Economic Update

Monthly update on economic issues affecting Seattle's tax revenue performance

JULY 2002

SPECIAL TOPIC

Real Estate Excise Tax in Seattle

The City relies heavily on the real estate excise tax, commonly known as REET, to help fund its ongoing general government major maintenance program. REET revenues fund projects such as roof repair, playfield replacement, and street paving in the Parks, Seattle Center, Library, Transportation, and Fleets and Facilities departments. Growing maintenance demands and tightened revenue sources have prompted an increased focus on REET revenues. The following provides a background of this tax and examines general characteristics of the transactions that have generated this revenue for the City since 1982.

What is REET? Excise taxes are taxes on the sales of selected items, and REET is an excise tax that is levied upon the sale price of real property. Generally, when a property changes hands, via a market sale or through a non-market conveyance, an excise tax is imposed on that transfer.[*] Excise taxes are often earmarked for particular programs and for Seattle, REET revenue must be used solely for capital purposes. For the State, REET proceeds must be used for funding K-12 education and public works assistance.

In Seattle, the REET rate is 1.78% on the sale price of real estate that is paid by the seller. This translates to $1,780 on the sale of a $100,000 property. Of that total, the State levies 1.28% and Seattle levies 0.5%. Without voter approval, the County can only impose REET in the unincorporated areas.

Seattle utilizes two of three REET options allowed by State law for cities. In 1982, State law authorized cities and counties to levy the basic rate of 0.25% for capital purposes identified in a capital improvement plan. Then in 1991, the State authorized an additional 0.25% for cities planning under the Growth Management Act to be used exclusively for capital projects. Seattle adopted the first quarter percent in 1982 and the second quarter percent in 1992 under these options.

Additionally, counties and cities have available up to 0.5% of REET authority if not levying the second half of the 1% sales tax. If this REET option is used, the receipts are not restricted in use; however, given that the sales tax is a much broader tax that generates more revenue, most cities including Seattle, have not chosen this REET option in lieu of the second 0.5 percent local sales tax.

Maximum Authorizations for REET in Washington
(applicable rates in Seattle are in bold)

	Rate
State tax	**1.28%**
Local option taxes	
1st REET option-Capital	**0.25%**
2nd REET option-Capital	**0.25%**
Conservation purchases(1)	1.0%
In lieu of sales tax	0.5%
Total authorized	3.28%

(1) Authorizes counties to impose up to 1.0% REET which is restricted to acquisition and maintenance of conservation areas and requires voter approval. Only San Juan County has implement this levy thus far

History of REET in Seattle

[*] There are various exemptions for approximately ¼ to 1/3 of real estate transfers, such as community property and marriage dissolution, gifts without debt., inheritances, etc.

Seattle began collecting REET in the last quarter of 1982 at the rate of 0.25%. This generated approximately $4 to $5 million annually which was placed in the cumulative reserve fund, the main source of payment of capital maintenance and renovation projects.

An additional 0.25% authority was granted in 1991; however, the 1992 State Legislature tightened the definition of allowable uses for both the first and second REET assessments. This meant that several specific types of capital facilities were no longer eligible for this revenue source. To help remedy the fact that a revenue stream established for housing and other critical needs was precluded under the new state restrictions, the Mayor and City Council issued councilmanic debt (debt issued by the City and repaid from existing revenues) in the amount of $35 million prior to the cut-off date of April 30, 1992. Proceeds were spent on housing, parks, and the Benaroya Hall. Proceeds from the second 0.25% REET are primarily used for parks (excluding acquisition) and transportation public works projects.

The following table list the eligible uses for the first and second REET authorities (REET I and REET II).

