



## BRIEFLY

This is the second policy brief in a four-part Research Council series on Washington State's infrastructure needs.

# Washington's Infrastructure Needs: Current Funding and Financing Tools

State and local agencies pay for infrastructure improvements through combinations of user fees, general funds, operating revenue and grants, and leverage these funds through various debt instruments. Utilities, because they have a defined and predictable rate base, can mostly finance system improvements through their customers' monthly bills, whereas transportation agencies rely on a wider variety of sources. This paper provides an overview of the basic fund sources and financing tools available to state and local governments, followed by a description of how those tools are used by various agencies.

Discussion of infrastructure finance frequently combines the topics of funding and finance. In the descriptions below, funding refers to the generation of revenue through taxes, fees or grants. Financing refers to mechanisms for borrowing against those revenue streams to gain earlier access to them.

## CURRENT FUND SOURCES

### Transportation User Fees

User fees create a connection between use of a facility and the funding of its construction and maintenance. The ideal user fee links the amount paid precisely to the amount the system is used. With most real-world fees, however, the connection is not perfect. For example, a fuel efficient car may take up the same amount of road space as a gas guzzler, but pay less tax. Even imperfect user fees tend to be politically more popular than general taxes. The primary transportation user fees are:

*Motor fuel tax.* The Motor Fuel tax (generally known as the "gas tax") in Washington State is levied on a per-gallon basis, collected from the fuel distributor and, along with federal gas taxes, built into the price at the pump. Currently, sales taxes are not levied on motor fuel by either state or local governments. The 18<sup>th</sup> Amendment to the State Constitution restricts the use of motor fuel tax revenue to "highway purposes." This has been interpreted to cover all roads and adjacent sidewalks, as well as the state automobile ferry system, which is considered part of the state highway network.

---

### **Washington Research Council**

108 S Washington St., Suite 406

Seattle WA 98104-3408

206-467-7088

fax: 206-467-6957

[www.researchcouncil.org](http://www.researchcouncil.org)

With the addition of five cents per-gallon in 2003, the motor fuel tax in Washington is currently \$0.28 per gallon. A statutory distribution formula sends that revenue to a number of state and local agencies. Figure 1 shows the distribution among agencies and levels of government. Descriptions of the programs are provided below. (Counties are authorized, subject to a vote, to levy a local fuel tax. See description below)

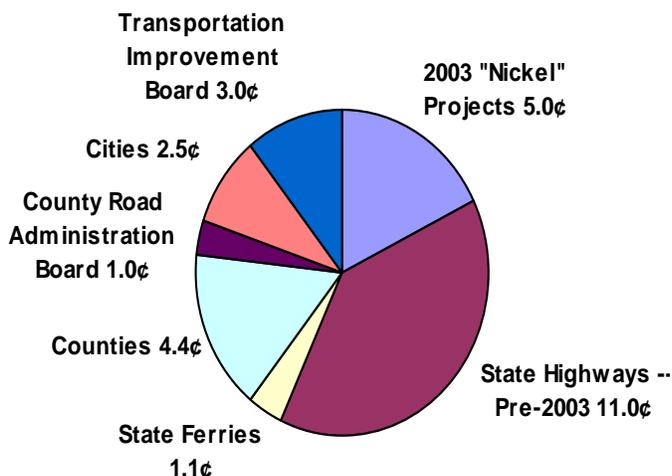
At 28 cents per gallon, Washington has the ninth highest state fuel tax in the country, after Hawaii, Illinois, Nevada, New York, California, Wisconsin, Rhode Island and Florida. The average among the states is about 20 cents per gallon, with the lowest tax at 8 cents in Alaska. (Washington State Department of Transportation, 2004a)

While the motor fuel tax is as popular as a tax can be, it suffers from two weaknesses as a revenue source. First, as a flat fee per-gallon, revenue does not rise with inflation. The tax was raised to 23 cents in 1991, and by 2003 the purchasing power of that tax had shrunk to about 18 cents. So, even with substantial growth in the state, and the pressures that growth puts on the transportation system, total fuel tax revenues remained flat for the past decade. The “nickel tax” added in 2003 barely brought the purchasing power of the fuel tax back to 1991 levels. (Washington State Transportation Commission, 2004)

