PRELIMINARY REPORT: 2021 TAX PREFERENCE PERFORMANCE REVIEWS

Targeted Urban Area Exemption

LEGISLATIVE AUDITOR'S CONCLUSION:

Cities may be ineligible to offer the preference. Legislative action is needed if the Legislature wants to ensure the preference is available.

January 2021

Executive Summary

The preference provides a local property tax exemption for new industrial or manufacturing development

Estimated Biennial Beneficiary Savings $0
Tax Type Local property tax RCW 84.25.040

The 2015 Legislature authorized cities meeting certain requirements to enact a ten-year local property tax exemption for new industrial or manufacturing development in designated areas.

The Legislature specified that cities could enact the preference and approve exemption applications if they:

- Are located in a county with a population between 700,000 and 800,000.
- Have a population of at least 18,000.
- Are located north or east of the largest city in the county.

At the time, only Snohomish County had a population between 700,000 and 800,000 and the cities of Arlington, Marysville, and Lake Stevens met the criteria.

Development projects that qualify for the preference must:

- Be located in undeveloped or underutilized areas of the city zoned for industrial or manufacturing uses.
- Be a minimum of 10,000 square feet with an improvement value of at least $800,000.
- Create at least 25 family living wage jobs, with wages of least $18 per hour.

The preference closes to new applicants December 31, 2022.

To date, stated objective to encourage development and create family wage jobs not achieved

The Legislature stated that the preference's objective is to encourage new development on undeveloped or underutilized land zoned for industrial and manufacturing uses. This new development is intended to increase family living wage jobs in the local communities.

To date, the stated objective has **not been achieved**. Snohomish County exceeded the 800,000 population maximum in 2018, and no other counties currently have a population between 700,000 and 800,000. No exemptions were approved before this time. The Department of Revenue determined that no cities currently qualify to offer the preference. Arlington, Marysville, and Lake Stevens disagree with the Department's position.

Objective (stated)	Results
Encourage new development on undeveloped or underutilized land zoned for industrial or manufacturing uses in targeted urban areas and increase family living wage jobs.	**Not achieved**. The preference has not been used and no cities may be eligible to offer it.

Recommendations

Legislative Auditor's Recommendation: Review and consider whether to extend

If the Legislature wants the preference to be available for future use, it should modify the preference's population criteria and determine an expiration date for new participants.

The Department of Revenue and the cities disagree about the cities' eligibility to offer the preference.

You can find more information in Recommendations.

Commissioners' Recommendation

Available on Citizen Commission website October 2021.

REVIEW DETAILS
1. Preference intended to encourage local development and jobs

Ten-year local property tax exemption intended to create new industrial development and jobs

Qualifying cities may offer a ten-year local property tax exemption for the value of new construction of industrial or manufacturing facilities in designated areas. Counties in which the cities are located may offer a county property tax exemption. The exemption applies to the city and county portions of property tax, not the state portion.