Eligible Uses of REET I and REET II

REET I	REET II
Parks & trails	Parks
Streets, roads, highways	Streets, roads, highways
Sidewalks	Sidewalks
Street lighting	Street lighting systems
Traffic signals	Traffic signals
Bridges	Bridges
Domestic water systems	Domestic water systems
sewer systems	sewer systems
Administrative facilities	
Law enforcement facilities	
Fire protection facilities	
Recreation facilities	
Libraries	
Judicial facilities	

Characteristics of REET

The REET has been one of the fastest growing sources of revenue since the mid-1990s. Because REET collections depend on real estate transactions, it is sensitive to factors influencing real estate markets. REET revenues increase with a strong economy through real estate appreciation, but also benefit from increased volume of transactions, which could be influenced positively during a slow economy. The lowering of interest rates, which is often used to spur a weak economy, is a key driver to housing demand and could increase transactions in a soft economy.

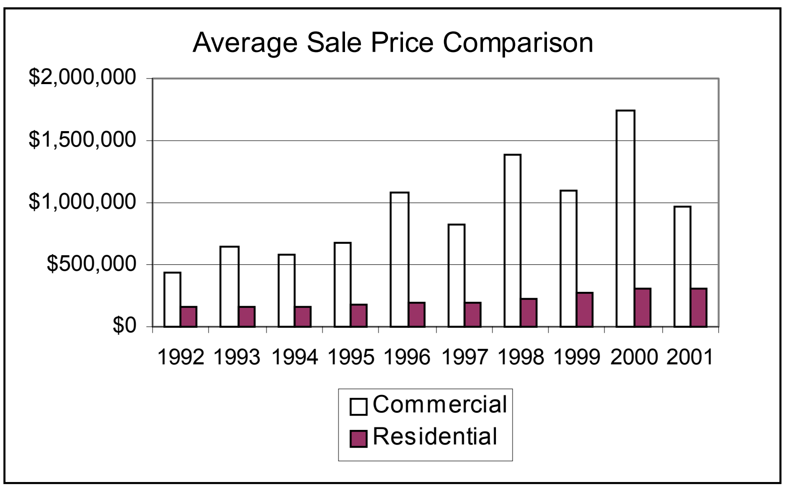
Real estate transactions include residential and commercial properties. For the most part, residential properties consist of single family houses and condominiums, but also include duplexes and triplexes. The range in commercial properties is broader and includes a variety of properties such as apartment buildings, downtown skyscrapers, parking lots, manufacturing plants, small retail shops, etc.

Both commercial and residential sales contribute to REET revenues but in somewhat different ways. The residential contribution to REET proceeds is far greater than commercial due to sheer volume of transactions. The following table shows how the number of residential sales dwarfs commercial by about 12-15 times, resulting significantly more in value.

Number and Value of Sales by Type

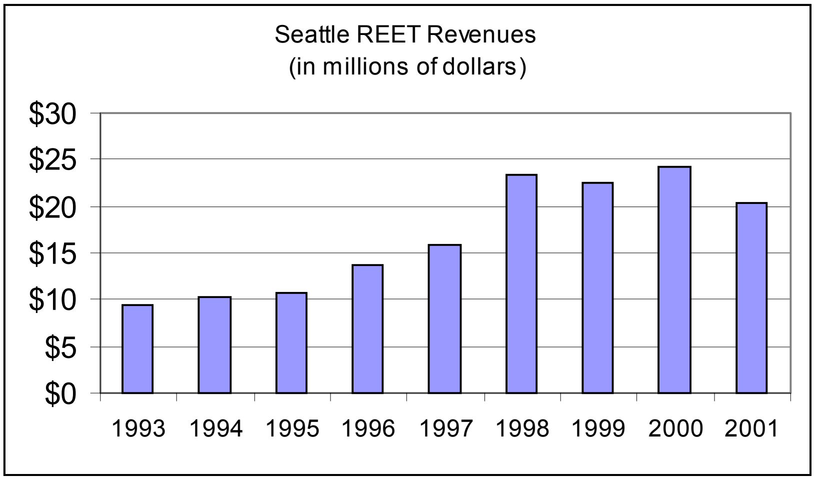
Year	Number of Sales Commercial	Residential	Value of Sales Commercial	Residential
1992	67	9,052	$250	$1,454
1993	501	8,409	$322	$1,353
1994	575	8,444	$334	$1,398
1995	642	8,668	$433	$1,501
1996	744	9,822	$801	$1,860
1997	777	11,533	$637	$2,322
1998	895	12,490	$1,239	$2,874
1999	887	11,698	$973	$3,262
2000	767	11,211	$1,341	$3,433
2001	724	11,101	$704	$3,363