A second weakness shows up in the improved fuel efficiency of vehicles: as vehicles become more efficient, less tax is collected per vehicle mile. While the popularity of light trucks in the past decade has slowed the trend toward more fuel efficiency, continued high gas prices may shift demand to more fuel efficient cars, shrinking fuel tax collections. (United States Department of Transportation, 2004)

*License and weight fees.* The second largest source of revenue for the State Department of Transportation (WSDOT) consists of a variety of vehicle licensing fees. Although Initiative 776 eliminated most of the Motor Vehicle Excise Tax (MVET) and local option license fees, the WSDOT still expects to collect \$674 million in the next biennium. This includes revenue from a 15 percent increase in truck weight fees adopted as part of the “nickel package” in 2003. Because the 18<sup>th</sup> Amendment does not apply to these funds, they can support non-highway programs, such as the State Patrol. The proposed 2005-2007 budget does call for spending 54 percent of licensing revenue on WSDOT programs. (Washington State Transportation Commission, 2004)

**Figure 1: Twenty-Eight Cent Gas Tax Revenue Distribution**



Source: Washington State Transportation Commission--Amounts are rounded to nearest tenth of a penny

Most license fees do not draw much of a connection between the fee level and the actual use of transportation systems. A flat fee collects the same revenue from a vehicle driven 1000 miles a year and a vehicle driven 30,000 miles. The previous MVET, which based fees on the value of the vehicle drew no relationship at all. The state's truck Gross Weight Fee does vary by reported gross weight – a 42,000 pound truck pays \$609 per year, and a truck straining the scales at 105,000 pounds pays \$3,400 per year. (Washington State Department of Licensing, 2004)

*Tolls.* The state has used tolls to fund bridges in various parts of the state, but no tolls are currently in effect. Tolls are typically used to pay off construction bonds, and once the bonds have been retired, the tolls are lifted. The \$850 million cost of the new Tacoma Narrows Bridge is being financed largely with tolls, which will initially be set at \$3.00, collected in the eastbound direction only. Planning for a replacement bridge on SR-520 across Lake Washington assumes financing through tolls. (Washington State Department of Transportation, 2004b)

Tolls provide a direct connection between facility use and fee. They have proved politically acceptable for funding new capacity, but very problematic for raising revenue on existing facilities. Tolls work best when motorists have limited options to by-pass the toll road or bridge, or when those options are very slow. In various parts of the country toll roads have been built parallel to existing congested freeways, offering a fast alternative for those willing to pay.

### **Intergovernmental Grants and Loans**

State and local transportation agencies rely to a substantial degree on infrastructure funding from higher levels of government. States receive grants from the federal government and local governments receive grants from both state and federal agencies. Granting programs originate in intergovernmental relationships where the higher level of government:

1. Has a direct interest in infrastructure, but does not want to build or own it. Example: the Interstate Highway System, built by states with 90 percent federal funding.
2. Has issued a regulatory mandate that requires investment, and therefore feels an obligation to take the political heat for funding that mandate. Example: federal aid for local sewage treatment, in response to the Clean Water Act.
3. Is asserting leadership in a certain area by offering funding assistance. Example: the state's Transportation Improvement Board, which funds regionally-significant local roads.
4. Provides a sort of insurance against failure or assistance in response to disaster. Example: state assistance to very small water systems to ensure safety.

---

To receive advance notice of Washington Research Council publications by e-mail send your e-mail address to [wrc@researchcouncil.org](mailto:wrc@researchcouncil.org)

---

On the surface, intergovernmental grants seem like a no-brainer: free money! But because they often promote specific objectives and tend to come with strings attached, they can distort priorities and divert resources. Lower priority projects can move to the head of the line sim-

ply because they qualify for state or federal assistance. While this assistance may allow agencies to leverage their own funding farther, the resulting projects may not be the best use of those funds.

Federal and state agencies have grant and loan programs for just about any conceivable infrastructure need. To help local governments find available money, the State of Washington has established an Infrastructure Assistance Coordinating Council which maintains a website covering most state programs. The website ([www.infracfunding.wa.gov](http://www.infracfunding.wa.gov)) lists nearly 100 grant programs, in addition to numerous loan and technical assistance programs. Many of these programs serve as conduits for federal money. Among the grant programs, 26 provide transportation funding, 11 provide water and sewer funding and 29 provide environmental and recreation infrastructure funding. (Infrastructure Assistance Coordinating Council, 2003)

Most grant and loan programs operate on a competitive basis, with applicants submitting requests in response to specific criteria and waiting for a decision. The federal government does still have a tradition of earmarking funding for specific projects. Intergovernmental programs rarely fund most or all of a project, and the outside assistance must be matched with other funds.

