

STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND
REVIEW COMMITTEE (JLARC)



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John Braun, *Vice Chair*
Annette Cleveland
David Frockt
Janéa Holmquist Newbry
Jeanne Kohl-Welles, *Secretary*
Mark Mullet
Ann Rivers

Representatives

Gary Alexander
Cathy Dahlquist, *Assistant Secretary*
Tami Green
Kathy Haigh, *Chair*
Ed Orcutt
Gerry Pollet
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AGENDA

September 18, 2013
10:00 a.m. – 12:00 p.m.
John L. O'Brien Building
House Hearing Room C
Olympia, Washington

1. Committee Business
 - A. Action Item: Approval of February 20, 2013, and August 14, 2013, JLARC Meeting Minutes
2. Scope and Objectives:
 - A. Forensic Accounting Audit of The Columbia River Crossing Project
 - B. Review of How the Washington State Department of Transportation Assesses Highway Preservation and Maintenance Needs
3. Preliminary Report:

Local Infrastructure Financing Tool (LIFT): Lack of Data Hinders Evaluation and Administration of the Program - Preliminary Report

Joint Legislative Audit and Review Committee (JLARC)



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JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE REGULAR COMMITTEE MEETING MINUTES

COMMITTEE BUSINESS

- Gary Alexander, JLARC Vice-Chair, called the meeting to order at 6:00 p.m.
- Representative Alexander welcomed to the Committee new members Senator Cleveland from the 49th Legislative District, Senator Mullet from the 5th Legislative District, Representative Springer from the 45th Legislative District, and Representative Van de Wege from the 24th Legislative District.
- Representative Alexander said a thank you to JLARC's former Chair, Senator Craig Pridemore, and reviewed the JLARC rule governing the election of Executive Committee members. He explained that the Chair for the remainder of the 2011-13 Biennium would be elected from the JLARC Senate Democrat members. He opened nominations for JLARC Chair for the remainder of the 2011-13 Biennium.

Senator Nelson nominated Senator Jeanne Kohl-Welles. Motion was seconded, and the Committee elected by unanimous decision Senator Kohl-Welles as Chair for the remainder of the biennium. Senator Kohl-Welles acted as Chair for the rest of the JLARC meeting.

- *A motion was made to approve the minutes from the September 19, 2012, and December 5, 2012, JLARC meeting. Motion was seconded and carried unanimously.*
- Senator Kohl-Welles indicated that the next item before the Committee was approval for distribution of the Alternative Public Works Procedures Sunset Review Proposed Final Report. She noted that the report had been presented to the Committee the previous September and December, but that JLARC had lacked a quorum at the December 2012 meeting to take up a motion to distribute. She added that the report would not be presented again at this evening's meeting. *Representative Haigh moved to approve for distribution the Alternative Public Works Procedures Sunset Review Proposed Final Report. Motion was seconded and carried unanimously.*
- Senator Kohl-Welles reminded the Committee that it had discussed adding a study to the JLARC work plan at its September 2012 work session and had selected a study on the quality and accuracy of fiscal notes. She invited Deputy Legislative Auditor John Woolley to provide a brief overview about the process and the selected study.

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The Deputy explained that the Committee had reviewed and discussed seven different study options at its September work session as part of selecting one study to fill some available staff capacity in the Committee work plan. He reported that the Committee had decided unanimously that it wanted staff to review the accuracy and quality of fiscal notes. He added that staff has undertaken some initial work on the project, looking at the practices of other states and gaining a better understanding of the processes in this state. *Representative Alexander made a motion to add a study of the quality and accuracy of fiscal notes to the Committee's work plan. Motion was seconded and carried unanimously.*

- Senator Kohl-Welles asked Legislative Auditor Keenan Konopaski to brief the Committee on Executive Committee request legislation to extend the expiration date on the sunset review process. She added that the House version of the bill had received a public hearing while the Senate version had not yet been scheduled for one.

The Legislative Auditor reminded the Committee that this was another item discussed at its September 2012 work session. He reported that the Sunset Act has been in place since 1977 and that JLARC staff have completed 113 sunset reviews since that time, resulting in the Legislature terminating 36 agencies or programs and continuing 77. He explained that the effect of the Executive Committee request legislation (HB 1860 and SB 5734) is to extend the expiration date on the sunset review process from 2015 to 2025.

Representative Alexander commented that, in addition to the importance of the legislation itself in allowing the Committee to continue to do sunset reviews, he saw this bill as the start of something he hopes the Committee will undertake on a continuing basis: the sponsoring of legislation by the Committee as a whole rather than individual members sponsoring bills to implement recommendations. He said he hopes this is a starting point for something he feels is important.

- Senator Kohl-Welles asked the Legislative Auditor to explain for the benefit of the new members the role of JLARC's Executive Committee. The Legislative Auditor explained that the Executive Committee has a representative from each of the four caucuses and that they work on a consensus basis to help address some of the administrative and planning issues of the Committee and to bring recommendations to the full Committee.

REPORTS, PRESENTATIONS, DISCUSSIONS

Trout Production: Estimates Suggest Price Competitive Options are Available – Proposed Final Report

Tracey Elmore and Elisabeth Donner from the JLARC staff presented the proposed final report for this study. The Legislature directed JLARC to identify the availability of alternative approaches to trout production and to compare the Washington Department of Fish and Wildlife's (WDFW) trout production costs with the costs of alternatives. Alternatives are available, and WDFW currently uses five of them. The Department approaches trout production in a business-like manner, but it does not track hatchery costs by fish species and size. This inhibits the Department's ability to compare costs with alternative approaches. Based on cost estimates that JLARC staff obtained during this study, it appears that both WDFW and the private sector may be able to supply rainbow trout for competitive prices. The Legislature will not know with certainty whether these estimates apply

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more broadly until: 1) the Department collects hatchery cost information by species and size, and 2) formal bids are available showing the prices private growers would charge. JLARC staff recommend that WDFW develop a process that allows the Department to collect fish production cost data by species and size at each of WDFW's hatcheries for comparison to private sector prices.

Senator Kohl-Welles invited representatives from the Department of Fish and Wildlife to come before the Committee (Jim Scott, Assistant Director for the Fish Program, and Kelly Cunningham, Deputy Assistant Director).

WDFW staff indicated that the agency is supportive of the report's findings and its recommendation. The staff said the Department wants to make four key points: 1) maintaining a strong trout program is essential to the long-term success of the Department because 50 percent of operating funds come from fishing and hunting license sales, and about 80 percent of those who buy fishing licenses fish for trout; 2) the initial findings from the comparison in the study show that costs for catchables are about the same for the Department and the private grower, while WDFW can produce the small fish at a cost lower than the private grower; 3) hatcheries are important to their local communities, for example, through school programs or other outreach opportunities; and 4) WDFW strongly supports the report's recommendation, seeing this as a valuable tool to help make the trout program successful.

Representative Orcutt asked for a breakdown by size of fish on what the Department expended for operating costs versus capital costs. WDFW staff estimated that it is 90 percent operating.

Senator Hewitt asked, for the catchables, how many the Department buys versus what it grows in its hatcheries. WDFW staff responded that the Department's largest purchase is for triploid trout, which are larger than the catchable size, and that on average the Department purchases 50,000 of those per year. They added that the Department has purchased as many as 151,000 triploid in recent years. They explained that the Department raises 3.3 million catchable-size rainbow trout per year.

WDFW staff commented that lowland lake opening day is a cultural event in Washington. Senator Kohl-Welles noted that this same culture is present in other states as well.

Representative Haigh asked for clarification about the triploid trout. WDFW staff explained that the triploid trout cannot mature sexually and so focus their efforts on growing body mass, which makes them a nice target for fishing.

Representative Alexander moved to approve for distribution the Trout Production: Estimates Suggest Price Competitive Options are Available Proposed Final Report. Motion was seconded and carried unanimously.

Puget Sound Partnership's 2012 Action Agenda Update: Revised Approach Continues to Lack Key Accountability Tools Envisioned in Statute – Briefing Report

John Woolley and Eric Thomas from the JLARC staff presented the briefing report. The 2011 audit of the Puget Sound Partnership (PSP) concluded that the 2008 Action Agenda lacked critical accountability tools. The 2012 Legislature directed JLARC to review the Partnership's updated Action Agenda to determine if those recommendations were implemented. JLARC staff found that the 2012 Action Agenda improves accountability but continues to have shortcomings in three key areas: linking actions to progress toward

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goals, prioritizing actions, and monitoring effectiveness. In its response to the audit, the Partnership states that it does not believe it is always possible to identify in a quantifiable way how much proposed investments in the Action Agenda will contribute to the restoration of Puget Sound. Without this linkage, it will not be possible for the Legislature to know what restoration progress has been achieved as a result of the state's investments, and whether those investments are making progress that is sufficient to achieve the goals expected for 2020.

The Legislative Auditor reminded the Committee that JLARC had had a previous assignment about the Puget Sound Partnership and that, following that first audit, the Legislature had tasked JLARC staff with a follow-up. He explained that this is an instance where the more important part of what members are hearing about this follow-up may be in the response letter from the Director of the agency, which is included in the report. He reminded the Committee that, when the Legislature established the Partnership, it did so with a very deliberate accountability framework, including the Legislature being able to see how much progress was being made as a result of investments made in the clean-up of the Sound. The Legislative Auditor noted that the response from the agency brings into question whether it is attainable to draw cause and effect relationships between the investments and what they might produce, which if true would create a challenge for the state in being able to monitor progress.

Senator Nelson asked if, in the underlying statute, the Legislature gave the Partnership the authority to intervene, for example, if development were occurring in a sensitive area or to prevent shoreline armoring. Staff answered that the Partnership is probably not an entity that is intervening, that the Partnership is more in a role of planning and identifying what is required to restore Puget Sound.

Senator Holmquist Newbry asked about what funding the Partnership received in the state budget in the last few biennia. Staff did not have a ready figure but raised the distinction between the Partnership's budget and all the other funding from local government and state government that goes into efforts to restore Puget Sound. Senator Holmquist Newbry said she would appreciate receiving that information from the Partnership staff.

Senator Kohl-Welles invited representatives from the Puget Sound Partnership to come before the Committee (Tony Wright, Director, and Rob Duff, Puget Sound ecosystem monitoring program). The Director thanked the JLARC staff for their work and indicated that, while the JLARC staff's facts and their representation are excellent, he does not completely agree with their conclusion. He said his response letter may have been taken out of context and that it was designed to be linked to the ability to say a particular action of a particular small, discrete restoration project cannot necessarily be linked to a particular change in an ecosystem. He called the Committee's attention to the third paragraph of the agency response letter and reported that the discrete sentence quoted is accurate but is certainly not his opinion or that of agency staff. The Director indicated that he thinks they can get reasonable certainty on many of the activities and that the urgency to restore the Sound calls for making decisions without absolute certainty, just as a business person would not wait for 100 percent certainty while competitors made decisions.

The Director commented that he is happy with the report and that the report accurately states the challenges they have. He said that there are many challenges in trying to handle an ecosystem that is this complex and that across the nation other large-scale ecosystem restoration efforts also face challenges. He reported that

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development of quantitative links is underway and that this effort is tied to monitoring. He stated that they do not have sufficient monitoring to make all the necessary decisions. The Director indicated they are making decisions based on insufficient intelligence. He said that, most of the time, those are generally correct. The Director said that trying to present certainty with limited monitoring means that they have to look where the problems are and that that allocation of monitoring assets competes against their ability to look to see what the results of their actions are. He indicated that both are incredibly important and that the shortage of monitoring activity affects their ability to achieve certainty in these areas.

The Director reported that he agrees with the report's assessment regarding no evaluation of the effectiveness of existing state agency programs. He added that, for the first time, the Partnership asked for copies of agency request budgets prior to submission to the Governor to evaluate those for consistency with the action agenda. He also said that they took the various activities associated with Puget Sound restoration, evaluating and prioritizing them against the action agenda and providing this priority list to the Governor, which she used in preparation of her budget. The Director indicated these are significant steps that need to be built upon in order to have an integrated approach at a time of limited state dollars so that they are spending the dollars in the right place and associating them with the priorities.

The Director explained that the Partnership has several sets of priorities associated with the action agenda. He added that, while the priorities are in three separate lists, they have been scientifically addressed and evaluated, and that they use those in conjunction with their activities.

The Director said that everything is not in place nor perfect. He explained that this is a work in progress with what is one of the three largest ecosystem restoration projects in the nation. He said he would put up its activities, plans, and effectiveness against the other two, especially when it comes to efficiency of funds.