Arlington, Lake Stevens, and Marysville initially offered the preference

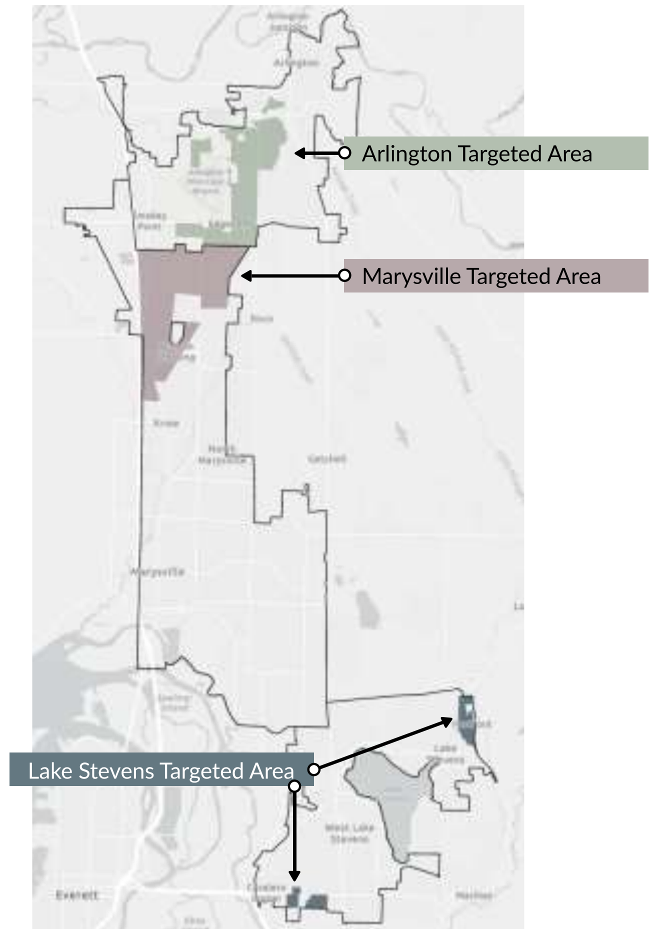
The legislation authorizing the preference outlines criteria for cities to offer the preference.

The legislation authorizing the preference limits its availability to cities that:	Are located in a county with a population between 700,000 and 800,000.	Have a population of at least 18,000.	Are located north or east of the largest city in the county.

Only Snohomish County met the county population requirement in 2015. Within the county, the cities of Arlington, Lake Stevens, and Marysville met the additional population and geographic criteria. The three cities enacted ordinances to offer the preference in 2016. Snohomish County adopted an ordinance that allows an exemption from county taxes in the cities' target areas.

The legislation's prime sponsor and city representatives testified they sought the local property tax exemption to encourage development on undeveloped and underutilized[1] land in the Stillaguamish Valley. Arlington and Marysville noted they were coordinating long-term efforts to encourage new industry and create local jobs, including the pursuit of other regional economic development incentives.

Exhibit 1.1: Targeted areas are undeveloped or underutilized properties in or near other economic development zones



Source: JLARC staff analysis of city boundaries and established targeted areas within them.

Qualifying developments must meet size, investment value, and job creation criteria

Statute requires that developments eligible for the exemption must be located in a city's designated target area, defined as undeveloped or underutilized properties near other economic development areas[2].

Developments eligible for the preference must meet several requirements.

Statute specifies that developments must:	Be at least 10,000 square feet with an investment of at least $800,000.	Be categorized as manufacturing under the U.S. Department of Labor Standard Industrial Classification Manual.	Create at least 25 family living wage jobs, defined as full time, paying $18+/hour.

Property owners and cities are required to file annual reports

Property owners of qualifying facilities apply to the city for the exemption. Facilities are exempt from local property taxes for ten years after construction is complete. Per statute, property owners may not apply for the exemption after December 31, 2022.

After construction is complete, the property owner must report annually to the city. Cities report annually to the Department of Commerce (Commerce).

[1]Undeveloped and underutilized property with no existing building improvements or portions of property targeted for new or expanded industrial or manufacturing uses.
[2]Innovation partnership zones, foreign trade zones, or EB-5 regional centers.

Exhibit 1.2: Property owners apply for the local tax exemption and report to the city. Cities report to the Department of Commerce.

Property owners report to cities	Cities report to Commerce
• The number of family living wage jobs at the facility on the anniversary date of construction. • If property use has changed, and any changes or improvements added since the exemption certificate was issued.	• The total number of exemptions approved. • The total number and type of manufacturing or industrial facilities built. • The number of family living wage jobs created by the new facilities. • The exemption value of each project and the total value of all exemptions.

Source: JLARC staff analysis of RCW 84.25.120.

