2015-2016 King County Executive Proposed Biennial Budget

King County

In Brief:

- **King County's economy is strong, but the nature of County revenue sources means that General Fund revenues are only growing slowly**
- **The state and local tax burden in Washington is well below the national average and has been declining steadily for 20 years**
- **The 1 percent growth limit on property tax revenue means that General Fund revenues will grow less than inflation and population growth under almost all circumstances**
- **Sales taxes exhibit less growth than in the past because the proportion of income spent on items subject to the sales tax is declining**
- **King County's implementation of the State Growth Management Act has eliminated almost all the commercial tax base in the unincorporated area**

Economic Situation

King County's economy is improving rapidly and has recovered from the Great Recession of 2008. Preliminary July 2014 data show the County's unemployment rate to be 4.9 percent, compared with 5.4 percent for the state and 6.2 percent for the nation. While some individuals remain under-employed and while wage growth has been stagnant in several economic sectors, the county is experiencing strong growth in software, technology, retail, construction, and hospitality services. Aerospace, education, business services, and health care sectors also are major components of the regional economy.

A resurgent housing market is fueling growth in property values. The latest forecast from the Office of Economic and Financial Analysis (OEFA) predicts growth in assessed property value to be 11.72 percent between 2014 and 2015. According to the Assessor's Office, growth in property values is occurring countywide, rather than being restricted to some neighborhoods in Seattle, Bellevue, and nearby cities, which was the case in the last two years. New construction is expected to add about $4.2 billion to the tax rolls in 2015, well above amounts during the Great Recession but still well below the peak period in the late-2000s.

Similarly, the County is experiencing considerable growth in the sales tax base. The latest OEFA forecast is for 5.96 percent growth in 2014 and 4.97 percent growth in 2015. This growth is broad-based, with particular strength in construction, hotels, motor vehicles, and various retail sectors.

Despite this strong economic growth, the revenue for many King County funds, including the General Fund, is growing only sluggishly. This is largely because of the structure of revenues available to the County under State law, which is mostly based on economic models from the 1930s.[1]

STATE AND LOCAL TAX BURDEN IN WASHINGTON

The effects of this structure and various tax limitation measures can be seen in Figure 1, which shows the trend in state and local taxes per $1,000 of personal income. The U.S. Census Bureau collects data about this combined state and local tax burden on an annual basis.[2] In 1991, Washington's combined state and local tax burden was $121.75 per $1,000 of personal income. This was about 8 percent higher than the national average of $112.67. As can be seen in Figure 1, Washington stayed above the national average until 2000. Since then, Washington's tax burden has been substantially below the national average. By 2011, this figure had declined to $98.95 per $1,000 of personal income, 9 percent less than the national average of $108.31.

