Statement for the Record
Submitted on behalf of the City of Seattle, Seattle City Light, and Seattle Public Utilities
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Hearing on Tax Reform and Tax Provisions Affecting State and Local Governments
House Ways and Means Committee
April 2, 2013

Thank you for the opportunity to provide a statement for the record related to your March 19 hearing on "Tax Reform and Tax Provisions Affecting State and Local Governments." This statement is written on behalf of the City of Seattle and its enterprise utilities, Seattle City Light and Seattle Public Utilities, which includes our water, drainage and wastewater, and solid waste utilities. While there are many ways in which the federal tax system impacts local government financing, we would like to focus on the current tax treatment of municipal bonds and possible changes to that tax treatment. We would first like to provide some context on the City's use of bonding authority.

City of Seattle's Use of Debt Service[1]

The City uses bonds and property tax levies to fund a variety of special capital improvement projects. The City's budget includes funds to pay interest due on outstanding bonds and to pay the principal amount of bonds at maturity. The City has issued three types of debt to finance its capital improvement programs:

Unlimited Tax General Obligation Bonds
By state law, the City may issue Unlimited Tax General Obligation (UTGO) Bonds for capital purposes if a proposition authorizing their issuance is approved by 60% of the voters in an election in which the number of voters exceeds 40% of the voters in the most recent general election. Payment of principal and interest is backed by the "full faith and credit" of the City. This means that the City commits itself to include in its property tax levy an amount that is sufficient to pay principal and interest on the bonds. Property taxes levied to pay debt service on UTGO bonds are not subject to the statutory limits in state law on the taxing authority of local governments, which is why UTGO bonds are "unlimited". However, state law does limit the amount of UTGO bonds that can be outstanding at any time to 7.5% of assessed valuation of property in the city: 2.5% for open space and park facilities, 2.5% for utility purposes, and 2.5% for general purposes. As of December 31, 2012, there were approximately $90 million in UTGO bonds outstanding.

Limited Tax General Obligation Bonds
The City Council may authorize the issuance of Limited Tax General Obligation (LTGO) Bonds, also known as Councilmanic bonds, in an amount up to 1.5% of assessed valuation, without a vote of the people. The City pledges its full faith and credit to the payment of

[1] The following discussion on City of Seattle Debt Service is taken from the 2013 Adopted and 2014 Endorsed Budget of the City of Seattle, pp. 698-700. The debt numbers were updated to reflect 2012 numbers.

principal and interest on LTGO bonds, but this pledge must be fulfilled within the City's statutory property tax limitations. Thus, these are "limited" general obligation bonds. The combination of UTGO bonds issued for general purposes and LTGO bonds cannot exceed 2.5% of assessed property valuation. If LTGO bonds are issued up to the 1.5% ceiling, then UTGO bonds for general purposes are limited to 1% of assessed value. As of December 31, 2012, there were approximately $890 million obligations counting in this LTGO debt limit.

Revenue Bonds
Revenue bonds are used to provide financing for the capital programs of Seattle City Light and the three other utilities – Water, Drainage and Wastewater, and Solid Waste – which are grouped together in Seattle Public Utilities. The City does not pledge its full faith and credit to the payment of debt service on revenue bonds. Payment of principal and interest on the bonds issued by each utility is derived solely from the revenues generated by the issuing utility. No tax revenues are used to pay debt service.

When revenue bonds are sold, the City commits itself to set fees and charges for the issuing utility that will be sufficient to pay all costs of operations and maintenance, and all payments of principal and interest on the bonds. While the amount of revenue bonds is not subject to statutory limits, the utility's ability to repay debt with interest is a practical constraint.

City Debt Management Policies and Bond Ratings

The use of debt financing by the City is subject not only to state law, but also to the debt management policies adopted by the Mayor and City Council. According to these policies, a capital project should be financed with bond proceeds only under certain circumstances including the following:

- In emergencies;
- When the project being financed will produce revenues that can be used to pay debt service on the bonds; or
- When the use of debt will result in a more equitable sharing of the costs of the project between current and future beneficiaries of the project.

Paying for long-lived assets, such as libraries or parks, from current tax revenues would place a large burden on current taxpayers, while allowing future beneficiaries to escape the burden of payment. The use of debt effectively spreads the cost of acquiring or constructing capital assets over the life of the bonds. The City's debt management policies require that 12% of the City's LTGO total issuance capacity be reserved for emergencies. They also state that net debt service on LTGO bonds (defined as total debt service, minus dedicated project revenues) should not exceed 9% of the General Fund budget, and should remain below 7% over the long term (currently about 6%).

The City has earned very high ratings on its bonds as a result of a strong economy and prudent financial practices.

The City's UTGO debt is rated Aaa by Moody's Investors Service, AAA by Fitch IBCA, and AAA by Standard & Poor's (S&P), which are the highest possible ratings. The City's LTGO debt is rated Aa1 by Moody's, AA+ by Fitch, and AAA by S&P. In addition, the City's utilities have very high ratings for revenue debt, reflecting sound finances and good management.