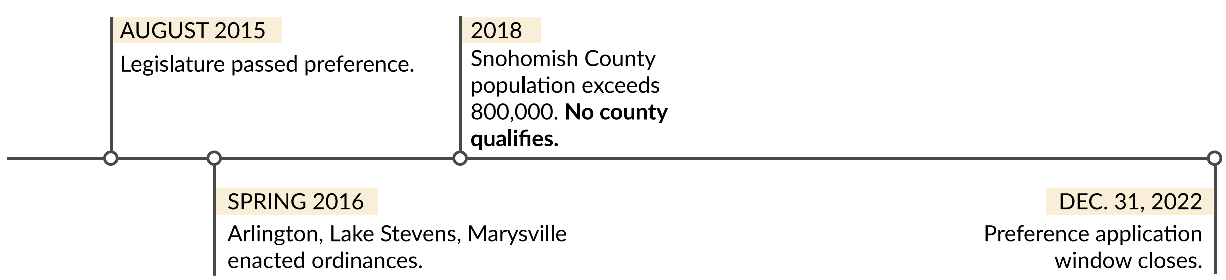
2. Cities may be ineligible to offer preference

County population growth may disqualify cities from offering the preference

Snohomish County exceeded the statutory population range in 2018

In 2018, Snohomish County's population exceeded 800,000. The Department of Revenue (DOR) determined that the local tax exemption cannot be legally offered by any city in the county. According to DOR, Arlington, Marysville, and Lake Stevens have been ineligible to offer the preference since 2018.

Exhibit 2.1: Snohomish County exceeded the statutory population limit for cities to offer the preference in 2018



Source: JLARC staff analysis of chapter 84.25 RCW, JLARC staff analysis of city ordinances, and Office of Financial Management documentation.

DOR stated that no other city currently meets the statutory criteria to offer the preference.

No data available to evaluate preference's performance

As of November 2020, there is no data available to evaluate whether the preference achieves the stated objectives of encouraging manufacturing and industrial development and creating family living wage jobs. No property owners applied for the local property tax exemption in Arlington, Lake Stevens, or Marysville prior to 2018.

DOR and cities disagree about eligibility to offer preference

Although DOR states that no cities are eligible to offer the preference, all three city codes allow the preference to be offered. The cities reported to JLARC staff that they interpret the statute to allow them to offer the preference through December 31, 2022, regardless of population changes.

The cities indicate that they intended the preference to complement other industrial development incentives in their target areas. For example, Arlington and Marysville pursued designating their target areas as a manufacturing/industrial regional center[3] by the Puget Sound Regional Council (PSRC). The PSRC certified the Cascade Industrial/Manufacturing Regional Center in May 2019. The cities anticipated that the regional center designation, combined with the local property tax exemption, would bring new industrial development to their target areas.

Legislative action needed if Legislature wants to ensure the preference is available for future use

If the Legislature wants the preference to be available in the future, it will need to:

- Modify the statutory population criteria.
- Determine an expiration date for new applicants.

3. Applicable statutes

RCWs 84.25.010, 84.25.020, 84.25.030, 84.25.040

RCW 84.25.010

Findings.

The legislature finds that:

(1) Many cities have planned under the growth management act, chapter 36.70A RCW, and designated and zoned lands for industrial and manufacturing use;

(2) The industrial and manufacturing industries provide family living wage jobs;

(3) In the current economic climate the creation of additional family living wage jobs is essential;

(4) It is critical that Washington state promote its continued strength in the fields of aerospace, technology, biomedical, and other industries that will provide family-wage job growth; and

(5) Planning for industrial and manufacturing use is inadequate to attract new industry and manufacturing and an incentive should be created to stimulate the development of new industrial and manufacturing uses in the existing inventory of lands zoned for industrial and manufacturing use in targeted urban areas through a tax incentive as provided by this chapter.

[3]Regional centers guide local and regional growth and transit planning, and receive priority for federal transportation funding.

[2015 1st sp.s. c 9 § 1.]

RCW 84.25.020

Purpose.