Representative Haigh asked about how well partners were able to break down silos and work together with all the different agencies and entities. The Director answered that working with all the different agencies was one of the biggest challenges. He noted that each agency has a specific charter, mission, and goal, and for the Partnership to step in and say how it wants to shape that mission and goal requires a collaborative environment where the agencies can participate in the development of the plan.

The Director reported that one of the things they are doing as part of Chinook recovery is developing adaptive management plans for each of the watersheds, with that work underway. He also reported that they are taking more of a project management approach in tracking all of these activities, with each activity requiring monitoring before, during, and after execution, each activity requiring resources, and each activity having an expected outcome that ought to be measured. The Director said they need to have a comprehensive plan that looks at these activities, identifies gaps either in results or monitoring or execution timeline, and weaves them into a comprehensive plan. He indicated this is something they are in the process of developing, in coordination with the Environmental Protection Agency. He explained that this is how he sees them approaching this particular problem, continuing to build on the action agenda that identifies a number of the things that need to be done, but that these need to be interwoven into a resource-identified plan that allows them to make the hard decisions about where they need to work first.

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Representative Alexander commented that the accountability issue goes back some 30 years of having goals and some way to measure the goals. He asked why we have not learned from this and why they have not focused on some specific areas in Puget Sound to see if they could find a successful accomplishment. He remembered the success with the Commencement Bay issue when we targeted resources into that one specific area rather than trying to spread resources through the large estuary. He asked why PSP does not focus on one or two areas and show their success. The Director answered that their charter is of the entire Puget Sound, with an Ecosystem Coordination Board with regional and functional representatives. He added that, without the clear criteria that he hopes to gain from the implementation plan, he would need to have a good argument to tell representatives, counties, and other stakeholders that they are not doing any work in their area and that what is most important to be done is elsewhere. He said the hard decisions require monitoring, linkages, and an overarching implementation plan that allows them to make the hard priorities.

Senator Holmquist Newbry asked what the agency's state fund budget is. The Director answered that it is about \$2.5 million per year. Senator Holmquist Newbry asked about federal funds. The Director answered that the federal funds vary and that this year's National Estuary Program dollars are about \$30 million, not to the Partnership but to the departments of Ecology, Fish and Wildlife, and Natural Resources, with a portion of that going to the Partnership for administration.

Senator Kohl-Welles asked about capital budget funding. The Director answered that they support capital budget requests for other agencies, for example, the Puget Sound acquisition and restoration activity managed by the Recreation and Conservation Office. He indicated they do have a budget request for the system-wide improvement framework to help increase people's flood protection while responding to habitat concerns.

Senator Nelson asked what the Legislature could do for the Partnership to make sure we restore Puget Sound, noting that Representative Alexander was correct that it has been 30 years and that we need to move forward. The Director responded that we need to "stop the bleeding," saying that they are not making much progress according to the gauges they have. He noted that the population continues to grow and that they have to figure out a way to protect what is there rather than restoring after degradation. He cited the impacts of upwelling and ocean acidification.

The Director further noted the need for an overall implementation plan that includes ongoing activities. He said the other agencies are rightfully cautious about how the Partnership coordinates and works with them, indicating they need continued support for comprehensive, coordinated activities for restoration. He also said there are insufficient funds to do what they need to do, at the state, federal, and local level. He indicated that, if they are not making the right decisions, they will be in trouble, and so they need a comprehensive plan that identifies their shortfalls in monitoring and where they need to focus. He said that the capital projects need to have monitoring monies applied to them. He concluded that there was insufficient time to identify the whole list of things that need to be done. Senator Kohl-Welles invited the Director to provide the Committee something in writing before his departure if he wanted to share additional thoughts.

Representative Dahlquist asked the Partnership to provide the Committee with line-item information on where the dollars come from in the \$641 million annual Puget Sound budget. The Director indicated that some of this information is in the *State of the Sound* report and that he can provide the Committee with that information. He

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added that some of the information is an estimate, for example, estimates from counties depend on how those counties define “spending on the Sound.” He said that the predominant amount of the funds is coming from the local level based on stormwater revenue districts and other activities.

Representative Dahlquist said that she wants the information to cover every dollar, local through federal, that is being spent within the Partnership or that the Partnership is associated or affiliated with. The Director responded that her question raised an important point that these dollars are being spent on the Sound but that the Partnership does not always get a vote on where the money goes.

Senator Kohl-Welles thanked the Director for his service and asked if a representative from the Leadership Council could provide the Committee with information on the next steps to find a new agency director. Martha Kongsgaard, Chair of the Partnership’s Leadership Council, came before the Committee. She indicated that the Partnership is a work in progress. She noted that they have been at this effort for a long time and that it will take a while to get out of it. She said she would argue that the action of the Legislature in 2007 to create the architecture of the Partnership has all the pieces that are needed to get the work done and was informed hugely by the GAO report on other large watershed restoration programs. She added that the promise of the Partnership is still incomplete. She said that the Partnership is only as good as their partners, and she asked for support for the framework that has been put in place over many years such as monitoring, NPDES permits, low impact development, the Growth Management Act, the Shoreline Management Act, industrial stormwater permits, HPAs, etc. She said there is a huge web of statutes that will help them get this work done and that, without them, the Partnership could not deliver on its mandate.

The Leadership Council Chair reported that there is a firm helping the new Governor assemble his natural resources cabinet and that they are vetting and interviewing PSP Director candidates by the day. She said that the salary is low, which may be a barrier, and that the person selected must understand that the Partnership itself does not have a lot of power but that the person must be able to go toe-to-toe with the EPA, NOAA, and all the other directors in the state, be able to inspire the counties, and be knowledgeable about the sector.

Senator Hewitt commented that it sounds like everything that is happening now would continue to happen even if there were not a Puget Sound Partnership and that he is a little confused about what the Partnership accomplishes. The Leadership Council Chair responded that a lot of people do not know what the Partnership does. She said that, without the Partnership, they would not have the same coordination or the same ability to set priorities and that they would not have the same ability to talk to the federal government or to the tribes. She described the Partnership as the one-stop shop that is solely interested in whether something is good for Puget Sound. She reported that, in earlier iterations, they had stapled together the budget requests and work plans from the different state agencies and called that the Puget Sound recovery plan. She said that was not working and that the work of the Blue Ribbon Panel and the GAO report indicated what we needed - getting the science and having local communities describe what needs to be done, and have that be the lens through which they look at all of this. She said that before they also did not have an end-date and that having goals, some urgency, and something to shoot for with an end-date is much different than it has been in the past. She concluded that, if they did not have the Partnership, they would have to invent something very much like it.

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A motion was made to approve for distribution the Puget Sound Partnership's 2012 Action Agenda Update: Revised Approach Continues to Lack Key Accountability Tools Envisioned in Statute Briefing Report. Motion was seconded and carried unanimously.

2012 Tax Preference Reviews – Proposed Final Report

Mary Welsh, Dana Lynn, and John Woolley of the JLARC staff presented this proposed final report. In 2006, the Legislature enacted EHB 1069, mandating performance audits of Washington's tax preferences. JLARC staff reviewed 23 tax preferences in 2012. All tax preference performance audits place an emphasis on whether the preference has met its public policy objectives. The reports include auditor recommendations to terminate one preference, review and clarify the intent of twelve preferences, and continue ten preferences. In addition, comments of the Citizen Commission for Performance Measurement of Tax Preferences are included in the report.

The Legislative Auditor reminded the Committee about the process for the tax preference reviews. He explained that the statute has a very deliberate process that culminates in the proposed final report before the Committee this evening: back in July, the staff initially presented to JLARC the audit recommendations, and the staff subsequently presented the materials to the Citizen Commission for the Performance Measurement of Tax Preferences. He noted that this is a five-member board of citizens, with four members appointed by the legislative caucuses and one member appointed by the Governor, and that the Commission's charge is to hear the reports, take public testimony, and then develop its comments and perspectives about the reports. The Legislative Auditor said that much of the focus of this evening's presentation would be to highlight the places where the Commission's views were different from the Legislative Auditor recommendations. He noted that representatives from the Commission were in attendance this evening and available to answer Committee member questions.

Representative Dahlquist said she wondered why JLARC staff did not take into consideration the competitive disadvantage that removing the insurance producer preference would place on Washington insurance agents who compete with out-of-state agents or with those who sell insurance in a non-commission scenario. Staff answered that, in this case, the public policy objective was not necessarily competition with out-of-state firms but was instead for the reasons mentioned in the report. Staff explained that the preference was initially instituted due to a B&O tax surcharge, which it was argued they could not afford. Representative Dahlquist asked if the Citizen Commission would be available to answer that same question. Senator Kohl-Welles said that yes, they would.

Representative Dahlquist noted that there are several slides where the JLARC staff "infers" the public policy objective of a tax preference and said that it appears that staff are trying to determine what possibly the Legislature was intending. She asked, for the stevedore preference, why trade was not inferred or competitiveness between ports or possibly that a shipper would choose to go elsewhere. The Deputy Legislative Auditor noted a recurrent theme of a lack of a statement by the Legislature of what the public policy objective was. He added that the staff's work is always better informed when the Legislature has directly stated what it wants to achieve. He then explained that staff spend a lot of time going into the historical record of the bill

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discussion, amendments, newspaper articles, etc., to try to get some sense of what the public policy purpose was. The Deputy explained further that, through the review of the record, staff look for the most supportive evidence of what the public policy objective was when the legislation passed; he added that, for the stevedore preference, the evidence did not allow staff to come to that conclusion.

Representative Dahlquist commented that, when JLARC staff infer something, they are making an opinion about what previously elected officials possibly wanted, and she asked for clarification about how JLARC staff determine what to infer and what not to infer. The Deputy answered that it is a finding on staff's part as auditors that the preponderance of the evidence allows them to come to a conclusion that this is what the Legislature intended. He added that it is admittedly an inexact process and repeated that, if the Legislature directly states what the public policy objective is, staff aren't placed in the difficult position of trying to infer the purpose.

The Legislative Auditor commented that, by default, staff are very conservative in the inferring. He said that, if staff do not have evidence to point to an inference, the auditors would stop and say that they don't know, and the Legislature would have to weigh in to identify the purpose. He explained that, in the case of this preference, while the staff had enough evidence to infer a general purpose, there is still some ambiguity about the objectives, which is why the auditor recommendation is to review and clarify.

Senator Hewitt commented that this brings up the often-debated subject of legislative intent language, noting that some people think it should be tighter, and some people think it should be looser. He asked for staff's opinion on whether there should be stronger intent language. The Deputy responded that in the end that is a policy decision for the Legislature, but our job to answer these questions as auditors is made easier when the Legislature directly identifies what it wants staff to evaluate the preference against. Senator Kohl-Welles added that many bills have no intent language with this type of information.

Representative Haigh commented that, on the high tech and biotech reviews, there are other things that staff were not able to include. She recalled that, when legislators were considering the biotech preference, they knew it was an investment on the state's part for long-term economic development, and that it may not have paid off in terms of dollars and cents in a few years. She said that they felt strongly that it was the right thing to do for the state for the next hundred years. She commented that this was a very short timeframe and that perhaps we are not yet able to ask all the right questions around the technology and what it has done for this state. She said that, while the Legislature may not have stated it, she believes the intent of the preference was to bring technology to Washington and make it strong for the next hundred years in this state.

Senator Kohl-Welles observed that staff were probably not able to measure other intangibles, for example, Washington's desirable environment and arts and so forth, and how many people want to come to work in Washington not only because of the B&O tax credit but because of other factors. She asked if staff can look at any of these other factors. The Deputy answered that, to some extent, staff look at indirect job development, but in this case the focus is on whether the tax preference is having an impact on the number of people employed. He said staff would not be able to feasibly identify these other ripple effects.

Senator Kohl-Welles invited representatives from the Citizen Commission for the Performance Measurement of Tax Preferences to come before the Committee (William Longbrake, Commission Chair, and Ruta Fanning,

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Commission member). The Commission Chair reported to the Committee that the Pew Center for the States did a comprehensive assessment of all 50 states on how they review tax preferences, and that they reported Washington is one of 13 states leading the way. He also reminded that Committee that the Citizen Commission is made up of five members, four from each of the caucuses and one appointed by the Governor, and he emphasized that the report before the Committee has the unanimous endorsement of all five members.