This does not mitigate the importance of commercial's contribution. The strength from commercial comes from the value of a single transaction compared to a single residential sale. The average commercial sale is about four times the size of an average residential sale. Although in Seattle single residential house sales can be well over a million dollars, there are single commercial transactions that can reach the several hundred million dollar mark. With sales of that magnitude, commercial contribution to REET is substantial.



Collection Trends

In 1993, the first full year that Seattle collected REET at the 0.5% rate, REET generated $9 million dollars. Since then, REET revenues have advanced significantly, particularly in the mid-1990s when the strong economy boosted real estate appreciation. With an average annual increase of over 10%, REET has far outpaced inflation, and in 2001 garnered over $20 million. Although significantly lower than 2000, it is substantially greater than the average amounts achieved in most of the 1990s.



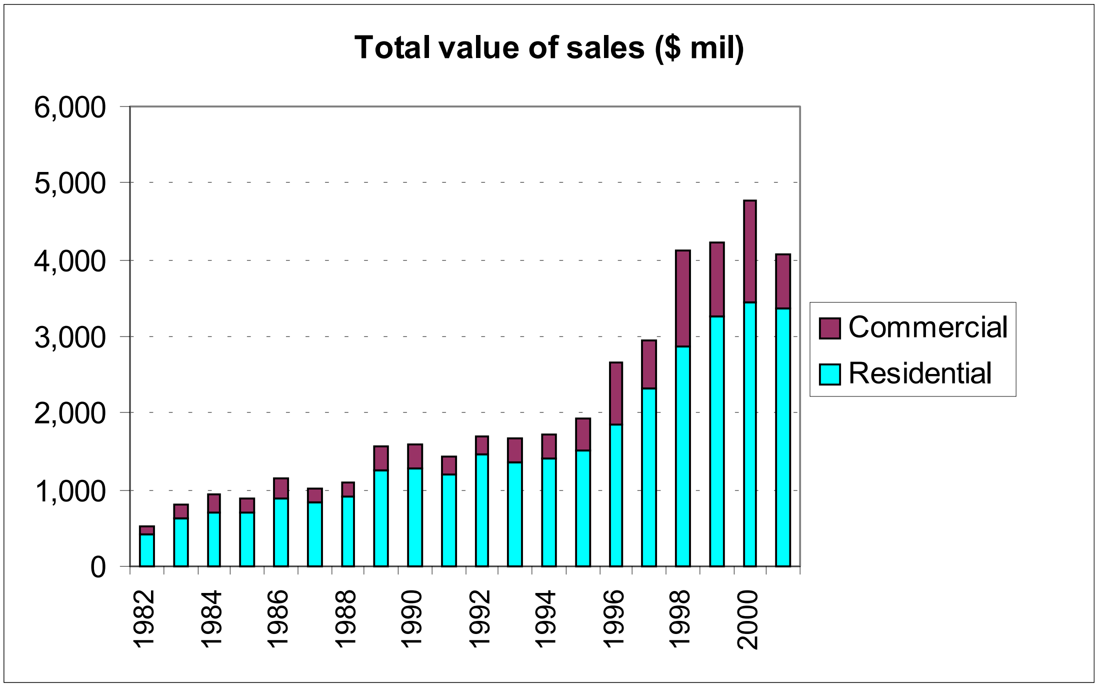
The year 2000 was a banner year for REET revenues and accounted for the highest amount received in any year. A closer glance at the data reveals that the commercial component was particularly strong that year and accounted for about 30% of the total. This compares to approximately 17% in 2001. Most notable that year was the number of large commercial transactions. In 2000, there were 23 transactions over $10 million and 235 transactions over $1 million. This compares to 5 sales over $10 million and 184 sales over $1 million in 2001. The following chart shows how the residential portion in 2001 almost kept its 2000 pace, but the commercial portion fell significantly and is mostly responsible for the sharp drop in revenues in 2001.