### **Property tax levy lid lift**

Local governments are subject to strict limits on how much they can raise property taxes each year. They can, however, ask voters for a temporary increase in property taxes to fund needs such as infrastructure. Although state law does not require it, most levy lid lift propositions set both a time limit for the levy and a specific purpose for the new revenues. Levy lid lifts have the advantage of only requiring a 50 percent majority vote, as opposed to the 60 percent majority required for a general obligation bond issue backed by a property tax levy.

### **Development fees**

Most brand new local roads are funded and built by land developers as part of their subdivisions. Cities and counties set standards for these roads and approve the plans for them, but the developer pays the whole cost and then turns the roads over to the city or county as public right-of-way. Similarly, new sewer lines and water lines within subdivisions are paid for by the developer and turned over to the local utility.

New developments do have impacts beyond their borders, and through the State Environmental Policy Act (SEPA) and the Growth Management Act (GMA), local governments can collect money from developers to finance improvements needed to accommodate the new development. Road mitigation fees are based on an assessment of the traffic impact and the identifiable improvements. Sewer and water systems usually have a standard hook-up charge that covers the average cost of adding one new unit to the overall system. Mitigation and hook-up fees can vary widely among jurisdictions.

Courts have clearly stated that local governments cannot require developers to fund existing infrastructure deficiencies. For example, new development cannot be required to pay all the costs of improving a nearby intersection that already operates beyond its capacity.

## **Local Improvement Districts**

Property owners can share the cost of building or upgrading their local infrastructure by forming a local improvement district (LID). During the LID process, each property owner that will benefit from the improvement is assigned a share of the cost, which is paid over time through property taxes. LIDs are often used to bring formerly underdeveloped areas up to urban standards with improvements such as sewer lines, sidewalks or buried utilities. (LIDs are covered more extensively in a subsequent brief in this series)

## **Real Estate Excise Tax (REET)**

Cities may levy a tax on real estate transactions to fund capital projects. All cities may charge one-fourth of one percent, and use these funds for items in their capital improvement plans. Cities planning under the GMA may levy an additional quarter percent and must also use the funds only for capital facilities. The statutes authorizing the REET, as well as subsequent Attorney General opinions, carefully define the sorts of things that are appropriate uses of REET funds. (Municipal Research and Services Center, 1999)

## **Local option transportation taxes**

As part of a larger transportation funding increase, the 1990 legislature authorized several local option funding sources for cities and counties. Three of these, a head tax, the street utility charge and the vehicle license fee, have been invalidated, and two remain, but are in little use.

Counties can, with voter approval, levy a gas tax at up to 10 percent of the state rate (i.e. up to 2.8 cents currently). The proceeds would be divided by a formula among the county and the cities within it, with the county getting a larger share. Only a few counties have tried to levy this local fuel tax, and none have succeeded in getting voter approval.

Cities and counties (in unincorporated areas only) can levy a tax on commercial parking. The statute leaves jurisdictions quite a bit of discretion about how to structure the tax. A few cities, including SeaTac and Bainbridge, have implemented the tax.

## **General Funds**

State and local governments will use general fund revenues to pay for infrastructure costs that cannot be loaded onto dedicated funding sources. Unlike local governments, state government does not ask for a property tax increase to accompany a general obligation bond issue, so it must use general fund revenues to repay bonds issued to build facilities like schools and state parks. For local governments, their share of fuel tax revenues falls well short of the needs of their road systems, and they must supplement fuel tax receipts with general funds.

Various proposals for infrastructure funding really just amount to diversion of general fund revenues. For example, forgiving sales tax on construction lowers the cost of infrastructure projects, but also lowers sales tax collections that go to the general fund. Similarly, dedicating sales tax collected on residential or commercial construction to infra-

structure funding, while logical, simply diverts those revenues from the general fund. And any councilmanic bonds a city has issued without an identified revenue source must be serviced with general funds.