Senator Kohl-Welles asked if it was difficult to reach that. The Commission Chair answered no, that there was good dialogue and good give-and-take. He noted that there is a provision in the statute for minority reports but that the Citizen Commission has not needed to use them. Senator Kohl-Welles commented that that was remarkable.

Representative Dahlquist asked if members of the Citizen Commission “infer” when they decide what to do. She noted the Commission is given information by the JLARC auditors. She asked what the Commission uses to determine its decisions and if the Commission is inferring also. The Commission Chair answered that the Commission does not independently conduct research; he said that is the responsibility of the JLARC audit staff. He explained that the Commission also receives public testimony, and that there are times in the public testimony where additional information comes to light that helps clarify what the intent might have been. He said they will factor that into their decisions but that otherwise they rely on the audit staff analysis.

Representative Dahlquist asked if that meant that lobbyists could come lobby the Commission on behalf of an interest one way or the other and help the Commission understand why it might want to infer something or not. The Commission Chair answered that that other parties can provide information through public testimony. He noted a case a couple years back where there was additional information that was introduced into the hearing record that the Commission found to be substantive. He said that the Commission included a comment about this in its report. The other Commission member added that the Commission asks diligently for testifying parties to give additional information and that the Commission has changed its recommendation if there is evidence presented at the Commission meeting.

Representative Orcutt asked how the Commission looks at a tax incentive that has an expiration date. He asked if there is some assumption about the intent of the Legislature if there is one versus if there is not one. The Commission Chair answered that they look at all tax preferences in the same way. He said that the an expiration date means is that they have to look at it before it expires. He added that otherwise they look at it based on the criteria outlined by the JLARC staff and that this is the legislative mandate.

Senator Kohl-Welles asked how much time the Commission spends on its task. The Commission Chair answered that they have four scheduled meetings each year, each running two to three hours, and that then there is outside time reading the 200+ page reports. The Commission member added that the Commission takes public testimony at any of its meetings if there are people in the audience who want to make a comment but that one meeting in September is set aside especially for public testimony.

Senator Kohl-Welles asked if the Commission takes electronic or written testimony at other times outside of the scheduled meetings. The Commission Chair answered that they do accept written testimony.

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Representative Dahlquist asked which caucuses the two Commission members were appointed by. The Commission Chair answered that he was the Governor's appointee, and the other Commission member indicated she was appointed by the Senate Democratic caucus. Senator Kohl-Welles asked who the other Commission members are. The Commission Chair answered that the other members are: Steven Miller, who is the representative of the House Democratic caucus; James Bobst, who is the representative of the House Republican caucus; and the representative for the Senate Republican caucus was Paul Guppy when the comments were adopted, but that that seat is currently vacant.

Representative Alexander asked, in its evaluation of the continuation or non-continuation of these tax preferences, if the Commission takes into consideration the impact on jobs created or lost, and if the Commission has that information when it is making its decisions on whether the removal of a preference would have an impact on jobs in Washington. The Commission Chair answered that, to the extent data and information are available, they take that into consideration. He added that frequently there is not information. He said for the example of the competitive impact on stevedoring, which was something asserted by the industry, the Commission had no information one way or the other. He said it was not something JLARC staff could find in the history and that the industry did not present anything.

The other Commission member added that at the hearing on the stevedoring preference there were lots of questions posed to the industry representative, such as if data are available on the profit margins, what is the tax burden, and what is the impact on the profit margin of the tax preference. She said that the answer was there is no information available on the tax burden, and that they did not know the impact on the profit margins. She said that they try very hard to see if there is any additional information that would be evidence rather than simply asserting a statement. She added that the Committee knows the JLARC staff have to rely on evidence whereas the people who come to present to the Commission can simply state something, so the Commission tries hard to see if there is validity to the assertions. The Commission Chair added that, when there is not good evidence, it leaves the Commission with questions as to what they should do, and that when they recommend either "review and clarify" or "terminate," he hopes the Legislature will hold hearings to find out more substantive information. He said that, with that more substantive information, legislators perhaps could come to a different conclusion.

Senator Kohl-Welles indicated that staff from the Department of Revenue were available if Committee members had any questions for them. There were no questions for DOR staff.

Representative Orcutt asked JLARC staff what the difference is in scheduling a tax incentive for review if there is an expiration date versus if there is not one. The Deputy Legislative Auditor answered that the Commission attempts to make certain it reviews the ones that are expiring at least two to three years before the expiration. He added that this gives JLARC staff time for analysis, time for the Commission to review that, and time for the Legislature to review that analysis. Representative Orcutt asked if this means this gives them a priority in review. The Deputy answered yes, in the queue of the ten-year review cycle.

Senator Kohl-Welles asked the Legislative Auditor to explain the process for adopting a Committee addendum. The Legislative Auditor explained that there is a process by which Committee members can seek to add a comment to the report in addition to the auditor recommendations and the comments by the Citizen

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Commission. He said it is completely within the purview of the Committee to add any comments they do want, adding that the one provision about this specified in statute is that any comments by the Committee must be in a separate addendum to the report and cannot modify the staff auditor findings. He said this is a statutory requirement that is rooted in ensuring the independence of the audit process. Senator Kohl-Welles commented that there have been suggestions that perhaps JLARC Committee members might be able to amend reports such as this one or amend State Auditor I-900 performance reviews. She explained that what they have had reinforced by House and Senate counsel is that members do not have the authority to amend any of the reports but that they do have a process for providing remarks in a separate addendum. She said the Executive Committee is moving to include this information at the beginning of future reports so that it is very clear.

Senator Kohl-Welles said the Committee has before it a motion to approve distribution of the report and any proposed Committee addenda. *Representative Haigh moved adoption of the first proposed addendum*, which was sponsored by the JLARC Executive Committee. In this addendum, the Committee notes that its action to distribute the 2012 Tax Preference Reviews: Proposed Final Report does not imply the Committee agrees or disagrees with auditor recommendations or the recommendations of the Citizen Commission for Performance Measurement of Tax Preferences. *Motion was seconded and carried unanimously.*

Senator Kohl-Welles said she believed there would be a motion to consider a second proposed Committee addendum, brought by Representative Dahlquist. Representative Dahlquist explained the sponsors of the proposed addendum said that, while they respect the work performed by the Legislative Auditor and the Tax Preference Commission, they reach different conclusions and would make different recommendations as to certain policies. Specifically:

1. With respect to the B&O Tax Rate for Stevedoring and International Charter and Freight Brokers they recommend that the rate continue without modification. These preferences lower costs and are one tool for increasing the competitiveness of our ports, which are major sources of jobs and economic growth.
2. With respect to the B&O Tax Rate for Insurance Producers, Title Insurance Agents, and Surplus Line Brokers they recommend that the rate continue without modification. This preference a) offsets the impact of pyramiding taxation on insurance producer commissions paid by locally owned and operated insurance businesses and b) minimizes the competitive disadvantages faced by Washington insurance producers who compete with out-of-state, non-commissioned direct selling insurance companies.

Representative Dahlquist asked for support for the comments to be included. Senator Kohl-Welles clarified for the Committee that these would be included as comments in an addendum and would not change any of the recommendations in the report.

Representative Alexander indicated he supports the policy of the JLARC Committee that members are not endorsing the recommendations put forth and that the action is to move for distribution of the report. He said that he thinks it is appropriate for members of the Committee to be able to add comments in an addendum to the report. He said they receive comments from state agencies, comments from local government, and in this particular case, significant comments from the Tax Preference Commission. He asked for support for the inclusion of the comments and that the Committee allow any Committee members to sign onto the comments at their discretion.

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Senator Mullet asked if this is the normal process to add a Committee addendum or if the Committee normally just releases the report. The Legislative Auditor said that there have been comments added before in the past but that it is not the majority of the reports that receive a comment appended to them. He said that it is not uncommon over the history of JLARC to have instances where the Committee elects to add a separate comment. Senator Kohl-Welles added that it is not the norm and that Committee members would not be voting to endorse this proposed language but that it could be part of an addendum.

Senator Hewitt commented that members should have the ability to do this and that he will support this addendum.

Senator Kohl-Welles said that, if the motion passes, if any members want to add their names to the addendum, to let JLARC staff know.

Representative Springer said that while this may have been a practice in years past on occasion, he could not remember seeing a Committee addendum like this before. He said his experience in the past was that if a member of JLARC had some concerns about some of the recommendations that the Auditor or the Citizen Commission had recommended, that there are other opportunities to make that clear before the other committees in the Senate or the House. He said that he is not sure what the Committee is accomplishing here and that he is a little troubled by the precedent that they may be changing the way this Committee reviews as opposed to working through its legislative authority when it gets to the appropriate committee in the House or Senate. He indicated he could not support the motion.

Senator Hewitt said it is similar to a minority report. Senator Kohl-Welles asked if it is correct that the Committee does not allow minority reports but does allow comments. The Legislative Auditor clarified that he understands the intent of the comment is for individual members to attribute their names to this comment and request that it be added to the entire report. He added that action by the Committee to do that would not necessarily represent that all members are endorsing the position, just that they are allowing the comment to be appended and attributed to those individual members.

Representative Dahlquist commented that the tax preference report is different than other reports that the JLARC Committee receives. She said the Committee can do this, that this is why they are elected and why the Committee is here. Senator Kohl-Welles said that was also the interpretation of the House and Senate counsel.

Representative Stanford commented that he was uncomfortable with this comment because if Committee members are taking the explicit position disagreeing with certain aspects of the report, he feels that it could be construed that members are then saying that they are endorsing the rest of the report. He asked, if this addendum is approved by the Committee, whether only certain members will be listed as supporting the position even though the whole committee has to vote to approve the addendum.

Senator Kohl-Welles asked two of the House and Senate attorneys (Mike Hoover, House Republican caucus, and Keith Buchholz, Office of Senate Counsel) to respond to member questions. The attorneys noted that the Committee does have the ability to add comments, and that members are voting on whether to add the comments, not endorsing the comments. They added that only the people signing the comments would have the comments attributable to them.

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Representative Dahlquist asked if there is a difference between adding comments to this type of tax preference report and other JLARC reports. The House attorney answered that they could add comments to any report. He explained that what makes this type of report complex to understand is that there is a series of statutes, one establishing JLARC and dealing with the reports, and one establishing the Commission and the process to look into the tax preferences. He said when you put those statutes together, there is a role for Commission's input, the Auditor's input, and the JLARC Committee input.

Senator Kohl-Welles asked JLARC staff to distribute a statement explaining this, which was prepared jointly by the attorneys that provide counsel for both the House and Senate. The Senate attorney noted that the ability of the Committee to add comments is contained in the broad JLARC statute, so this is an option available to the Committee with each type of performance audit. He added that there are different types of JLARC reports. However, in the statutory history of the tax preference process, tax preference reports were described by the Legislature as a particular type of a performance audit as well, even though it is not the same type of performance audit that the JLARC staff commonly perform.

Representative Orcutt indicated that he supports the motion and that he has signed on to the comments. He said that Committee action on JLARC reports can be confusing, because if the Committee puts something out with a vote, it appears that the Committee has endorsed everything in that report. He indicated that, having served on other committees that have received reports from JLARC, that is the impression he was given in the past.

Representative Orcutt said he thinks it is absolutely critical that if someone has a concern with the work or the product that has come out of JLARC staff or the Citizen Commission, Committee members voice those. He stated that members are here because they are the legislators, the ones elected by the citizens, the ones who have to make the policy decisions. He commented that he thinks staff generally does a good job but that there are times when he disagrees. He said it is incumbent upon them as legislators and members of JLARC to make sure the public knows that certain members of this body have concerns about a particular work product that the Committee is looking at tonight. He said this is why he endorses the addendum.

Senator Kohl-Welles repeated that they do have the process to add comments in an addendum. She clarified that the Committee is not taking a vote that requires each member to endorse those comments. She said that, if members want to change this process, they could seek to amend the statute.

A second was made to the motion to append the proposed comments attributed to specific members, and the Committee voted to approve the motion. Senator Kohl-Welles said that, if members want to sign on to Representative Dahlquist's comments, please let JLARC staff know.

Representative Dahlquist thanked the Chair for allowing her the opportunity to bring the addendum forward. She thanked JLARC staff and said that sometimes members ask questions and do not know where they will lead us. She thanked everyone and expressed appreciation for their patience on this complicated matter. She said what she hopes is that when members create policy, and they have JLARC do reviews, and they create legislative intent, that members are very conscientious, especially with tax preferences.

Representative Alexander moved to release for distribution the 2012 Tax Preference Reviews – Proposed Final Report, including the two addenda. Motion was seconded and carried unanimously.