It is the purpose of this chapter to encourage new manufacturing and industrial uses on undeveloped or underutilized lands zoned for industrial and manufacturing uses in targeted urban areas, thereby increasing employment opportunities for family living wage jobs. Cities that plan under the growth management act meeting the criteria of this chapter where the governing authority of the affected city has found there is insufficient family living wage jobs for its wage earning population may designate a portion of the city's industrial and manufacturing zoned and undeveloped land to receive an ad valorem tax exemption for the value of new construction of industrial/manufacturing facilities within the designated area.[2015 1st sp.s c 9 § 2.]

RCW 84.25.030

Definitions.

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "City" means any city that: (a) Has a population of at least eighteen thousand; and (b) is north or east of the largest city in the county in which the city is located and such county has a population of at least seven hundred thousand, but less than eight hundred thousand.

(2) "Family living wage job" means a job with a wage that is sufficient for raising a family. A family living wage job must have an average wage of eighteen dollars an hour or more, working two thousand eighty hours per year on the subject site, as adjusted annually for inflation by the consumer price index. The family living wage may be increased by the local authority based on regional factors and wage conditions.

(3) "Governing authority" means the local legislative authority of a city having jurisdiction over the property for which an exemption may be applied for under this chapter.

(4) "Growth management act" means chapter 36.70A RCW.

(5) "Industrial/manufacturing facilities" means building improvements that are ten thousand square feet or larger, representing a minimum improvement valuation of eight hundred thousand dollars for uses categorized as "division D: manufacturing" by the United States department of labor in the occupation safety and health administration's standard industrial classification manual.

(6) "Lands zoned for industrial and manufacturing uses" means lands in a city zoned as of December 31, 2014, for an industrial or manufacturing use consistent with the city's comprehensive plan where the lands are designated for industry.

(7) "Owner" means the property owner of record.

(8) "Targeted area" means an area of undeveloped lands zoned for industrial and manufacturing uses in the city that is located within or contiguous to an innovation partnership zone, foreign

trade zone, or EB-5 regional center, and designated for possible exemption under the provisions of this chapter.(9) "Undeveloped or underutilized" means that there are no existing building improvements on the property or portions of the property targeted for new or expanded industrial or manufacturing uses.

[2015 1st sp.s. c 9 § 3]

RCW 84.25.040

Exemption—New construction of industrial/manufacturing facilities.

(1)(a) The value of new construction of industrial/manufacturing facilities qualifying under this chapter is exempt from property taxation under this title, as provided in this section. The value of new construction of industrial/manufacturing facilities is exempt from taxation for properties for which an application for a certificate of tax exemption is submitted under this chapter before December 31, 2022. The value is exempt under this section for ten successive years beginning January 1st of the year immediately following the calendar year of issuance of the certificate. (b) The exemption provided in this section does not include the value of land or nonindustrial/manufacturing-related improvements not qualifying under this chapter.

(2) The exemption provided in this section is in addition to any other exemptions, deferrals, credits, grants, or other tax incentives provided by law.

(3) This chapter does not apply to state levies or increases in assessed valuation made by the assessor on nonqualifying portions of buildings and value of land nor to increases made by lawful order of a county board of equalization, the department of revenue, or a county, to a class of property throughout the county or specific area of the county to achieve the uniformity of assessment or appraisal required by law.

(4) This exemption does not apply to any county property taxes unless the governing body of the county adopts a resolution and notifies the governing authority of its intent to allow the property to be exempted from county property taxes.

(5) At the conclusion of the exemption period, the new industrial/manufacturing facilities cost must be considered as new construction for the purposes of chapter 84.25 RCW.

[2015 1st sp.s. c 9 § 4]

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Review and consider whether to extend

If the Legislature wants the preference to be available for future use, it should modify the preference's population criteria and determine an expiration date for new participants.

The Department of Revenue and the cities disagree about the cities' eligibility to offer the preference.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

Letter from Commission Chair

Available on Citizen Commission website October 2021.