## **Bonding**

Most agencies borrow extensively for infrastructure projects for two basic reasons. First, revenue streams cannot support pay-as-you go financing of large projects. Second, future beneficiaries of infrastructure should have the opportunity to help pay for it. Governments can use several types of bonding.

### **General obligation bonds**

State and local governments can issue general obligation bonds for most purposes. At the local level these bonds are backed by an identified revenue stream, such as a special property tax levy. They are also backed by the full faith and credit of the issuing government, so that if the revenue source falls short for any reason, the government must dip into its general fund to repay the bonds. In Washington State, cities and counties must get a 60 percent voter approval in order to issue property tax-backed general obligation bonds, but the state can issue them without any voter approvals.

### **Councilmanic bonds**

These general obligation bonds are issued by cities and counties and are backed by their full faith and credit. They do not require voter approval or a dedicated revenue stream, but are subject to a strict ceiling. Debt service on councilmanic bonds comes out of the city or county general fund, although the projects financed by them may have an identifiable revenue stream. These bonds are often used when the revenue stream is not quite predictable enough to back revenue bonds.

### **Revenue bonds**

These bonds are backed by a guaranteed stream of revenue generated by the project itself, but are not backed by the full faith and credit of the government and do not require a vote of the people. Utilities typically fund their system improvements with revenue bonds, covering debt service through the utility bills of the captive ratepayers. Transportation projects, including ferries, that charge tolls can issue revenue bonds backed by the tolls. Washington State, however, has not used toll-backed revenue bonds since the 1970s, preferring lower-rate general obligation debt. (Transportation Economic Partnerships Office) For a utility or other agency to use revenue bonds the income stream must be very secure and predictable. Because issuers do not back revenue bonds with their full faith and credit, they carry a higher interest rate than general obligation bonds.

### **“Double barreled” gas tax bonds**

WSDOT finances construction projects by selling bonds that are repaid with gas tax revenue. These are known as “double barreled” bonds, since they are backed by both the gas tax and the full faith and credit of the State. So, if the gas tax does not produce enough revenue, the State services the debt through the general fund. But because the bonds are

primarily backed by the gas tax, they are not subject to the State's constitutional debt ceiling. (Transportation Economic Partnerships Office).

## **INFRASTRUCTURE FUNDING AND FINANCING STRATEGIES**

### **State highways**

The revenue dedicated to WSDOT's highway budget comes primarily from three sources: fuel tax, licenses and permits, and federal funds. But because of the use of bonding, there is a big difference in any given year between the cash flowing into WSDOT and the outflow of capital expenditure dollars. In 2003 about 35 percent of fuel tax income was dedicated to servicing existing debt. This old debt will taper off, but, at the same time, the new nickel fuel tax will be leveraged very aggressively with debt. This will substantially increase the funds available for capital projects in the next few years, but eventually the debt load catches up, and by 2015, about 45 percent of fuel tax revenue will be needed to service debt. (Washington State Transportation Commission, 2004)

The "nickel package" of fuel tax increase represents a significant new direction in state highway funding. The legislation that authorized the tax also contained specific lists of projects, and obligates WSDOT to deliver those projects. Thus, the heavy bonding: since the projects are all identified, there is no reason to wait until the cash shows up. The WSDOT budget makes a clear distinction between its ongoing capital and maintenance programs and the new nickel fund projects. (Washington State Transportation Commission, 2004)

### **Local Roads**

Cities fund their local street program primarily through a combination of fuel tax distribution, general funds and developer contributions. Counties get a fuel tax distribution and also have a separate property tax levy in unincorporated areas that is dedicated to roads. Since larger subdivisions tend to be built in unincorporated areas, counties in urbanized areas also receive substantial developer contributions for roads. In addition to these local funds, cities and counties have access to three additional sources:

*Transportation Improvement Board (TIB).* This state agency receives 3.04 cents out of the 28 cent state fuel tax, and uses those funds to assist local projects throughout the state. TIB funded projects are generally of regional significance and include matching funds. In 2003, 149 projects were completed using TIB funds. The value of these projects totaled \$339 million, \$109 million of which came from the TIB. (Transportation Improvement Board)

*County Road Administration Board (CRAB).* This program aims primarily at preserving important arterials in rural parts of the state. The CRAB gets 1.03 cents out of the 28 cent fuel tax, and targets those funds primarily at smaller counties. For example, in 2003, Pend Oreille County and Garfield Counties received \$1.3 million and \$1.4 million, respectively, while King and Snohomish Counties received only \$295,000 and \$117,000 respectively. (County Road Administration Board)

*Regional Transportation Planning Organizations (RTPOs)*. These regional bodies, also known as Metropolitan Planning Organizations, fulfill important growth management and planning functions. They are also, however, conduits for federal transportation assistance aimed at local governments. They operate competitive processes through which member agencies (i.e. cities, counties, transit systems) apply for funding assistance.