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With no further business before the Committee, the Chair adjourned the meeting.

ATTENDANCE

ILARC Members Present: Senator Jeanne Kohl-Welles, Chair; Senator Mike Hewitt; Senator Mark Mullet; Senator Sharon Nelson; Senator Janéa Holmquist Newbry; Representative Gary Alexander, Vice-Chair; Representative Kathy Haigh, Assistant Secretary; Representative Cathy Dahlquist; Representative Ed Orcutt; Representative Larry Springer; Representative Derek Stanford; Representative Kevin Van De Wege; Representative Hans Zeiger.

ILARC Staff Present: Keenan Konopaski, Legislative Auditor; John Woolley, Deputy Legislative Auditor; Valerie Whitener, Audit Coordinator; Linda Byers, Research Analyst; Elisabeth Donner, Research Analyst; Tracey Elmore, Research Analyst; Peter Heineccius, Research Analyst; Suzanne Kelly, Project Management and Research Assistant; Dana Lynn, Research Analyst; Matt Stoutenburg, Senior Committee Support Assistant; Eric Thomas, Research Analyst; Mary Welsh, Research Analyst.

ADJOURNMENT

The meeting was adjourned at 8:20 pm.

CHAIR

VICE CHAIR

Joint Legislative Audit and Review Committee (JLARC)



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REPRESENTATIVES

Gary Alexander
Cathy Dahlquist, *Assistant Secretary*
Tami Green
Kathy Haigh, *Chair*
Ed Orcutt
Gerry Pollet
Derek Stanford
Hans Zeiger

August 14, 2013

JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE REGULAR COMMITTEE MEETING MINUTES

COMMITTEE BUSINESS

- Representative Kathy Haigh, JLARC Chair, called the meeting to order at 10:00 a.m.
- Representative Haigh explained that Committee members had conducted an election for the Executive Committee electronically after determining there would not be a quorum in attendance today. She introduced the JLARC Executive Committee for the 2013-15 Biennium: herself as Chair; Senator John Braun as Vice Chair; Senator Jeanne Kohl-Welles as Secretary; and Representative Cathy Dahlquist as Assistant Secretary.
- Representative Haigh welcomed new members to the JLARC Committee: Senator Braun, Senator Frockt, Senator Rivers, Representative Green, and Representative Pollet. Representative Haigh encouraged members to make every effort to attend Committee meetings.
- Approval of the February 20, 2013, meeting minutes was postponed due to the lack of a quorum.
- Legislative Auditor Keenan Konopaski explained the process the Committee used to update its Work Plan, noting that this process was also conducted electronically. The Committee needed to determine which studies to include in the work plan because more studies were requested than were possible for JLARC staff to conduct. A prioritization process was developed by the Executive Committee, and using this process, the full Committee chose the Public Recreation and Habitat Lands Study to add to the JLARC Work Plan. Consideration of pursuing other new studies listed in the 2013-15 operating budget are deferred to future biennia. Staff will publish and distribute this newly adopted 2013-15 JLARC Work Plan, reflecting the decisions of the Committee.

REPORTS, PRESENTATIONS, DISCUSSIONS

Status Report on the Implementation of State Auditor I-900 Recommendations to the Legislature

Eric Thomas of the JLARC staff presented the annual Status Report on the Implementation of State Auditor's Office (SAO) I-900 Recommendations to the Legislature. He presented a table that shows the

status, following the 2013 Legislative Sessions, of new SAO recommendations made during Calendar Year 2012 and unresolved SAO recommendations to the Legislature made between 2009 and 2011. The report shows that the Legislature adopted both new recommendations made in 2012.

Representative Haigh invited a representative from the SAO (David Dean, Deputy Director of Performance Audit) to come before the Committee to answer any questions. Representative Dahlquist asked if the State Auditor might be able to pick up some of the studies that JLARC was unable to add to its Work Plan as a result of their recent prioritization process. The SAO representative explained that SAO is in the process right now of updating its work plan for the year, and indicated that, now that JLARC has completed its prioritization process, SAO would consider the topics that were not selected.

Representative Alexander commented on the importance of economic development as a topic for the State Auditor's Office to study. The SAO representative said he would pass that comment along to the State Auditor.

DSHS Report on Implementation of JLARC Staff Recommendations from the Involuntary Treatment Judicial Cost Study—Follow-Up Report

John Bowden, JLARC staff, provided some background information as context for the Department of Social and Health Services (DSHS) report. The state's Involuntary Treatment Act (ITA) allows for the civil commitment of individuals who pose a threat to themselves or others. There are 13 counties with Evaluation and Treatment (E&T) facilities where individuals across the state may be sent. Once at an E&T, if a civil commitment is necessary, the county incurs judicial costs. In 2011, the Legislature created a process for Regional Support Networks (RSNs) to reimburse counties for their judicial costs, using case rates based on each county's actual judicial costs. The Legislature also directed JLARC to study county ITA judicial costs, and JLARC staff found that actual cost data were largely unavailable and that types and levels of reported expenditures varied. The study recommended that DSHS report back to the Legislature on what types of costs should be allowed and how actual costs might be collected.

Representative Green asked for a brief characterization of some of the differences in what the counties included in their costs. JLARC staff explained the major components of the judicial costs: the prosecutor's office, the public defender, and the court system. Staff provided the example that, in Pierce County, the prosecutor's costs were three and a half times greater than that cost in other court counties. Staff added that King County included some additional costs for things like security at the court proceedings and EMTs for transport; and further explained that some counties use video links while others prefer to have the individuals in the courtroom.

Representative Haigh asked if the courts know that the process is handled differently in different places and if the courts are sharing that information. JLARC staff did not know if counties are sharing cost information, though staff does know that the process is done differently in different places. Staff added that each county court system makes choices about how it wants to proceed.

Representative Haigh invited staff from DSHS (Michael Paulson, Office Chief for Behavioral Health and Managed Care, and Travis Sugarman, Behavioral Health Supervisor) to report to the Committee on the

agency's implementation of the JLARC staff recommendations from the Involuntary Treatment Judicial Costs Study. In its written response to the Legislative Auditor, DSHS reports it is using a process that requires the home RSN and its ITA court system to negotiate a rate based on reasonable evidence of actual costs directly associated with allowable activities.

DSHS staff noted that there were differences in costs among the counties and that part of their job was to determine why and what to do about these differences. A DSHS work group looked at the cost differences the JLARC report had identified and determined that the differences were warranted and could be explained. He said the differences are largely due to how the courts are set up and how the E&Ts are paid for their costs. DSHS staff added that the current cost structures may change now that the reimbursement process is in place. DSHS worked with the RSNs and the counties on the different categories of costs and how to differentiate whether something is a direct court cost or a cost that is associated with the process but is already included in the rate the RSN pays to the E&T. DSHS indicated the result was a table that can be used in the rate negotiation process.

Representative Alexander commented that it did not make sense to him to have the variation in charge rates for equal services being provided to the individual. He asked how the RSNs would know how to budget for this and how they would know when they are going to send people to different areas. DSHS staff said they did not disagree with this, acknowledging that it is part of our state's system that an RSN will not know where beds will be available and where their clients will be going.

Representative Alexander asked if DSHS will reimburse for the different rates wherever they are. DSHS staff answered that their rates are based on history, so the reimbursement would take this into account if there is a history of placement. Representative Alexander commented that he has been on the budget committee for a number of years and does not recall factoring this into the budget levels for DSHS. DSHS staff responded that this is not something outside of the capitalization rate that DSHS pays the RSNs, that it is part of the RSNs' administrative costs.

Representative Alexander said he also had some experience from the provider side and that he remembers the capitalization rates being quite consistent throughout the state for the mental health services they provided. He commented that the variation here surprises him.

Representative Dahlquist asked for more information on the procurement process for services; for example, is there a process of competitive bidding where the lowest bidder provides the service? DSHS staff clarified that the RSNs do not get to determine the rates of the prosecuting attorneys in the counties. DSHS staff explained further how state law sets up the RSNs as the providers of services for the seriously mentally ill, adding that each RSN does have procurement processes for certain services, but that this would not include things like prosecuting attorneys.

Representative Dahlquist asked why Lewis County would not avoid sending any clients to more expensive Pierce County and instead send all of its clients to less expensive Yakima County. DSHS staff explained that there is not an abundance of E&T beds in the state and that the origin RSN will be looking for any available E&T bed, which could be anywhere in the state.

Representative Green reminded the Committee that the Legislature has expanded the ITA and so there will be increased costs. She commented that it is important for the Legislature to get a handle on these costs. She observed that one of the reasons policymakers wanted to expand the ITA was to ensure that the “right” people are being detained, noting there had been tragedies when people who needed to be detained were not detained. She expressed a concern that there might be a disincentive to detain people if there are varying costs around the state. She also reported on the Legislature’s intent to increase the number of E&Ts in the state and the consultation with DSHS about where to place those new E&Ts.

Representative Green asked DSHS staff if they were seeing any disincentive to detain as a result of the cost differences. DSHS staff responded that they have not seen any adverse effects from implementing the reimbursement process. DSHS staff reported that the agency is working on not only additional E&T beds but also community resources for diversion, which may be even more important than the E&T beds. DSHS staff added that the designated mental health professionals doing the evaluations do have the responsibility to detain people who need to be detained.

Representative Green also reported to the Committee on the current dilemma regarding the federal government bringing action against Washington’s RSN system, an action the state is appealing. She commented that the state will be finding out if it has to competitively bid the RSNs.

Representative Haigh commented that the health and human service policy committees of the Legislature will probably want to keep an eye on implementation of the reimbursement negotiations.

2013 Tax Preference Performance Reviews—Preliminary Report

Dana Lynn and John Woolley of the JLARC staff presented the preliminary report. In 2006, the Legislature enacted EHB 1069, mandating performance audits of Washington’s tax preferences. JLARC staff reviewed 22 tax preferences in 2013. All tax preference performance audits place an emphasis on whether the preference has met its public policy objectives. The report includes Legislative Auditor recommendations to terminate one preference, review and clarify the intent of nine preferences, and continue twelve preferences.

Dentistry Prepayments Preference

Representative Haigh asked if the Legislature’s switch of HMOs and HCSCs from taxation under the B&O tax to taxation under the insurance premium tax was intended to yield an increase in revenue or be revenue-neutral. Staff responded that the intent was to generate revenue.

Representative Dahlquist asked about the 85 percent in deductions allowed under the B&O taxation. Staff answered that it is largely a function of the actual payments going out to providers being allowed as a deduction and the interpretation of the B&O tax provisions by the Department of Revenue. Staff contrasted this with taxation under the insurance premium tax, where a lower amount is allowed for deductions, mainly Medicare and Medicaid payments.

Representative Dahlquist asked if the dentistry prepayment review takes into account the impact to those who are insured. Staff answered that, in terms of the beneficiary savings, the savings estimates are driven solely by the beneficiaries taking advantage of the preference. Staff added that, if the preference was

terminated, insurers could be allowed by regulators to incorporate tax increases into their rates charged to consumers.

Representative Haigh commented that oral health is very much a part of one's overall health. She observed that basic health should cover basic oral health but that, on the other hand, there are many things in dentistry now that have to do with cosmetics. She indicated that, if the Legislature were to make a change in taxation, it may need to consider what aspects of dentistry are part of basic health and make some exemptions for that.

Representative Green commented that she can appreciate the recommendation to terminate the dentistry preference based solely on what the policy was originally intended to do. She added that the Legislature should also take into consideration that health care has really changed since 1993, particularly on the physician side of health care. She commented that many physicians are now integrated into systems while many dentists have stand-alone operations, so the B&O may make more sense there. She also observed that there are problems with dental access. She said the Legislature will have a lot more to consider than whether the policy does what it was originally intended to do.

Representative Haigh commented that we need to remember that we are not dealing with the dentists but rather with the insurance. She observed that there was more work to be done but that she appreciated the enlightenment from the report because she was not aware before of the different taxation, adding that this is the point of having the reviews.

Prescription Drug Administration Preference

Representative Haigh commented that, when drugs are infused in-clinic, there is often a charge, and that charge may cover the cost of someone doing the infusing or giving the injection. She explained that they had this situation in veterinary clinics, where anything that went out the door had a sales tax on it, while things administered in-hospital were taxed under the B&O tax. She observed that it is very complicated and that it will be a challenge if the Legislature decides to change this. Staff added that the preference is only for the cost of the drug and not any service charge.