Commissioners' Recommendation

Available on Citizen Commission website October 2021.

Agency Response

If applicable, available on Citizen Commission website October 2021.

MORE ABOUT THIS REVIEW

More about 2021 reviews

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 Representatives 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 findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

Timeframe for the study

This preliminary audit report will be presented at the January 2021 JLARC meeting. The remainder of the 2021 tax preference preliminary audit reports will be presented at the July 2021 JLARC meeting. All preliminary 2021 tax preference reviews will be presented at the August 2021 meeting of the Citizen Commission for Performance Measurement of Tax Preferences. A final report will be presented to JLARC in December 2021.

Study questions

Washington JLARC

PROPOSED STUDY QUESTIONS
Targeted Urban Construction

State of Washington Joint Legislative Audit and Review Committee — October 2020

JLARC to review a local property tax exemption for new industrial or manufacturing construction in targeted cities

This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

In 2015, the Legislature authorized certain cities to enact a 10-year local property tax exemption for new industrial development in designated areas. Businesses can apply for the property tax exemption until December 31, 2022.

The Legislature specified that cities could enact preference if they:

- Have a population of at least 18,000.
- Are located north or east of the largest city in the county.
- Are located in a county with a population between 700,000 and 800,000.

In 2015, the cities of Arlington, Marysville, and Lake Stevens met these criteria. Development projects that qualify for the preference must:

- Be located in undeveloped on underutilized areas zoned for industrial or manufacturing uses.
- Be a minimum of 10,000 square feet with an improvement value of at least $800,000.
- Create at least 25 family living-wage jobs, with wages of least $18 per hour.

The preference is intended to grow industrial development and create jobs

The Legislature stated that the incentive's purpose is to encourage new development on undeveloped or underutilized land zoned for industrial and manufacturing uses in targeted urban areas. This new development is intended to increase family living-wage jobs in the local communities.

This study will address the following questions:

1. Which cities have adopted the preference?
2. To what extent have businesses applied for and used the preference? What circumstances have affected the preference's use?
3. How many family living-wage jobs were created at facilities built using the preference?

Study Timeframe

Preliminary Report: July 2021 **Proposed Final Report:** December 2021

Study Team

Team Lead	Dana Lynn	(360) 786-5177	dana.lynn@leg.wa.gov
Research Analyst	Rachel Murata	(360) 786-5293	rachel.murata@leg.wa.gov
Project Coordinator	Eric Thomas	(360) 786-5182	eric.thomas@leg.wa.gov
Legislative Auditor	Keenan Konopaski	(360) 786-5187	keenan.konopaski@leg.wa.gov

JLARC Study Process

Study Mandate — Budget, legislation, committee direction → Proposed Study Questions → Legislative Auditor's Preliminary Report → For Tax Preferences: • Citizen Commission meeting • Public testimony • Commission adopts comments → Legislative Auditor's Proposed Final Report — Agency response included → Final Report — Option to append committee comment

Committee votes to distribute completed audit

JOINT LEGISLATIVE AUDIT & REVIEW COMMITTEE
106 11th Ave SW, Olympia, WA 98501 | Email: JLARC@leg.wa.gov | Website: www.jlarc.leg.wa.gov
Twitter: @WALegAuditor | Phone: (360) 786-5171 | Fax: (360) 786-5180

More about 2021 reviews

Study process

What is a tax preference?

Tax preferences are defined in statute (RCW 43.136.021) as exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. Washington has approximately 600 tax preferences.

Why a review of tax preferences?

Legislature creates a process to review tax preferences

In 2006, the Legislature stated that periodic reviews of tax preferences are needed to determine if their continued existence or modification serves the public interest. The Legislature enacted Engrossed House Bill 1069 to provide for an orderly process for the review of tax preferences (RCW 43.136).