### **Sewer and water systems**

Public utilities have the advantage of a reliable rate base onto which they can load a reasonable amount of capital costs. Users have no choice but to join the system and pay their bills, so simply adding to those bills generates a steady income to pay for ongoing maintenance and debt service on borrowing. Utilities generally use revenue bonds since the income stream for debt service is reliable and they do not have to go before the voters. These systems are, however, governed by elected officials – councilmembers or district commissioners – so there is some practical limit to how much they can raise rates to fund improvements.

Public utilities also use hook-up fees on new development to fund system expansion. These fees can get quite high in some areas, and by themselves have been known to inhibit development. From a political perspective, it is far better to load capital improvement funds onto new development than to load them onto the bills of current ratepayers.

Sewer systems are eligible for grant and loan assistance. The State Department of Ecology offers low interest loans through the Centennial Clean Water Fund and the State Revolving Loan Fund. (Washington State Department of Ecology) More general infrastructure financing programs, such as Public Works Trust Fund loans and Community Development Block Grants can be used for wastewater systems. Introducing sewers into already developed areas on septic systems usually requires an LID.

Private water utilities have much more limited access to financing for improvements. Community covenants may make provision for maintenance of a water system, but such covenants are often difficult to enforce. Community water systems have access to the Drinking Water State Revolving Fund, which provides low interest loans for capital improvements aimed at safety and regulatory compliance. (Washington State Department of Health)

### **CONCLUSION**

The first theme that emerges from a description of infrastructure finance is complexity. For any agency looking to expand or rebuild its capital facilities, revenue from its immediate sources – taxes, fees and rates – is just the beginning of financing a project. Those funds need to be leveraged by borrowing against future revenue streams, seeking matching grants or loans from higher units of government, and securing reasonable contributions from private development. One look at the funding sources for a major arterial expansion, for instance, shows what a large task it can be to stitch together project financing.

A second central, and often elusive, theme of infrastructure financing is tying funding sources to benefits, in terms of both time and geography. Individuals, businesses and institutions are much more likely to favor funding for projects that will improve their neighborhood and for which they will pay a reasonable portion of the bill. Yet the tools to make this nexus are often missing or difficult to use. The next paper in this series will examine tax increment financing, local improvement districts, latecomer fees and other ways to capture the benefits of infrastructure investments. It will also look at innovative user fees, such as High Occupancy Toll (HOT) lanes that capture the value of improvements.

## REFERENCES

- Infrastructure Assistance Coordinating Council (Washington State). 2004. Infrastructure Database. [www.infracfunding.wa.gov](http://www.infracfunding.wa.gov).
- Municipal Research and Services Center of Washington. 1999. A Revenue Guide for Washington's Cities and Towns.
- Transportation Economic Partnership Office, Washington State Department of Transportation. 2004. Final Report, Transportation Infrastructure Financing Alternatives.
- United States Department of Transportation. 2004. Summary of Fuel Economy Performance.
- Washington State County Road Administration Board. 2004. 2003 CRAB Annual Report
- Washington State Department of Ecology. General Information About Water Quality Financial Assistance.
- Washington State Department of Health, Office of Drinking Water. 2003. Drinking Water State Revolving Fund. DOH Pub #331-233.
- Washington State Department of Licensing. CMB Gross Weight Fees
- Washington State Department of Transportation. 2004a. Fuel Taxes: A State-by-State Comparison.
- Washington State Department of Transportation. 2004b. SR-520 Bridge Replacement and HOV Project (brochure).
- Washington State Transportation Commission. 2004. 2005-2007 Current Law Budget.
- Washington State Transportation Improvement Board. 2004. Transportation Improvement Board 2003 Annual Report