Artistic and Cultural Organizations Preference

Senator Rivers asked if the 1981-82 funding cuts for artistic and cultural organizations were ever restored. Staff answered that the cuts were restored and directed members to two charts in the report that show information on funding levels for a 30-year period. Staff added that the funding levels have fluctuated over the years.

Representative Pollet asked for information about the difference between the federal taxation of artistic and cultural organization business income versus state taxation. Staff answered that the federal government taxes "unrelated business income" while these organizations are exempt from Washington's B&O tax on this income, explaining that this is the area where Washington's exemption is more broad than the federal government's.

Nonprofit Youth Recreation Services and Local Government Physical Fitness Classes Preference

Representative Dahlquist asked if there is a direct correlation between childhood obesity and publicly subsidized health clubs. Staff answered this is not something they looked into.

Representative Dahlquist asked if there is a definition of “character-building.” Staff responded that the term “character-building” is defined in statute.

Representative Alexander asked if the participants in the local government physical fitness classes had to be local government members. Staff answered that there was no discussion about having to be a “member” or a citizen to participate. Representative Alexander commented that this was an interesting issue for him, remembering a bill about private laundry services for nonprofit hospitals. He noted that he is not concerned when we provide a B&O exemption for the benefit of individuals and families but that he is concerned when the exemption is given to entities that are competing with private businesses that do pay the B&O tax.

Representative Pollet asked about the value of the personal services like escort services and tanning services receiving the exemption. Staff clarified that those services would have to be provided by a nonprofit youth organization in order to receive the exemption, adding that the point the review is trying to make is that these do not seem to be the kind of services that nonprofit youth organizations typically offer. Staff explained that they do not know why the Legislature did not specify physical fitness services in the statute rather than including all of the personal services classified as retail sales.

Legislative Auditor Recommendations on Tax Preferences

Legislative Auditor Keenan Konopaski noted that JLARC staff receive questions every year on the status of implementation of previous auditor tax preference recommendations. He explained that, in the members’ packets, there is a handout that shows a snapshot of the Legislature’s action on prior recommendations as of the conclusion of the 2013 Sessions. He walked through how to read the table. He also noted that much more information on the prior reviews is available on the Citizen Commission website (www.citizentaxpref.wa.gov).

Representative Haigh asked the Legislative Auditor to walk through the different roles of the participants in the tax preference review process. The Legislative Auditor explained that:

- The audit staff do not take policy positions on the tax preferences. Staff work hard to identify what the Legislature intended to do when it originally set up the preference and whether the preference is meeting that objective. This is what the Legislative Auditor recommendation is based on. This does not mean that views of legislators about the underlying policy may not have changed since the preference was first started.
- After the presentation to JLARC today, the reviews go to the Citizen Commission for Performance Measurement of Tax Preferences. There are five members on the Commission, one appointed by each of the four legislative caucuses and one appointed by the Governor. The Commission takes public testimony on the tax preference reviews. Subsequent to that, the Commission adopts its own comments. Since the Commission does not serve in an audit function, Commission members

have the prerogative to take a policy position on the preferences. The public testimony informs what comments they might want to make as a body.

- The Commission comments are appended to the report, and the report comes back to JLARC. JLARC members have the option of appending comments to the report if members wish to take a position. These comments do have to be appended as a separate addendum to the report, so that the audit findings and recommendations stand alone and the Citizen Commission comments stand alone.

The Legislative Auditor explained that this last step completes the process in front of JLARC, and then any action taken on the recommendations would go through the fiscal committees.

Representative Haigh reminded Committee members of the JLARC I-900 Subcommittee meeting later that afternoon.

With no further business before the Committee, the Chair adjourned the meeting.

ATTENDANCE

JLARC Members Present: Senators Annette Cleveland and Ann Rivers; Representatives Gary Alexander, Cathy Dahlquist, Tami Green, Kathy Haigh, and Gary Pollet.

JLARC Staff Present: Keenan Konopaski, Legislative Auditor; John Woolley, Deputy Legislative Auditor; Valerie Whitener, Audit Coordinator; and John Bowden, Linda Byers, Peter Heineccius, Rachel Murata, Dana Lynn, Audrey Phillips, Matt Stoutenburg, and Eric Thomas.

ADJOURNMENT

The meeting was adjourned at 11:40 a.m.

CHAIR

VICE CHAIR

FORENSIC ACCOUNTING AUDIT OF THE COLUMBIA RIVER CROSSING PROJECT

SCOPE AND OBJECTIVES

JULY 2013



STATE OF WASHINGTON
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Why a Forensic Accounting Audit of the Columbia River Crossing Project?

The 2013-15 Transportation Budget (ESSB 5024) called for a forensic audit of the Interstate 5/Columbia River Crossing project to investigate possible misuse of public funds. JLARC was authorized to contract with the State Auditor's Office to conduct the audit.

What Is a Forensic Accounting Audit?

A forensic accounting audit is an audit that specifically looks for whether there has been financial misconduct or abusive or wasteful activity.

Columbia River Crossing Project Background

According to the Washington State Department of Transportation (WSDOT), the proposed project was to improve safety and congestion in the five-mile segment of I-5 between State Route 500 in Vancouver, Washington, and Victory Boulevard in North Portland, Oregon. The Department's proposed project scope was to replace the existing interstate bridge, make improvements to five miles of I-5, extend light rail to downtown Vancouver, and improve bicycle and pedestrian facilities.

WSDOT and the Oregon Department of Transportation (ODOT) completed an analysis of the transportation needs in the Portland/Vancouver corridor in 1999. The analysis recommended a "multi-faceted" approach to address the safety and congestion issues, including a recommendation for new highway and transit capacity over the Columbia River.

In 2005, WSDOT began a partnership with ODOT, the Federal Highway Administration, and various local jurisdictions to develop a "long term, comprehensive solution for five miles of Interstate 5 between Portland and Vancouver."

The proposed project was estimated to cost between \$3.1 and \$3.5 billion, with the bridge comprising \$2.05 billion, Oregon roadway and interchanges \$595 million, and Washington roadway and interchanges \$435 million.

The State Auditor's Office reports the project has spent \$168 million to-date, with 82% of expenditures for architectural and engineering (A&E) services. The 2013-15 Biennium transportation budget did not provide funding to continue the project.

Study Scope

JLARC will contract with the State Auditor's Office (SAO) to conduct a forensic accounting audit of the Interstate 5/Columbia River Crossing project. The SAO audit will be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). The primary focus of SAO's audit will be expenditures for architectural and engineering services (A&E). The audit will determine whether the state has been overcharged for A&E services, charged for services that are beyond the scope of the original contract, or charged for unauthorized services.

Study Objectives

The SAO will examine the following:

- 1) Were contract task orders within the scope of the original contract?
- 2) Did work charged agree with contract task orders?
- 3) Were there charges for unusual or excessive hours or expenditures?
- 4) How have labor, profit, and overhead rates increased since 2004?
- 5) Were labor rate increases capped by contract?
- 6) Did labor rate increases conform to contract caps?
- 7) Did labor, profit, and overhead rates charged conform to contract rates?
- 8) Did the overhead rate charged agree to the A&E firm's audited overhead rate?
- 9) Has WSDOT been directly charged for administrative staff that are in the overhead rate?

Timeframe for the Study

The State Auditor's Office will report the results of its forensic audit by April 2014.

JLARC Staff Contact for the Study

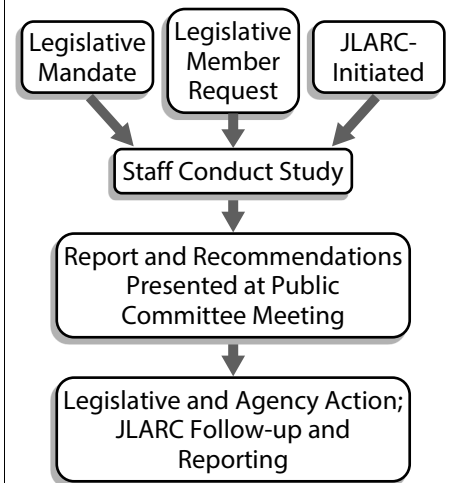
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JLARC Study Process



Criteria for Establishing JLARC Work Program Priorities

- Is study consistent with JLARC mission? Is it mandated?
- Is this an area of significant fiscal or program impact, a major policy issue facing the state, or otherwise of compelling public interest?
- Will there likely be substantive findings and recommendations?
- Is this the best use of JLARC resources? For example:
 - Is JLARC the most appropriate agency to perform the work?
 - Would the study be nonduplicating?
 - Would this study be cost-effective compared to other projects (e.g., larger, more substantive studies take longer and cost more, but might also yield more useful results)?
- Is funding available to carry out the project?

REVIEW OF HOW WSDOT ASSESSES HIGHWAY PRESERVATION AND MAINTENANCE NEEDS

SCOPE AND OBJECTIVES

AUGUST 20, 2013



STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND
REVIEW COMMITTEE

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Why a JLARC Study of How WSDOT Assesses Highway Preservation and Maintenance Needs?

The Washington State Department of Transportation (WSDOT) is responsible for maintaining and preserving a statewide highway system of more than 20,000 lane miles of pavement, over 3,400 bridges and structures, and numerous other supporting assets such as signal systems and drainage ditches.

The 2013-15 Transportation Budget (ESSB 5024) directs the Joint Legislative Audit and Review Committee (JLARC) to conduct a review of the methods and systems used by WSDOT to develop asset condition and maintenance service level needs and subsequent funding requests for highway preservation and maintenance programs.

Maintaining and Preserving Highways Is an Ongoing Responsibility

“Maintenance” and “preservation” represent the activities needed to keep the highway system functioning. Maintenance begins when a highway asset such as a pavement surface, is placed in service and includes activities that keep the asset in service over its lifetime. For example, routine pavement maintenance includes filling potholes, sealing cracks, and restoring traffic markings. Crews from the six WSDOT regional offices perform these routine activities. The 2013-15 Transportation Budget appropriates \$407 million to WSDOT for highway maintenance.

In contrast, preservation occurs at the end of the asset’s service life when, even with the best routine maintenance, the asset must be replaced. For example, asphalt pavement typically has a service life of 15 years after which it can no longer provide a smooth and safe driving surface and prevent failure of the underlying substructure. A preservation project would replace the asphalt on a stretch of highway. Preservation work is performed by private contractors. The 2013-15 Transportation Budget appropriates \$699 million to WSDOT for highway preservation.

WSDOT is responsible for identifying highway maintenance and preservation needs. WSDOT also estimates the costs of meeting these needs.

Study Scope

The Legislature directed JLARC to conduct this review in two parts. Phase 1 will provide an overview of the methods and systems used by WSDOT to estimate highway maintenance and preservation needs and costs. Phase 2 will examine whether the methods and systems WSDOT uses for estimating highway preservation and maintenance needs and costs are consistent with industry practices and other appropriate standards.

Study Objectives

Phase 1 of this review will address the following questions:

- 1) What methods and systems does WSDOT use to develop estimates of highway maintenance and preservation needs and costs?
- 2) Is each stage in the estimating process fully documented?

Phase 2 will address the remaining questions of the mandate:

- 3) Are the methods and systems WSDOT uses consistent with industry practices and other appropriate standards?
- 4) Are practices in place to minimize life-cycle preservation and maintenance costs?
- 5) How does WSDOT quantify risks to its need and cost estimates?
- 6) What steps are in place to ensure that requests are not unduly impacted by outside pressures?

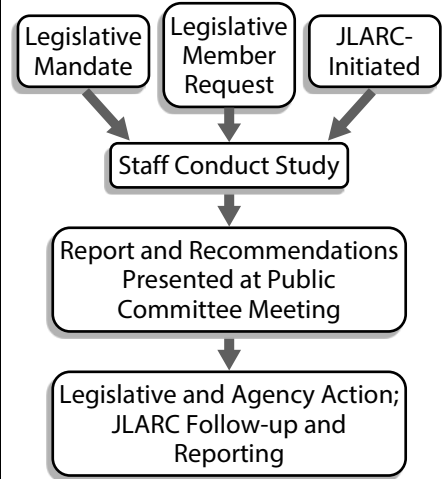
Timeframe for the Study

Staff will present the Phase 1 report at the January 2014 JLARC meeting. Staff will present the Phase 2 report at the December 2014 JLARC meeting.

JLARC Staff Contacts for the Study

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JLARC Study Process



Criteria for Establishing JLARC Work Program Priorities

- Is study consistent with JLARC mission? Is it mandated?
- Is this an area of significant fiscal or program impact, a major policy issue facing the state, or otherwise of compelling public interest?
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- Is funding available to carry out the project?