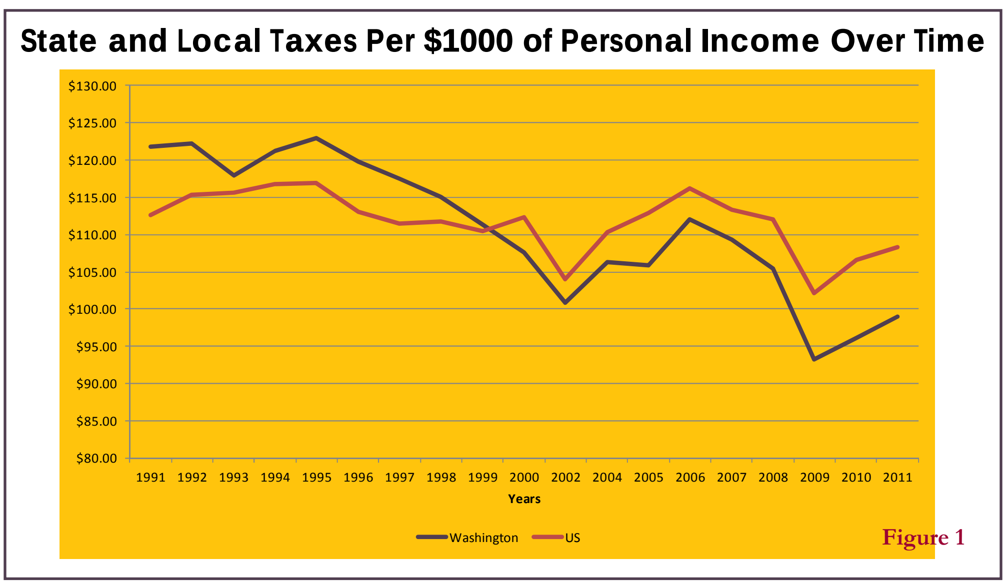

Figure 1

Viewing this information in another way, the national average tax burden has moved in a fairly narrow range between 1991 and 2011, with changes driven largely by economic conditions. Washington shows some of the same economic effects, but with a 19 percent decline in tax burden over the period. Washington now ranks 35th among the 50 states in state and local tax burden.[3]

[1] Most of Washington's tax structure was established as a result of the Great Depression. Sales taxes and Business and Occupation (B&O) taxes were added to the previously established property and gasoline taxes. Unlike the State and cities, counties were not given the authority to levy B&O taxes. When local sales taxes were authorized in 1970, counties were given a much smaller portion of the tax than cities in incorporated areas. No significant changes to the tax system of counties have been made since then.

PROPERTY TAXES

Legislatively-imposed limitations on local revenues are a major factor behind this decline in tax burden. The most notable of these was the enactment of Initiative 747, which limited annual growth in property tax revenues to 1 percent, plus the value of new construction.[4] This has been particularly burdensome for county governments because property tax is by far the largest authorized source of General Fund revenue. I-747 was ruled unconstitutional in 2007, but its provisions were reenacted by the Legislature immediately thereafter.

The 1 percent property tax revenue growth limit has had a significant effect on revenues for the County's General Fund. For the 2015/2016 biennium, property taxes are projected to be 43 percent of the General Fund's revenue, more than double any other revenue source. Capping property tax revenue growth so far below the rate of inflation and population growth (typically 3.0-3.5 percent per year) has led to continued reductions in County services, despite significant efficiencies achieved in recent years.

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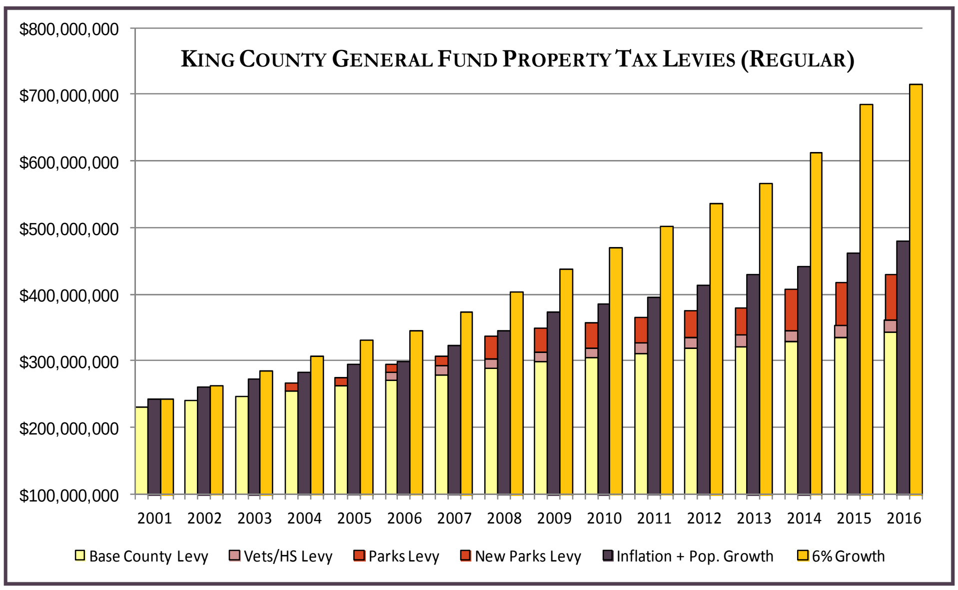

Figure 2

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[2] This analysis was not done in 2001 or 2003. As of this writing, the latest data available is for 2011.