Forecasting REET

The volatility of the commercial component only increases the difficulty in forecasting REET. It is not clear whether the commercial component will continue to play as strong a role as it did in the late 1990s. During the last real estate boom in the late 1980s, the rapid growth of the housing market diminished the commercial component to less than 20% of the total. In contrast, a look at the most recent boom shows a huge growth in commercial sales, averaging almost 30% of the total during 1998-2000, then retreating sharply in 2001.

Against expectations, the single-family housing market has been largely untouched by the weakness of the local economy; however, recent data show indications that the local recession could finally be taking a toll on the housing market. For the first time since October, pending sales of single-family homes in the county declined in June by almost 6% compared with June of last year. It is too early to predict if this trend will continue throughout this year as blips in real estate during the summer are common and June 2001 was a particularly strong month for comparison.

So far, REET proceeds in 2002 have kept pace with 2001; however, economist Dick Conway predicts a 10% drop in home sales in the region this year, compared to 2001, and the 2002 REET forecast anticipates a 10% decline. A continuing decrease of commercial sales that began its decline in 2001 will further dampen REET revenues in 2002.



Monthly Cash Update

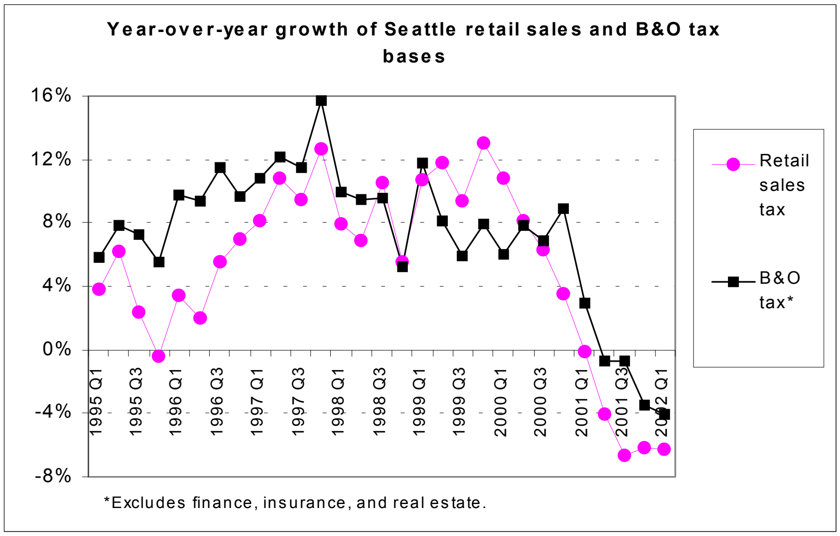
Comparing year-to-date revenues for general fund taxes and other major revenues with adopted forecast.

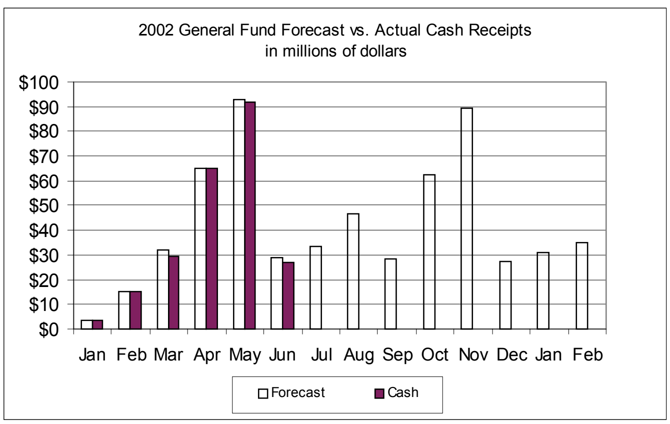
CITY REVENUE

Year-to-date through June: The following describes how actual 2002 collections for the most important general subfund revenues, through June, compare to the forecast that was prepared in November 2001 for the adopted budget. Overall, actual revenue is lagging the forecast by 2.3%, although there is considerable variability among individual revenues.