State of Washington
Joint Legislative Audit & Review Committee (JLARC)



**Local Infrastructure Financing Tool (LIFT):
Lack of Data Hinders Evaluation and
Administration of the Program**

Preliminary Report

September 18, 2013

*Upon request, this document is available in
alternative formats for persons with disabilities.*

Joint Legislative Audit and Review Committee

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Audit Authority

The Joint Legislative Audit and Review Committee (JLARC) works to make state government operations more efficient and effective. The Committee is comprised of an equal number of House members and Senators, Democrats and Republicans.

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

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Committee Action to Distribute Report

Action to distribute this report does not imply the Committee agrees or disagrees with Legislative Auditor recommendations.

**Local
Infrastructure
Financing Tool
(LIFT): Lack of
Data Hinders
Evaluation and
Administration of
the Program
Preliminary Report**

September 18, 2013



STATE OF WASHINGTON

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REPORT SUMMARY

LIFT Program Provides State Contributions for Local Infrastructure Projects

The Local Infrastructure Financing Tool (LIFT) is a state program designed to help local jurisdictions fund public infrastructure projects, which are in turn intended to foster economic development. LIFT projects may receive a state contribution of up to one million dollars per year for 25 years. Total state contributions are limited to \$7.5 million per year for all LIFT projects combined.

To participate in the LIFT program, local jurisdictions establish a revenue development area (RDA) and apply to the Community Economic Revitalization Board (CERB) for approval. There are currently nine LIFT projects around the state; the program is closed to further projects unless the Legislature increases the total amount of funding available for state contributions. The amount of state contribution each project receives per year is limited to the lowest amount of the following four caps:

1. One million dollars;
2. The amount of local revenue dedicated to the project;
3. The amount awarded to the project by CERB; or
4. The “state benefit” amount.

The “state benefit” amount is based on a complicated statutory formula intended to approximate increases to state property and excise tax revenues within the RDA. Statute directs each local jurisdiction to submit an annual report to CERB and the Department of Revenue (DOR) that contains the information necessary to calculate the state contribution, as well as information about the progress of its LIFT project.

Insufficient Data for JLARC Staff to Evaluate LIFT Program or Projects

In the LIFT enacting legislation (2006 E2SHB 2673), the Legislature directed JLARC to report every five years on changes to six different metrics within each RDA, and to also complete an analysis of the economic impact of expanding the LIFT program in 2028. However, the data necessary to accurately report on these metrics or to conduct an economic analysis of the projects either does not exist or may not be feasible to collect without significant additional resources. Even if the necessary data was readily available, there are significant challenges to isolating the impact of LIFT projects on the surrounding economy.

LIFT Statutes Do Not Assign Ongoing Oversight Responsibilities

The LIFT statutes do not assign either CERB or DOR with responsibility for ongoing oversight of the LIFT program. For example, there is no state agency responsible for verifying the information provided by the local jurisdictions that is used to determine the state contribution. Similarly, there is no state agency that can provide authoritative guidance to local jurisdictions if questions arise regarding statutory interpretation or program administration.

Formula for Calculating State Contributions Does Not Reflect Changes in Revenue or Economic Growth in the Project Areas

The formula to calculate the “state benefit” cap on state contributions does not measure actual changes to state tax revenues. For example, the formula captures increases in revenue from property and excise taxes, but not decreases. Additionally, the formula only captures a small portion of increases to property values, and is primarily based on whether there were large increases in retail sales. Furthermore, the amount of state contributions might depend less on the success of the project and more on the scheduling of project construction and the composition of the RDA. Finally, the data necessary to accurately calculate this formula does not currently exist.

Legislative Auditor Recommendations

The first recommendation is intended to address what JLARC staff observed about the lack of state agency oversight and guidance for the LIFT program and the operation of the current “state benefit” formula.

Legislative Auditor Recommendation 1

In consultation with local jurisdictions, the Department of Revenue and the Community Economic Revitalization Board should identify and recommend to the Legislature whether any statutory changes should be instituted that could improve: 1) oversight of the LIFT program; 2) state guidance to the local jurisdictions; and 3) the function of the “state benefit” cap to better serve the LIFT program’s purpose of encouraging economic development.

The second recommendation is based on the observation that JLARC staff will be unable to provide a meaningful evaluation of LIFT projects without substantial changes to data reporting, collection, and management practices by private businesses, local jurisdictions, and state agencies.

Legislative Auditor Recommendation 2

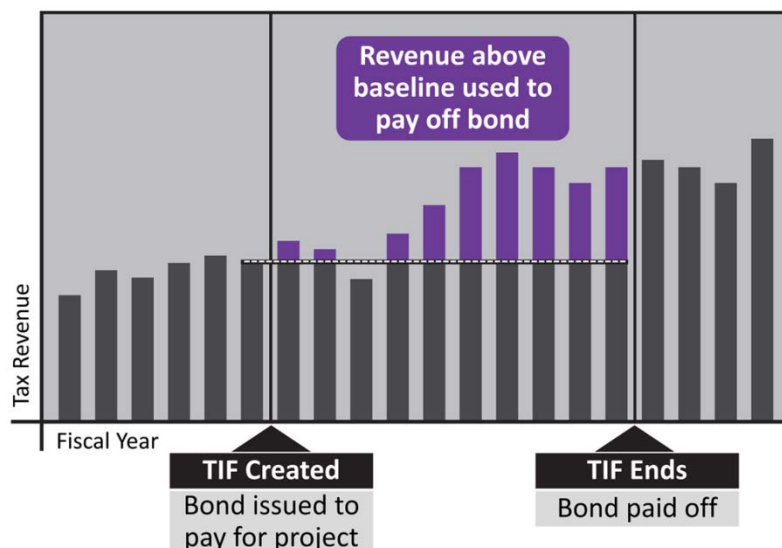
The Legislature should suspend future JLARC studies of the LIFT program.

CHAPTER 1 – DATA NECESSARY TO EVALUATE THE LIFT PROGRAM AND PROJECTS IS NOT AVAILABLE

How Does LIFT Compare to Traditional Tax Increment Financing?

The Legislature enacted the LIFT program in 2006 as one in a series of state programs that attempt to use tax increment financing (TIF) in Washington. TIF is a way of financing infrastructure projects that theoretically pay for themselves. In a traditional TIF project, a local jurisdiction issues a bond to pay for public infrastructure in a designated area, and then the jurisdiction pays off the bond using future increases in tax revenues from that area. It is important to note that only increases in revenues are intended to pay for the bond; the initial baseline amount of tax revenues are reserved for existing uses. See Exhibit 1 below for an illustration of traditional tax increment financing.

**Exhibit 1 – Traditional TIF Projects in Other States
Pay for Bond with Future Tax Revenue Increases**



Source: JLARC staff analysis.

While all other states except for Arizona have some form of TIF programs, there are several constitutional and statutory provisions that constrain the implementation of a traditional TIF in Washington. This is especially true when a TIF relies on increases in property taxes, as is common in other states. For example, the Washington State Supreme Court struck down an earlier TIF-like program because it diverted state property tax funds, which are dedicated to support of public schools under the Washington State Constitution.

Even more restrictive to traditional TIF design is that Washington uses a levy-based property tax system. This means that increases in property values caused by economic development do not necessarily result in an increase in property tax revenues. Instead, only an increase to levy amounts will increase tax revenues. Several statutes limit the extent to which local jurisdictions may increase levy amounts (e.g., RCW 84.55.010).

How Does the LIFT Program Work?

While LIFT is similar to traditional TIF programs in many respects, it may operate differently than in other states due to the legal restrictions in Washington. Like a traditional TIF, the first step is for local jurisdictions to designate the geographic boundaries of the project. In the LIFT program, this project area is called a “revenue development area” (RDA).

The next step is for a local jurisdiction to apply to the Community Economic Revitalization Board (CERB), which approves projects and sets award amounts through a competitive process. There are several requirements for a successful application, including a committed private developer who intends to build within the RDA. The Legislature also included some specific projects in statute as demonstration projects. Between these demonstration projects and the competitive projects approved by CERB, there are currently nine LIFT projects in Washington that are eligible for state contributions.

Six of the nine LIFT projects may receive state contributions up to one million dollars per year for up to 25 years. CERB awarded the remaining three projects a maximum of \$500,000 per year for up to 25 years. Per statute, the total amount of state contributions to all LIFT projects combined in any single year is \$7.5 million, which is already accounted for in the nine current projects. Without further allocation of funding by the Legislature, the LIFT program is effectively closed to new projects.

Like in a traditional TIF program, the annual state contribution is intended to reflect the increase in state tax revenues in the RDA following approval of the project by CERB. However, due to state constitutional provisions, it is not permissible to simply give local jurisdictions state property tax revenues. Instead, local jurisdictions receive their state contribution by imposing a local sales and use tax (the “LIFT tax”), which is then credited against the state sales tax. Consumers do not see any increase in sales tax at the register, but instead some of the state portion of the sales tax is diverted to the local jurisdiction to pay for the LIFT project.

Per statute, the annual state contribution for each local jurisdiction is equal to the lowest amount of the following four caps:

- 1) **One Million Dollars:** The state may not distribute more than one million dollars to any LIFT project in a fiscal year.
- 2) **Local Match:** The state contribution is limited to the amount of local revenue the local jurisdiction dedicated to paying for the LIFT project in the previous year.
- 3) **CERB Award:** These amounts range from \$500,000 to one million dollars per year, and are specified in the award letter given to each qualifying jurisdiction.
- 4) **State Benefit:** The “state benefit” amount is based on a complicated statutory formula designed to approximate the increases in state property and excise taxes from within the RDA. The formula to calculate this amount has changed over the course of the LIFT program. See Appendix 3 for a more detailed explanation of the current formula.

What Are the Current LIFT Projects?

The nine current LIFT projects are located in eight different counties around the state. Exhibit 2 below provides a brief description of each project, as well as the project's status as reported by the local jurisdiction. In addition, the boundaries of each RDA may be viewed on Google Maps at the following website address: <http://goo.gl/maps/bHYga> (address is case sensitive).

Exhibit 2 – Nine Current LIFT Projects Vary Widely in Scope and Goals, but All Report Being Behind Schedule

Project Description	Project Status
City of Bellingham – New Whatcom RDA	
This is a multiphase redevelopment of the heavy industrial area along Bellingham's downtown waterfront. The City's goals include remediating environmental contamination and developing business, housing, and recreational opportunities in the downtown region. Early work has focused on project planning, constructing an interim access road, and clean-up of mercury-contaminated land and petroleum containment.	The City reports that progress is behind schedule due to economic conditions and the complexity of environmental clean-up.
City of Bothell RDA	
This project seeks to create new commercial land in the downtown region and provide better transit and pedestrian access, as well as improve access to the Sammamish River by relocating the intersection of State Route 522 and State Route 527 one block south of its current location. Early work has focused on demolishing buildings in anticipation of the road realignment and soil decontamination.	The City reports that litigation and economic conditions have slowed progress, but that it anticipates imposing the LIFT tax and issuing bonds sometime in 2014.
City of Everett – Riverfront RDA	
This project proposes to redevelop a reclaimed landfill, a former paper mill site, and a former logging yard while protecting a Wetland Enhancement Area. The City's primary goal is to efficiently use this tract of land by developing it for commercial, residential, and recreational opportunities. Early work has involved design, completing the Environmental Impact Statement process, and relocating a portion of the railroad tracks that parallel the western border of the RDA.	The City reports that progress is behind schedule due to economic conditions and their impact on commercial credit and development markets.