Proposed Changes to the Municipal Bond Tax Exemption and Impacts on the City of Seattle

Municipal bonds are the engine driving our infrastructure development and our economic growth. Not only do the projects financed by municipal bonds provide construction jobs in the short term, in the long term, the infrastructure built by bonds provides the backbone of economic growth in city. Municipal bonds are financing projects all over the city, including the replacement of the Elliott Bay Seawall and the construction of a new substation in the burgeoning South Lake Union neighborhood. These projects are essential to the long term economic health of our city.

The current discussion around changing the municipal bond tax exemption revolves around two proposals. The first proposal would eliminate the municipal bond tax exemption altogether. The second would include the tax exemption on municipal bonds as part of any cap on deductions. The level of the cap being discussed is 28 percent. Both of these proposals would result in an increase in borrowing costs for the city of Seattle. These costs would be borne by our taxpayers, slowing our long-term economic growth and development and requiring the city to forgo or delay projects in order to pay the increased borrowing costs.

In the normal course of our capital program, we project that the city (including our publicly-owned utilities, Seattle City Light and Seattle Public Utilities) will issue at least $2 billion of new debt over the next 5 years. Based on this current level of debt maintenance and using a conservative estimate of what the change in the interest rate would be, if the municipal bond tax exemption were eliminated, it would result into increased interest expense for all of our projects of about $20 million annually, or about half a billion dollars over the next 30 years. Under a scenario where there is a 28 percent cap on the tax exemption, the annual impact would be just under $4 million or about $100 million over the next 30 years. And this is when interest rates are at an all-time low. These costs will only go up as interest rates do. Below are examples of specific projects that would affected by a change in the tax-exempt status of municipal bonds.

Examples of Projects Funded by Municipal Bonds

The Elliott Bay Seawall Project

The Elliott Bay Seawall Project is a critical public safety project. Failure of the seawall would have significant impacts to the public, the City of Seattle, the Puget Sound region, Washington State, and the nation. Protection from coastal storm damage and shoreline erosion is vital to preserving Seattle's downtown, the economy, and the region's quality of life and economic competitiveness. The Elliott Bay Seawall:

- Protects Seattle's downtown waterfront from wind-driven storm waves and the erosive tidal forces of Puget Sound and Elliott Bay.
- Supports and protects major public and private utilities, including power for downtown Seattle and the western seaboard, natural gas, and telecommunications.
- Supports State Route 99, the ferry terminal, and rail lines, all of which transport local commuters and visitors as well as local, regional, and international freight.

This past November, Seattle voters, with **77 percent of the voters voting in favor**, passed a $290 million bond to replace the existing southern half of the Elliott Bay Seawall along Seattle's waterfront with a structure that meets current safety and design standards.

The loss of the tax exemption on municipal bonds would have an immediate impact on Seattle taxpayers. Based on conservative estimates, the complete loss of the tax exemption would increase annual costs on the seawall to taxpayers by about $2.5 million or over $75 million over 30 years. A 28 percent cap on tax exemption would potentially increase annual costs on the seawall project by almost $500,000 or $14 million over 30 years.

Denny Substation Project
The City's municipal electric utility, Seattle City Light, is building a new north downtown substation to create a stronger and better-integrated distribution system through the city. In addition, the substation, when complete provides highly reliable power to serve the city's growing biotechnology research and information technology sectors.

As a part of Seattle City Light's capital program, Seattle City Light is using some of its bonding capacity on this substation. The remaining substation project costs are around $152 million. Based on conservative estimates, the complete loss of the tax exemption would increase annual costs on to ratepayers by about $1.3 million or about $40 million over 30 years. Assuming a 28 percent cap on tax exemption, the impact on financing would be a total of $7.6 million higher for Seattle City Light ratepayers. This averages out to around a $253,000 increase per year over the repayment period.

We appreciate that the federal government is facing fiscal challenges, but we believe one of the ways to meet those challenges is to support programs and policies that encourage economic growth. Municipal bonds have a proven track record of helping to create jobs and providing the infrastructure that underlies a strong economy. Now is not the time to change this policy.

About the City of Seattle, Seattle City Light and Seattle Public Utilities
With a population of over 615,000, **Seattle** is the largest city in Washington State and the 23rd largest city in the country. Seattle has a budget of $4.1 billion, with Seattle City Light and Seattle Public Utilities accounting for about one-half of the budget.

Seattle City Light is the 10th largest public electric utility in the United States. It has some of the lowest cost customer rates of any urban utility, providing reliable, renewable and environmentally responsible power to nearly 1 million Seattle area residents. City Light has been greenhouse gas neutral since 2005, the first electric utility in the nation to achieve that distinction.

Seattle Public Utilities (SPU) is comprised of three separate utilities- Water, Drainage and Wastewater, and Solid Waste. SPU delivers an average of 120-130 million gallons of drinking water per day to more than 1.3 million people and businesses in Seattle and 22 surrounding cities and water districts, collects and disposes of the solid waste generated within the City of Seattle and maintains the drainage and wastewater system in Seattle.