[3] The Tax Foundation, an independent non-profit organization, prepares these calculations in a slightly different way. Their analysis for 2011 ranks Washington 27th, still below the national average. Most of the difference appears to be due to how payments by residents of one state to other states are calculated.

[4] I-747 was approved statewide by 57.6 percent of the voters, but failed in King County with only a 48.3 percent "yes" vote.

[5] Property tax rates, expressed as $ of tax per $1,000 of assessed value (AV), are also limited by State statute. The County's General Fund tax rate is limited to $1.80 per $1,000 AV, but the actual rate is much lower. In contrast, the Road Levy, which is levied only in the unincorporated area to pay for roads and streets in that area, is at its statutory maximum of $2.25 per $1,000 AV.

[6] The County has two other levy lid lifts that are not shown in Figure 2. The Automated Fingerprint Identification System (AFIS) levy has been in place for decades and long predates the 1 percent limit. The levy for the Children & Family Justice Center is for a capital project and does not support the operating budget. Counties in Washington have little capacity to fund major capital projects from existing revenues, so projects such as courthouses and jails are typically financed with voter-approved property taxes.

The County has used the property tax levy lid lift as a tool to maintain some programs. The levy lid lift is a ballot measure submitted to the voters that temporarily raises property taxes for a specified purpose. As can be seen in Figure 2, the County's voters have approved levy lid lifts for parks and for veterans and human services programs on multiple occasions.[6] These ballot measures have allowed funding for programs to continue, offsetting cuts in General Fund support. In 2001, the General Fund provided $25.7 million for parks. By 2011, parks had been eliminated from the General Fund budget. Similarly, General Fund support for human services peaked at $20.1 million in 2005. By 2011, this support had declined to about $1 million.[7]

Despite voter approval of levy lid lifts, property tax collections have lagged behind inflation and population growth. After including the parks and veterans and human services lid lifts, the 2015 levy is about $42 million less than it would have been had property tax revenues kept up with inflation and population growth since 2001. Under the 6 percent limit that was in place for most of the 1980s and 1990s, property tax revenue could have been nearly $236 million more in 2015 than will actually be received.

SALES TAXES

Another trend that is affecting County revenues is the decreasing share of personal income subject to the sales tax. The sales tax was insitututed in the 1930s and is based largely on purchases of goods. Over time, spending patterns have shifted to services and investments, and some goods purchases have escaped sales taxes by being done through mail order or over the Internet. Figure 3 shows the trend in the share of King County personal income spent on items subject to the sales tax.