Project Description	Project Status
City of Federal Way – City Center RDA	
<p>The primary goal of Federal Way’s City Center Redevelopment Area is to convert its auto-oriented central business district into a high density, mixed use area with pedestrian-friendly and transit-oriented improvements. LIFT funds are anticipated for roadway upgrades intended to alleviate congestion, the creation of open spaces and trails, and public parking.</p>	<p>The City reports that this project is behind schedule because the original developer was unable to continue involvement due to economic conditions and subsequent developers have also been unsuccessful in significantly advancing their plans.</p>
City of Mount Vernon RDA	
<p>The primary goal of Mount Vernon’s multiphase Revenue Development Area is to create a commercially viable riverfront district with high density residential options. The first phase of the project—constructing a flood wall, consistent with Federal Emergency Management Administration (FEMA) regulations, to protect the downtown area—is complete. The second phase will focus on a river walk plaza along the Skagit River, and the third phase includes the construction of a parking facility. The plaza is fully funded and scheduled to begin in 2013, and the parking facility will be financed in part by LIFT funds.</p>	<p>The City reports that it is waiting for FEMA to rule on moving the downtown area out of the floodplain and that it is still working on the financing for phase three.</p>
City of Puyallup RDA	
<p>This project concentrates on redeveloping city-owned parcels and infrastructure improvements for telecommunications, storm water runoff, drainage, parks, trails, and pedestrian bicycle access. The RDA includes a large portion of the downtown and South Hill areas along State Route 161. In 2012 the City completed a street realignment at SR 161 and 39th Avenue Southeast intended to reduce traffic congestion and improve safety for bicyclists and pedestrians. The City also reports the completion of storm drainage improvements and ongoing upgrades to high speed fiber optics lines.</p>	<p>The City reports that it has made progress on select parts of the project, while other plans were put on hold due to economic conditions.</p>

Project Description	Project Status
Spokane County – River District RDA	
<p>This project seeks to provide infrastructure, including access roads, water, sewer and storm water handling facilities, and highway interchange improvements to Interstate 90. One of the primary goals of the project is to develop a mixed-use area for residential, commercial, and recreational purposes.</p>	<p>The County reports that the project is behind schedule due to economic conditions, a pending Interchange Justification Report required under federal law, and the County's desire to manage risks to taxpayers in terms of issuing bonds.</p>
City of Vancouver – Riverwest RDA	
<p>This project includes three distinct projects on one city block. The City has secured the involvement of a private developer who committed to be involved in all projects within the RDA. The first project, completed in 2011, consisted of a new public library funded by local bonds and private donations. The second project, an underground parking garage, will be financed using LIFT dollars but is currently on hold. The third project will also involve a parking structure for a proposed hotel and residential components, but will not be funded by LIFT dollars.</p>	<p>The City reports that development was put on hold due to economic conditions.</p>
City of Yakima – Cascade Mill RDA	
<p>This project seeks to create a development zone for commercial, light-industry, and entertainment purposes by cleaning up and repurposing an old municipal landfill and former paper mill site. The City's primary goals include efficiently using land and improving the quality of life for residents. The project will involve various infrastructure improvements, connecting the Yakima River Greenway to a proposed employment and commercial center and transit lines, and modifying an existing highway interchange.</p>	<p>The City reports that the project is more than one year behind schedule, due in-part to delays associated with a federally required Interchange Justification Report, environmental clean-up, and remediation studies.</p>

Source: JLARC staff interviews with local jurisdiction officials and local jurisdiction reports to CERB.

In addition to the individual project goals and progress, the nine LIFT projects vary on a number of different attributes. See Exhibit 3 below for a summary table of some of these differences. As of July 2013, five of the nine local jurisdictions had imposed the LIFT tax, but only three of these had received state contributions by the end of Calendar Year 2012.

Exhibit 3 – Summary of LIFT Project Attributes

RDA Jurisdiction (Year Approved)	RDA Size (Acres)	Has Construction Begun?	Max CERB Annual Award	LIFT Tax Imposed?	Total State Contribution (Through CY 2012)
Bellingham (2007)	137	Yes	\$1,000,000	July 1, 2013	\$0
Bothell (2008)	255	Yes	\$1,000,000	Not Yet (Expected 2014)	\$0
Everett (2008)	233	No	\$500,000	Not Yet	\$0
Federal Way (2008)	358	No	\$1,000,000	July 1, 2013	\$0
Mount Vernon (2009)	138	Yes	\$500,000	Not Yet (Expected 2015)	\$0
Puyallup (2009)	1,200	Yes	\$1,000,000	July 1, 2010	\$3,000,000
Spokane County (2008)	1,540	Yes	\$1,000,000	July 1, 2010	\$1,756,420
Vancouver (2008)	4	Yes	\$500,000	Not Yet (Expected 2019)	\$0
Yakima (2009)	556	No	\$1,000,000	July 1, 2011	\$757,194
Total	4,421	6 of 9	\$7,500,000	5 of 9	\$5,513,614

Source: JLARC staff analysis of data provided by the Department of Revenue and local jurisdictions.

Legislation in the 2013 Second Special Session removed a requirement that local jurisdictions issue a bond within five years of imposing the LIFT tax; projects may now complete their infrastructure projects on a pay-as-you-go basis. To date, none of the local jurisdictions have issued a bond.

Every year the sponsoring local jurisdiction of each project must submit a report to CERB detailing the goals and progress of the projects. CERB compiles these annual reports and presents a biennial report to the Legislature. The next CERB biennial report is due in 2014.

There Is Insufficient Data to Evaluate Either the LIFT Program or the Economic Impact of Individual Projects

As part of the LIFT enacting legislation in 2006, the Legislature directed JLARC to report every five years on changes to six different metrics within each RDA: sales and use taxes; employment; property taxes; property values; housing; and commercial activities. However, the data necessary to accurately report on these metrics either does not exist or may not be feasible to collect. For example:

- It is not currently possible to reliably determine the amount of sales and use taxes or employment from within an RDA. Data from the Department of Revenue and the Employment Security Department is not collected at the level of detail necessary to identify specific business locations within an RDA. Private businesses are not currently required to report at the level of detail necessary to isolate sales or employment within an RDA.
- Property values and taxes may be acquired from County Assessors and Treasurers, but collecting the data for each RDA may present significant challenges with data coordination, storage, and standardization. For example, not all Assessors maintain records of which parcels were located in an RDA in prior years. Since parcel boundaries may change or subdivide, this can present challenges in determining property values or taxes in prior years.
- The Legislature directed JLARC to measure housing and commercial activities based on the mitigation plans contained in each local jurisdiction's application to CERB. These mitigation plans were intended to preserve low-income housing and small businesses. However, none of the jurisdictions' plans included measurable targets. Furthermore, due to a lack of detailed data, it is not possible to reliably determine these amounts for an RDA.

In order to obtain the data necessary to complete a thorough analysis, there would need to be significant changes to data reporting, collection, and management practices by private businesses, local jurisdictions, and state agencies.

Beyond JLARC's requirement to issue regular five-year reports, the Legislature also directed JLARC to complete an analysis of the economic impact of expanding the LIFT program in its 2028 report. At a minimum, this would require resolving the data challenges referenced above. Additionally, it is unlikely that a conclusive economic analysis would be possible due to the significant challenges in isolating the impact of individual LIFT projects on the economy of an area.

CHAPTER 2 – LIFT STATUTES DO NOT ASSIGN OVERSIGHT RESPONSIBILITY OR BASE STATE CONTRIBUTIONS ON REVENUE OR ECONOMIC GROWTH

While gathering information about the LIFT program for this report, JLARC staff observed two aspects of the LIFT statutes that may be of interest to the Legislature. First, the LIFT statutes do not assign any ongoing oversight or guidance responsibilities to a state agency. Second, the statutory formula to calculate state contributions does not appear to reflect either revenue growth or economic growth from within an RDA.

Note: These observations are not intended to reflect any conclusion about the success or economic impact of any individual LIFT project.

Statutes Do Not Assign Ongoing Oversight or Guidance Responsibilities to a State Agency

The LIFT statutes in Chapter 39.102 RCW do not assign a state agency with any ongoing oversight responsibility after the LIFT projects have been approved. While the Community Economic Revitalization Board (CERB) has a well-defined role in the project approval process, it has no ongoing responsibility in statute. For example, statute does not direct CERB to review the accuracy of the local jurisdictions' annual reports. Further, CERB has no responsibility to assess the continued viability of a LIFT project, even if the circumstances have changed substantially since CERB initially approved the application.

Similarly, the Department of Revenue (DOR) has a well-defined role in the administration of distributing the LIFT tax revenues (see RCW 82.14.475), but it is not clear whether DOR has the responsibility to verify the information provided by local jurisdictions in their annual reports. For example, DOR must determine the state contribution for each local jurisdiction each year based on values reported in the local jurisdiction annual reports. However, there is no corresponding responsibility in statute to ensure that these values are accurate or that local jurisdictions understand how to calculate them correctly. As detailed in Appendix 3, these calculations are complex and require several pieces of information that may not be readily available.

Additionally, when questions arise among local jurisdictions about how to interpret statute or administer the LIFT program, it is unclear whether CERB or DOR can give authoritative guidance. For example, in interviews with JLARC staff, several local jurisdictions were unclear about how to comply with statutory reporting obligations. Statute does not specify to what extent CERB and DOR are authorized to provide guidance on these issues.

JLARC staff compared the LIFT program to other statutorily-established infrastructure/economic development programs. For example, the statute for the public facilities loans and grant program provides clear direction on oversight responsibilities. In that program, CERB is required to conduct biennial outcome-based evaluations of projects receiving state funds.

Formula for State Contributions Does Not Reflect Revenue Increases or Economic Growth in the Project Areas

Per statute, the amount of the state contribution for a particular LIFT project is equal to the lowest amount of four caps: 1) one million dollars, 2) the local match amount, 3) the CERB award amount, and 4) the “state benefit” amount. To determine the state contribution, the local jurisdictions and DOR must calculate the “state benefit” cap amount each year. This calculation is significant because it directly impacts how large or small the state contribution will be to the jurisdiction. See Exhibit 4 below for a simple example of how the calculation impacts the total amount the jurisdiction is eligible to receive. As mentioned earlier, the formula used to calculate the “state benefit” cap is complicated, and more details about how it works can be found in Appendix 3.

Exhibit 4 – Amount of State Contribution to LIFT Project May Be Highly Dependent on the “State Benefit” Calculation

State Contribution Caps	Hypothetical Scenario 1: Small “State Benefit”	Hypothetical Scenario 2: Large “State Benefit”
One Million Dollars	\$1,000,000	\$1,000,000
Local Match	\$750,000	\$750,000
CERB Award	\$1,000,000	\$1,000,000
“State Benefit”	\$50,000	\$800,000
State Contribution to Jurisdiction	\$50,000	\$750,000

Source: JLARC staff analysis of Chapter 39.102 RCW and RCW 82.14.475.

The “state benefit” cap was intended to approximate the revenue increases in state property and excise taxes within an RDA. However, unlike a traditional TIF program, the current “state benefit” formula does not measure actual changes in state revenues or actual economic development within an RDA. Below are four examples of how the formula may not accurately reflect state revenue increases or economic growth.

1) Formula Captures Increases in Revenue, but Ignores Decreases in Revenue

Instead of using the actual revenue change in the current year, the “state benefit” formula uses the highest amount calculated in *any one year* since the beginning of the LIFT project. This means the formula effectively ignores any decreases in state tax revenues, and does not adjust downward when increases are less than the “record high” increase.

In order for a jurisdiction to receive the amount awarded by CERB, the “state benefit” amount must meet or exceed the award amount only once. Since the formula ignores anything but record highs, once the “state benefit” amount equals the award amount, the “state benefit” cap is effectively removed from the calculation of the state contribution in all future years of the project. This means that the only remaining limitations on future state contributions would be the jurisdiction’s award amount (up to one million dollars) and the amount of local revenue dedicated to the project. Once

this happens, the LIFT program begins to function more like a state grant matching program rather than a traditional TIF program.

2) Formula Only Accounts for a Portion of Increases to Property Values

Unlike in some other states, Washington’s property tax revenues do not increase when property values rise; instead, property tax revenues only rise when the local taxing jurisdiction increases the levy amount. The property tax portion of the “state benefit” formula only captures the increases in property value that County Assessors designate as being due to “new construction.” The formula ignores increases due to any other reason (e.g., improved land value or any building improvements that do not qualify as “new construction”), which means that the “state benefit” formula only captures a portion of economic growth.

The result is that the amount of property tax increases measured by the formula will often be relatively small compared to the award amount. This means that for a local jurisdiction to receive their award amount, they will likely need to substantially rely on the other formula component: year-over-year increases in sales and use tax revenues within the RDA.

3) State Contribution Might Depend Less on Success of Project and More on Scheduling of Project Construction and Composition of RDA Boundaries

The emphasis on retail sales in calculating the “state benefit” formula means that the same infrastructure project could yield very different state contributions, based on factors unrelated to the effectiveness of the project itself. JLARC staff observed two ways in which a jurisdiction might have high year-over-year increases in sales tax revenue that are unrelated to long term economic growth:

Scheduling of Construction: If a jurisdiction schedules a large construction project (for example, the moving of a highway) over a short period of time, then the sales tax generated from that single project may be sufficient to remove the “state benefit” cap entirely. A jurisdiction that scheduled the same project over the course of 20 years might never achieve such a large year-over-year increase in a single year, and the “state benefit” cap may restrict the state contribution for the life of the LIFT program.