Reflecting the severity of the local recession, revenue from the retail sales and B&O taxes has fallen sharply in recent quarters. Growth measured on a year-over-year basis turned negative in the first half of 2001, and has remained negative since then (see figure). Though growth appears to have stabilized, we are still awaiting signs of a turnaround.

The decline in the tax base has been more pronounced for the sales tax than for the B&O tax. This difference reflects the fact that the B&O base is broader, and is more dependent upon services than is the sales tax. In general, service activity fluctuates less with swings in the economy than does other types of economic activity. Thirty-nine percent of B&O revenue comes from services, compared to 18% for the sales tax. In contrast, the sales tax receives 41% of its revenues from retail trade businesses, compared to 15% for the B&O tax.





2002 Major General Fund Revenues through June, including REET, compared to adopted budget

	YEAR TO DATE				COMPARISON TO 2001		
	Cumulative Forecast	Actual	Difference	Percent	Cumulative 2001	Yr/Yr Difference	Yr/Yr Cumulative
PROPERTY TAXES							
General + EMS	88,969,000	89,594,000	625,000	0.7%	84,306,000	5,288,000	6.3%
Leasehold Excise Tax	1,972,000	1,932,000	-40,000	-2.0%	1,924,000	8,000	0.4%
Real estate excise tax (REET)	10,764,000	10,490,000	-274,000	-2.5%	10,632,000	-142,000	-1.3%
RETAIL SALES TAX							
General	36,780,000	36,167,000	-613,000	-1.7%	39,085,000	-2,918,000	-7.5%
Criminal Justice	3,559,000	3,338,000	-221,000	-6.2%	3,650,000	-312,000	-8.5%
BUSINESS TAXES AND OTHER							
Business and Occupation	26,827,000	26,294,000	-533,000	-2.0%	28,325,000	-2,031,000	-7.2%
Utilities - City Light	13,724,000	14,391,000	667,000	4.9%	11,829,000	2,562,000	21.7%
Utilities - City Water	2,435,000	2,171,000	-264,000	-10.8%	2,033,000	138,000	6.8%
Utilities - City Drainage/Waste Water	6,127,000	5,325,000	-802,000	-13.1%	4,705,000	620,000	13.2%
Utilities - City Solid Waste & Garbage	3,482,000	2,940,000	-542,000	-15.6%	3,019,000	-79,000	-2.6%
Utilities - Cable Television	3,133,000	3,212,000	79,000	2.5%	3,231,000	-19,000	-0.6%
Utilities - Telephone	14,800,000	12,134,000	-2,666,000	-18.0%	13,493,000	-1,359,000	-10.1%
Utilities - Private Energy	4,780,000	5,921,000	1,141,000	23.9%	6,017,000	-96,000	-1.6%
Admission Tax	2,140,000	2,115,000	-25,000	-1.2%	2,294,000	-179,000	-7.8%
Court Fines and Forfeitures	8,819,000	7,150,000	-1,669,000	-18.9%	7,754,000	-604,000	-7.8%
Interest Income	1,532,000	1,573,000	41,000	2.7%	1,606,000	-33,000	-2.1%
Parking Meters	4,914,000	4,686,000	-228,000	-4.6%	4,876,000	-190,000	-3.9%
Misc. Revenues	2,736,000	2,698,000	-38,000	-1.4%	2,669,000	29,000	1.1%
TOTAL, Selected Non-Tax Rev.	237,493,000	232,131,000	-5,362,000	-2.3%	231,448,000	683,000	0.3%