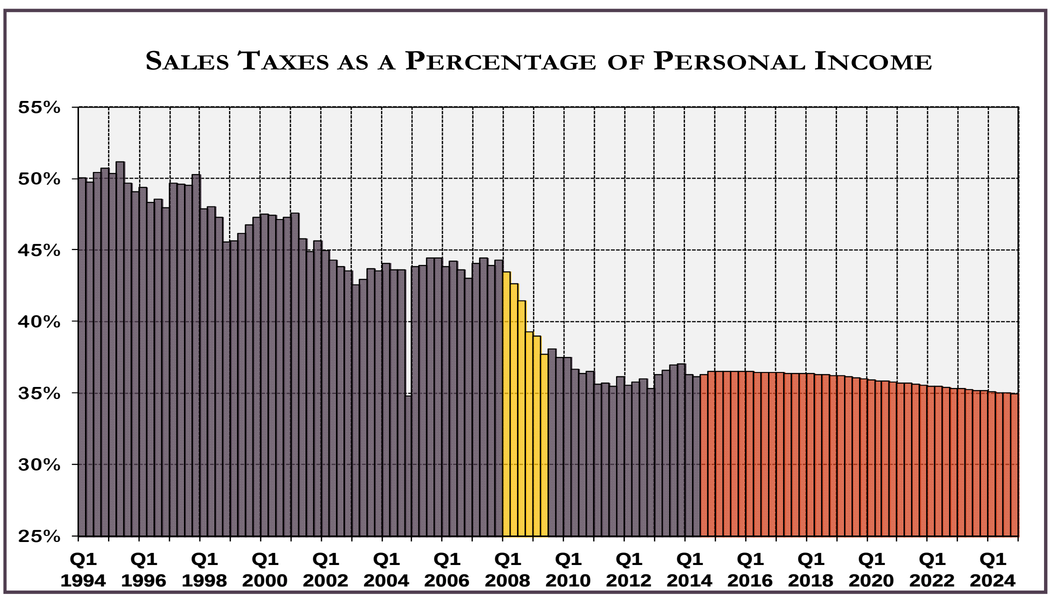

Figure 3

[7] These figures do not include the Children and Family Services "set-aside", a diversion of some General Fund revenue to a separate fund. This fund is being merged into the General Fund for 2015/2016 to improve budget transparency. Including this set-aside in the figures would increase the totals but not change the trend.

In the mid-1990s, about 50 percent of every dollar of personal income was spent on items subject to the sales tax. This gradually declined to about 44 percent through 2007, then plunged during the Great Recession. Unlike in prior recessions, it has not recovered substantially as the economy has improved, continuing to hover around 37 percent. Most economists attribute this to increased emphasis on saving. In King County, it is also affected by demographic trends and purchasing patterns. King County is attracting many young individuals, who often have significant college debt and thus less income to spend on taxable items. These individuals also have different purchasing patterns, preferring smaller housing and often foregoing car ownership. This reduces purchases of taxable items such as vehicles, appliances, and furniture. As a result of these trends, the very strong sales tax growth seen in previous economic recoveries (often exceeding 10 percent annually) appears unlikely to occur again.

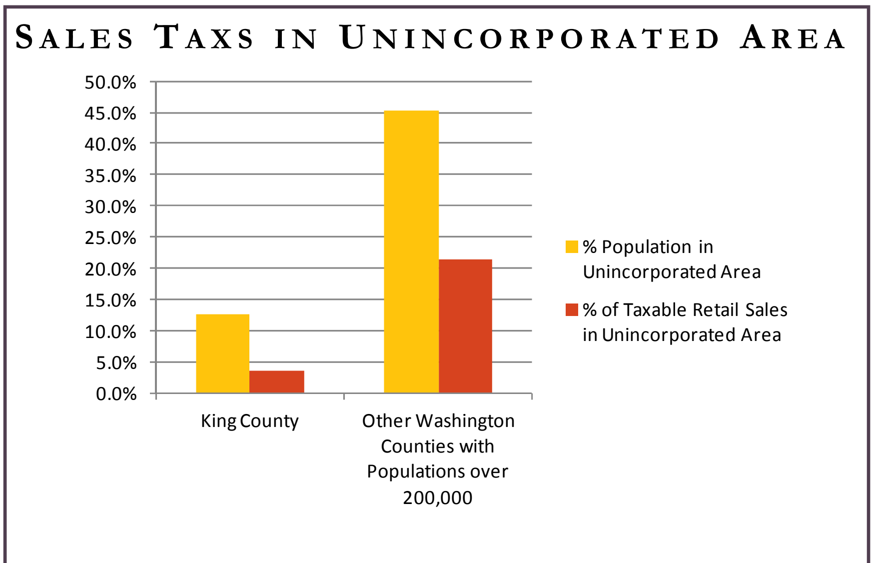

Figure 4

King County is also unique among Washington urban counties in having almost no sales tax base in unincorporated areas. As shown in Figure 4, King County has only about 12.5 percent of its population in the unincorporated area, compared to an average of 45.3 percent for the other eight counties with populations over 200,000. Even more remarkably, only 3.6 percent of taxable retail sales occur in unincorporated King County, versus an average of 21.4 percent for the other counties. These differences are likely due to the more complete implementation in King County of the State Growth Management Act, which calls for urban areas to become part of cities. The significance of this difference is that counties receive the entire 1.0 percent local sales tax rate on sales in unincorporated areas, while receiving only 0.15 percent on sales within cities. As a result of its adherence to the Growth Management Act, King County's General Fund sales tax revenue is much less than it otherwise would be.