Composition of the RDA Boundaries: If a jurisdiction established the boundaries of its RDA to include a large amount of existing retail activity (e.g., its downtown retail core), then the natural fluctuations of retail sales in the area may be enough to produce a year-over-year increase in sales tax to remove the “state benefit” cap entirely. If the same jurisdiction had included only a small amount of retail businesses in its RDA, then even with the same infrastructure project the jurisdiction might never achieve such a large year-over-year increase in a single year, and the “state benefit” cap may restrict the state contribution for the life of the LIFT program.

4) Data to Accurately Calculate Formula Does Not Currently Exist

The complete set of data necessary to accurately calculate the “state benefit” cap amount does not currently exist. The information required to calculate the property tax portion of the formula must be tracked and supplied by County Assessors. Based on the data received by JLARC staff, it appears

that Assessors do not currently organize their regularly maintained data in such a way as to allow all of this information to be extracted. This means that supplying this information would require a specially prepared report specifically for the purposes of the LIFT program. Of the eight County Assessors with LIFT projects in their counties, only one has provided a special report that would allow local jurisdictions to accurately calculate the property tax portion of the “state benefit” formula.

Furthermore, it is not currently possible to accurately calculate the sales and use tax portion of the “state benefit” cap amount, and it may not be possible for local jurisdictions to reliably estimate it. There are currently no separate tax codes for businesses to use that identify which sales are attributable to an RDA. The Department of Revenue estimates that the administrative costs to add these codes would be approximately \$250,000 for upfront implementation and \$90,000 per year for ongoing monitoring and administration.

CHAPTER 3 – LEGISLATIVE AUDITOR RECOMMENDATIONS

The first recommendation is intended to address what JLARC staff observed about the lack of state agency oversight and guidance for the LIFT program and the operation of the current “state benefit” formula.

Legislative Auditor Recommendation 1:

In consultation with local jurisdictions, the Department of Revenue and the Community Economic Revitalization Board should identify and recommend to the Legislature whether any statutory changes should be instituted that could improve: 1) oversight of the LIFT program; 2) state guidance to the local jurisdictions; and 3) the function of the “state benefit” cap to better serve the LIFT program’s purpose of encouraging economic development.

Legislation Required:	None.
Fiscal Impact:	JLARC staff assume that this can be completed within existing resources. The agencies should identify if implementing any recommendations would require additional resources.
Implementation Date:	By September 1, 2014, in advance of the 2015 legislative session.

The second recommendation is based on the observation that JLARC staff will be unable to provide a meaningful evaluation of LIFT projects without substantial changes to data reporting, collection, and management practices by private businesses, local jurisdictions, and state agencies.

Legislative Auditor Recommendation 2:

The Legislature should suspend future JLARC studies of the LIFT program.

Legislation Required:	Yes, to repeal or modify RCW 39.102.200.
Fiscal Impact:	None; could free up JLARC staff capacity for future studies.
Implementation Date:	During the 2014 legislative session.

**LOCAL
INFRASTRUCTURE
FINANCING**

SCOPE AND OBJECTIVES

SEPTEMBER 19, 2012

STATE OF WASHINGTON



JOINT LEGISLATIVE AUDIT
AND REVIEW COMMITTEE

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APPENDIX 1 – SCOPE AND OBJECTIVES

Why a JLARC Study of Local Infrastructure Financing?

In 2006, the Legislature passed ESHB 2673 creating the Local Infrastructure Financing Tool (LIFT) program. The goal of the program is to provide state matching funds to local governments to develop public infrastructure in defined areas. The underlying purpose is to use the public investment to attract private investment and improve the economic conditions of the selected areas. Currently, there are nine projects approved under LIFT.

The LIFT legislation requires the Joint Legislative Audit and Review Committee (JLARC) to report to the Legislature on the program every five years beginning in 2013. The program terminates in 2039.

What is LIFT?

LIFT is a variation on a type of program known as tax increment financing. LIFT projects are authorized on the assumption that local public infrastructure investment will result in increased local property values, tax revenues, and economic growth. LIFT projects are financed by locally approved bonds. LIFT projects that demonstrate increases in tax revenues from the project area qualify for state matching funds to help cover the cost of the project. LIFT projects must be approved by the state's Community Economic Revitalization Board (CERB).

The Legislature has also established other, similar financing programs, such as the Local Revitalization Financing (LRF) program. State law limits the total amount of state contributions for both the LIFT and LRF programs. Generally, new projects will require legislation authorizing additional state funding.

Study Scope

JLARC will report to the Legislature every five years for the life of the LIFT program.

In order to conduct its analysis, JLARC will require information on an annual basis from, at a minimum, cities and counties with tax increment financing projects, county assessors, the United States Census, and the departments of Revenue, Employment Security, and Commerce.

The initial report in 2013 will identify the resources and methodology JLARC will use to evaluate local infrastructure financing projects. Beginning in 2018, the reports will provide the descriptive measurements identified by the Legislature on all of the approved projects.

Study Objectives

Initial Report (2013)

The initial report to the Legislature will focus on establishing the data collection and analysis methodology for this large, multi-decade study. The study will address the following questions:

1. What is the current status of the LIFT projects?
2. What methodology does JLARC identify as appropriate to measure changes in employment, property values and taxes, sales and use taxes, housing, and existing businesses within the project areas?
3. Should other tax increment financing programs similar to LIFT be included in the analysis?
4. What methodology does JLARC identify as appropriate to evaluate the economic impacts of Washington's tax increment financing programs?
5. Are any changes in the timing or nature of subsequent reports appropriate?
6. What resources will JLARC need to conduct this study?

Subsequent Reports

The 2013 report will identify the specific objectives for subsequent reports. The objectives will evaluate the effectiveness of the program by focusing on changes and impacts in the project areas. The evaluation will concentrate on the following topics listed in the enacting legislation:

- Property values
- Employment
- Property taxes
- Housing
- Sales and use taxes
- Businesses

These subsequent reports will also address how projects' interim results compare to their selection criteria. The Legislature specifically directed JLARC to report by 2028 on whether the program should be expanded and what impact the expansion would have on economic development in Washington.

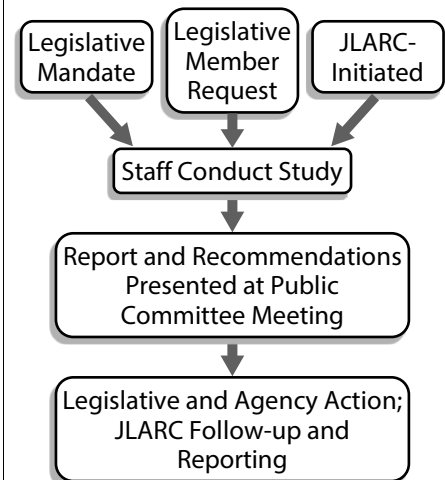
Timeframe for the Study

This study requires reports every five years beginning in 2013. Staff will present the first report at the JLARC meeting in September 2013.

JLARC Staff Contact for the Study

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JLARC Study Process



Criteria for Establishing JLARC Work Program Priorities

- Is study consistent with JLARC mission? Is it mandated?
- Is this an area of significant fiscal or program impact, a major policy issue facing the state, or otherwise of compelling public interest?
- Will there likely be substantive findings and recommendations?
- Is this the best use of JLARC resources? For example:
 - Is JLARC the most appropriate agency to perform the work?
 - Would the study be nonduplicating?
 - Would this study be cost-effective compared to other projects (e.g., larger, more substantive studies take longer and cost more, but might also yield more useful results)?
- Is funding available to carry out the project?

APPENDIX 2 – AGENCY RESPONSES

Agency responses will be included in the final report.

APPENDIX 3 – STATUTORY FORMULA TO CALCULATE ANNUAL STATE CONTRIBUTIONS

State Contribution Amount

Under RCW 39.102.020(29), the annual amount of the state contribution to a particular LIFT project is calculated to be the lowest amount of the four following caps:

- a. One million dollars: however, it is worth noting that all CERB awards are already \$1 million or less, so this cap never actually comes into play.
- b. The local revenue dedicated to the project in the prior year: these can be local allocation revenues or any other source of money dedicated by local jurisdictions to pay for the bond or pay-as-you-go improvement costs. However, these cannot include any local funds derived from state grants, state loans, or any other state moneys including any local sales and use taxes credited against the state sales and use taxes.
- c. The amount awarded by CERB: this amount is contained in the approval notice that CERB sends to the local jurisdiction.
- d. The “state benefit”: this is a complicated formula (explained in detail below) that was intended to approximate the increase in state property and excise tax revenues in the RDA.

“State Benefit” Cap Calculation

“State benefit” is not a term used in statute, but how DOR staff refer to the cap in RCW 39.102.020(29)(d). The “state benefit” is determined to be the highest amount in any year (current or previous) of “state *excise* tax allocation revenues” (SETAR) and “state *property* tax allocation revenues” (SPTAR). The basic formula to calculate the current year “state benefit” value is:

State Benefit = SETAR + SPTAR

- **SETAR (State Excise Tax Allocation Revenues)** (RCW 39.102.020(30)): This is the single year-over-year increase in sales and use tax revenues from taxable activity “within” the RDA that is received by the state. In general, this would be 6.5% of this year’s taxable RDA sales less last year’s taxable RDA sales, minus any other state shared taxes. Note that this amount cannot be negative, because it only considers increases, not decreases.
- **SPTAR (State Property Tax Allocation Revenue)** (RCW 39.102.020(32)): The basic formula to calculate State Property Tax Allocation Revenue is:

SPTAR = SPTR * PTARV

- **SPTR (State Property Tax Rate)**: This is the rate of property tax imposed by the state for the support of common schools. This rate will vary county by county, due to adjustments DOR makes to convert the county assessed value to state market rate value.

The average rate in 2012 was approximately \$2.40/\$1,000 of assessed value (see RCW 84.52.065). This rate is determined by DOR each year.

- **PTARV (*Property Tax Allocation Revenue Value*)**: This value is meant to approximate the increase in assessed property values due to new construction within an RDA. This value is to be determined by County Assessors under RCW 39.102.120(2) each year. According to RCW 39.102.020(19), the basic formula for PTARV is:

$\text{PTARV} = 0.75 * (\text{NC} + \text{PTNC} + \text{IAVEB})$
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- **NC (*New Construction*)**: This is the increase in assessed value to a property within the RDA resulting from new construction (or other improvements, conversions, or rehabilitations deemed to be “new construction” by the Assessor for tax purposes). The “new construction” could be of an entire building or substantial changes to an existing building. Only new construction that was initiated after the RDA was approved by CERB applies. Note that this amount only applies to properties that are taxable (i.e., exempt properties such as government buildings and churches do not qualify). This value only counts in the year that the new construction is placed on the assessment roll. See RCW 39.102.020(19)(a)(i)-(ii).
- **PTNC (*Prior Taxable New Construction*)**: This value is the sum of prior NC values in each year following the approval of the RDA by CERB, but only for parcels that are still taxable (i.e., never became exempt). To be able to exclude exempt parcels, Assessors must necessarily keep a parcel by parcel breakdown of all prior NC values and indicate which parcels are taxable or exempt. See RCW 39.102.020(19)(a)(ii).
- **IAVEB (*Increased Assessed Value of Entire Buildings*)**: This value is any subsequent increase in assessed value of taxable properties in the RDA that once had new construction, but only if that new construction was of an entire building (i.e., not just an addition to an existing building). For these properties the initial increase in value when first placed on the roll would be captured by NC, and any increase in assessed value in subsequent years would be captured by IAVEB. Note that this value does not apply if the property is exempt. To be able to exclude subsequent exemptions and partial-building-new-construction, Assessors must necessarily keep a parcel by parcel breakdown of all prior NC values, and indicate which parcels are taxable or exempt, as well as which NC values were for entire buildings. See RCW 39.102.020(19)(b).

To summarize, the formula to calculate “state benefit” can be expressed as follows:

State Benefit = SETAR + SPTR * 0.75 * (NC + PTNC + IAVEB)
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Note that if this value is lower than a prior year’s “state benefit,” then the prior year’s value will be used for purposes of calculating the state contribution. If any of these values are unknown (e.g., if a County Assessor has not maintained a record of whether prior new construction was of an entire building), it may not be possible to calculate the “state benefit.” This in turn means it may not be possible to accurately determine the state contribution.