Statute assigns specific roles to two different entities:

- The Citizen Commission for Performance Measurement of Tax Preferences ("The Commission") creates a schedule for reviews, holds public hearings, and comments on the reviews.
- Staff to the Joint Legislative Audit and Review Committee (JLARC) conduct the reviews.

Citizen Commission sets the schedule

The Legislature directed the Commission to develop a schedule to accomplish an orderly review of most tax preferences over ten years. The Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law. The Commission may also exclude preferences from review that the Commission determines are a critical part of the tax structure.

The Commission conducts its reviews based on analysis prepared by JLARC staff. In addition, the Commission may elect to rely on information supplied by the Department of Revenue.

The Commission's website includes analysis of preferences completed in previous years: See http://www.citizentaxpref.wa.gov/.

JLARC staff's approach to the tax preference reviews

Statute guides the main topics typically covered in the reviews.

Public policy objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))

2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

Revenue and economic impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impacts of government activities funded by the tax? (RCW 43.136.055(j))

Other states:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(k))

JLARC staff's analysis of tax preferences

JLARC staff carefully analyzes a variety of evidence when conducting these reviews:

- Legal and public policy history of the tax preferences.
- Beneficiaries of the tax preferences.

- Government and other relevant data pertaining to the utilization of these tax preferences.
- Economic and revenue impact of the tax preferences.
- Other states' laws to identify similar tax preferences.

Key: understanding the purpose of the preference

The Legislature now requires that any legislation creating a new preference, or expanding or extending an existing preference, must include a tax preference performance statement. The performance statement must contain a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference (RCW 82.32.808).

Some of the preferences included in this report were passed before the 2013 legislation that requires performance statements. When a preference's purpose or objective is identified in statute, staff are able to affirmatively state the public policy objective. Sometimes the objective may be found in intent statements or in other parts of statute if there is no tax preference performance statement.

When the Legislature did not state the public policy objective of a preference, JLARC staff may be able to infer what the implied public policy objective might be. To arrive at this inferred policy objective, staff review the following:

- Legislative history, including
    - Final bill reports for any statements on the intent or public policy objectives.
    - Bills prior to the final version and legislative action on bills related to the same topic.
    - Bill reports and testimony from various versions of the bill.
    - Records of floor debate.
- Relevant court cases that provide information on the objective.
- Department of Revenue information on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax. Agencies may provide data on the value and usage of the tax preference and the beneficiaries. If the beneficiaries of the tax preference are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

If there is sufficient information in this evidence to infer a policy objective, JLARC staff state that in the reviews. In these instances, the purpose may be a more generalized statement than when there is explicit statutory language.

JOINT LEGISLATIVE AUDIT & REVIEW COMMITTEE

Contact information

JLARC staff members

Scott Hancock, **Research Analyst** - 360-786-5182

Dana Lynn, **Research Analyst** - 360-786-5177

Rachel Murata, **Research Analyst** - 360-786-5293

Pete van Moorsel, **Research Analyst** - 360-786-5185

Eric Whitaker, **Research Analyst** - 360-786-5618

Eric Thomas, Audit Coordinator

Keenan Konopaski, Legislative Auditor

JLARC members on publication date

Senators

Bob Hasegawa
Mark Mullet, Chair
Rebecca Saldaña
Shelly Short
Dean Takko
Lynda Wilson, Secretary
Keith Wagoner

Representatives

Jake Fey
Noel Frame
Larry Hoff
Christine Kilduff
Vicki Kraft
Ed Orcutt, Vice Chair
Gerry Pollet, Assistant Secretary
Drew Stokesbary

Citizen Commission for Performance Measurement of Tax Preferences

Voting members

Dr. Grant D. Forsyth
Ronald L. Bueing
Diane Lourdes Dick
Sharon Kioko
Andi Nofziger-Meadows

Non-voting members

Mark Mullet, JLARC Chair
Pat McCarthy, State Auditor

Washington Joint Legislative Audit and Review Committee

106 11th Ave SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171

Email: JLARC@leg.wa.gov