature act, the following discussion outlines (1) what sales tax streamlining is and (2) how potential streamlining rule changes would be likely to affect the proposed City.

History of Sales Tax Streamlining

In recent years, the Washington State Department of Revenue has engaged in a cooperative effort among states and private industries to create more uniform sales tax structures, referred to as the Streamlined Sales Tax Project. The Project’s mission is to simplify the rules surrounding the levying of sales taxes, with a goal to pave the way for taxation of delivered goods (such as catalog and Internet sales) whose sale originates out-of-state.

States participating in the project have been changing their sales tax laws to be consistent with provisions of the Streamlined Sales and Use Tax Agreement (SSTA), a set of provisions developed by participants in the by the Streamlined Sales Tax Project. The Department of Revenue believes that Washington needs to implement the sourcing rule to comply with the model agreement and to become a member of the governing board, which will decide the rules for future streamlined sales tax provisions. As a member, Washington State will receive additional sales taxes from remote sellers who have agreed to voluntarily to comply with the SSTA, in part to benefit from its tax liability protections. Under the terms of the SSTA, those retailers will collect sales taxes for every member state that has implemented the model agreement.

In 2003, the Washington State Legislature enacted a bill including several provisions of the SSTA, but the new law did not include key provisions that redefine the “sourcing” of delivered retail sales. The “source” of a sale determines the place of sale, which in turn, determines the jurisdiction to which the local portion of sales tax accrues for a given transaction.

Under current State law, the “source” of sale for most delivered goods is deemed to be the store or warehouse from which the delivery originates. Thus, the local sales tax on sales of goods is allocated to the jurisdiction of the retail outlet at which, or from which, delivery is made.

What this means for Washington cities is that under the sourcing provisions of the agreement, the “source” of most delivered goods would shift local sales taxes to the place of delivery instead, and the potential exists for substantial shifts in revenues from jurisdictions with businesses that involve delivery of goods to customers in other areas (such as software sales and warehouses that deliver goods like furniture to retail customers outside the jurisdiction).

For example, under current law, a mattress that is delivered to a house in Covington from a warehouse in Tukwila will generate local sales taxes for the City of Tukwila, where the delivery originates. If enacted, the sourcing provisions of SSTA will change the “source” of that sale (and therefore the recipient of the local sales tax dollars) to the destination of the delivery (the City of Covington). Given the potential for large losses by certain cities, including Tukwila, Kent, and Woodinville, some local jurisdictions originally objected to legislative passage of the SSTA sourcing provisions, which is why the provisions were left out of the 2003 bill.

To assess the revenue implications of SSTA sourcing provisions on local jurisdictions, the State Legislature directed the Department of Revenue (DOR) to conduct a study of the fiscal impacts on jurisdictions. In 2004 and 2005, Streamlined Sales Tax and the implementation of destination-based sourcing was divisive for cities, and the Legislature adjourned without taking action on either of the proposals to implement destination-based sourcing and provide mitigation to impacted jurisdictions. The Association of Washington Cities also convened a group of cities to work with an outside facilitator in an effort to devise an acceptable solution to this controversial issue over the interim. That process began in April 2004, with the assistance of a workgroup that is composed of 12 cities that represent an equal number of positively and negatively impacted jurisdictions.

The Department of Revenue released a 2005 sourcing mitigation proposal, but later decided not to submit legislation. The proposal would have dedicated expected revenues from additional sales tax from remote seller voluntary compliance with the streamlined sales tax model agreement, and provided mitigation for cities, counties, and transits impacted by the implementation of sourcing, to be phased out over 10 years. In addition, the proposal would have provided ongoing backfill funding, based on 2005 distributions, for those cities and counties that were substantially impacted by the repeal of the motor vehicle excise tax (MVET). The Legislature did not take action on any of the four bills before it adjourned for the year.

What Potential Streamlining Rule Changes Could Mean for Fairwood

The contemplated City of Fairwood has a relatively weak commercial tax base, and it appears to have few, if any, businesses that generate sales taxes through delivered goods. On the other hand, as a primarily residential city, households in Fairwood certainly purchase delivered goods now. This means that Fairwood would be likely to benefit from the expected change in sourcing rules. Assuming that the rule change will occur at some point, in addition to the immediate benefit the City would see from currently delivered goods, a City of Fairwood may also see opportunities to promote purchases of delivered goods to secure financial support for City goals.

While few reliable data are currently available to inform estimates of how much additional revenue a city like Fairwood could expect to see as a result of changed sourcing rules, most plausible estimates suggest that the impact would be relatively modest.

If, for example, each Fairwood resident were to purchase an average of \$1,000 of delivered goods (from retailers located outside of Fairwood, but within Washington State), then the City of Fairwood would receive new sales taxes equal to roughly 0.85% of those orders (\$.850 per resident). Under this illustrative example, combining resident expenditures with local business purchases of delivered goods (furniture, supplies, etc.) might mean that the City of Fairwood could expect to see a net increase in sales tax revenues of roughly \$250,000.

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Of course, if Fairwood residents and businesses purchased more or less in delivered goods, then City revenues would be higher or lower.

As a final point, it is worth noting that potential changes in retail sourcing rules offers cities like Fairwood an opportunity to ask residents to change their purchasing behavior in ways that benefit the City.

12. LIST OF SOURCES

Following is a list of sources that were used in developing the feasibility assessment for the incorporation of Fairwood. Typically, estimates included in this analysis reflect Berk & Associates' integrated analyses of data from many of these sources. For example, estimates of current population in Fairwood are based on Berk & Associates' combination of (1) U.S. Census data; (2) King County Assessor's Office data extracts; (3) King County GIS datasets; (4) Puget Sound Regional Council building permit data; (5) King County Annual Growth Reports; and (6) conversations with the Chief Demographer of King County.

As a result of the integrated use of multiple datasets, on multiple platforms (GIS, database analysis, Excel, and statistical analysis software) for a more detailed discussion of the sources used for a given estimate, readers should see the discussions of Fairwood characteristics and discussions of revenues, expenses, and market analysis for more information about the method of analysis.

Sources:

- City of Burien
- City of Covington
- City of Kenmore
- City of Edgewood
- City of Normandy Park
- King County Annual Growth Reports
- King County Assessors Office data extracts
- King County GIS
- King County Office of Financial Management
- King County Parks Division
- King County Roads Division
- King County Sheriff's Office
- King County Water & Land Resources Division
- Municipal Services & Research Center
- Puget Sound Regional Council
- United States Census Bureau
- Washington State Auditor's Office
- Washington State Department of Revenue
- Washington State Office of Financial Management

APPENDICES

The following section provides five documents that provide further background into the conduct of this study:

King County Sheriff's Office Fairwood Police Contract Options

King County Department of Transportation Roads Division Pavement Condition Data

King County Water and Land Resources Division Inventory and Historic Projects

Participants in Study Review

"Comparable" Cities Referenced in the Report