SEATTLE CITY COUNCIL
CENTRAL STAFF

June 6, 2019

M E M O R A N D U M

To: Finance and Neighborhoods Committee
From: Yolanda Ho and Aly Pennucci, Council Central Staff
Subject: Statement of Legislative Intent 1-5-B-1
(Sweetened Beverage Tax and Short-Term Rental Tax Funds)

On June 11, 2019, the Finance and Neighborhoods Committee will discuss the response to Statement of Legislative Intent (SLI) 1-5-B-1 concerning the Sweetened Beverage Tax (SBT) and Short-Term Rental (STR) Tax Funds.[1] This SLI requested that the City Budget Office (CBO) submit legislation, by March 28, 2019, that would create separate funds for SBT and STR revenues, and propose financial policies for use of those revenues. The SLI was in response to the Executive's proposed spending plans for calendar years 2019 and 2020, which did not fully align with the Council's policy intent.

On March 28, 2019, CBO responded to SLI 1-5-B-1. Rather than submitting legislation establishing the new funds as requested, the response outlined the Executive's justification for not establishing the funds at this time, committing to delivering a "comprehensive proposal for financial policies for the newly created funds with the 2020 budget legislation transmitted to the Council in September 2019."[2]

This memo:

(1) Outlines policy considerations for the Council about why waiting to establish the funds and financial policies for use of these tax revenues until the 2020 budget is transmitted may not be in the Council's interest;

(2) Provides background on the SBT, describes Councilmember O'Brien's draft legislation that would establish the SBT fund, propose financial policies, and outline alternative options; and

(3) Provides background on the STR Tax, describes Councilmember O'Brien's draft legislation that would establish the STR Tax fund, proposes financial policies, and outlines alternative options.

Policy Considerations

The Mayor's proposed 2019-20 Budget allocated SBT and STR Tax revenues in a manner that did not fully align with the Council's intent and did so in a manner that made it difficult to amend the spending plans without reducing or eliminating funding for other Council/City

[1] SLI 1-5-B-1 was sponsored by Councilmember O'Brien, with Councilmembers González, Herbold, Juarez, Mosqueda, and Sawant signing on as cosponsors. The SLI was adopted by an 8-0 vote.
[2] Response to SLI 1-5-B-1.

priorities. The Council always has the option of amending the proposed budget and associated budget legislation; however, the primary purpose of SLI 1-5-B-1 was to provide adequate time outside of Council's compressed Fall budget season to develop clear financial policies to inform the 2020 budget. If the Council chooses to concede to the Executive's proposed timeline (i.e. wait until the 2020 proposed budget is transmitted to adopt legislation establishing the separate funds and associated financial policies), the Mayor's proposed use for these revenues may be again proposed in a manner inconsistent with Council's intent and be proposed in a manner that would be difficult to unravel. This may, as previously mentioned, require the Council to make cuts or propose new revenue sources.

If instead the Council chooses to reject the Executive's SLI response and act swiftly to adopt legislation establishing the funds and financial policies, the Council's priorities will have a greater chance of being reflected in the Mayor's proposed budget. If the Mayor proposes a budget that is still inconsistent, it will be in direct disagreement with the Council's articulated policy direction (which is informed by community support) – but would be transparent if/should the Council choose to alter the proposed budget.

Options:

A. Take no action. Accept CBO's response to SLI 1-5-B-1 and await the Executive's budget proposal to establish separate funds and financial policies.

B. Council takes no action on legislation now and instead outlines expectations (via resolution or letter) for financial policies that should be included in any legislation the Executive transmits with the proposed 2020 Budget for establishing separate SBT and STR Tax funds.

C. Introduce legislation in early summer to establish separate funds for SBT and STR Tax revenues and adopt financial policies that align with Council's intent for use of these funds (as described in the next sections of this memo).

D. Introduce legislation in early summer to establish a fund and financial policies for one but not both taxes.

Sweetened Beverage Tax

<u>Background</u>

On January 1, 2018, the City began collecting revenues from the SBT, which was established by [Ordinance 125324] in 2017. The tax is generally $0.0175 per fluid ounce of beverage distributed, with exceptions for manufacturers having annual gross receipts (business income) of $5 million or less. Table 1 presents initial and revised revenue estimates, based on actual revenues received versus revised estimates, as well as the difference between the two revenue projections.

Table 1. Sweetened beverage tax revenue estimates, 2018

	Revenue
Initial estimate	$14,816,000
Revised (May 2019)	$22,254,000
Difference	$7,438,000

The SBT ordinance established financial policies that directed the revenues to specific purposes. For the first five years that the tax is collected, the adopted policies directed 20 percent of net proceeds to fund the following one-time or limited-duration expenditures:

1. One-time costs necessary to enable the Department of Finance and Administrative Services (FAS) to administer the tax, such as computer systems;
2. Up to $5 million in total as a one-time contribution to an endowment for the Seattle Colleges' 13th Year Promise Scholarship program;
3. Up to $1.5 million in total for job retraining and placement programs for workers adversely impacted by the tax; and
4. Funding to construct or enhance classroom facilities for use by the Seattle Preschool Program.

In 2018, consistent with the adopted polices, 20 percent of SBT fund balance was allocated to the above expenditures. Given the higher than anticipated revenues received, this policy was amended by the Council as reflected in the Adopted 2019-20 Budget to reduce the amount of spending in this category to 10 percent for 2019 to 2022. This amount is expected to provide sufficient funding for the priorities while allowing for greater investment in the uses of SBT revenues described below.

The remainder of the proceeds from the SBT are limited to use in support of and in order of priority, as follows:

1. Expanding access to healthy and affordable food, closing the food security gap, and promoting healthy food choices through programs such as:
   a. Community-based investments to expand food access, such as food banks and meal programs;
   b. Fresh Bucks and Fresh Bucks to Go;
   c. Implementation of the Seattle Food Action Plan;
   d. Public health and nutrition programs targeted to assist persons experiencing diabetes and obesity;
   e. Public awareness campaigns to highlight the impact of sugar-sweetened beverages on health outcomes and increase education about healthy food and beverages; and
   f. Capital investments to promote healthy choices, such as water bottle filling stations in schools and community centers.

2. Supporting evidence-based programs that improve the social, emotional, educational, and physical and mental health for children, especially those services that seek to reduce the disparities in outcomes for children and families based on race, gender, or other socioeconomic factors and to prepare children for a strong and fair start in kindergarten.
3. Administration of assessing and collecting the tax.
4. Ensuring resources for the Office of Sustainability and Environment (OSE) and the SBT Community Advisory Board (CAB).
5. The cost of evaluations by the Office of the City Auditor (AUD) of SBT-funded programs, including health outcomes, and the economic impacts of the tax.

The legislation that established the SBT also established the CAB as an advisory board charged with making recommendations to the Mayor and Council regarding the SBT, including funding recommendations across the range of programs previously described. The CAB is required to publish an annual report summarizing tax collection efforts, programs funded to date, and any completed studies evaluating the tax or program funded by it, as well as making recommendations for the allocation of SBT revenues to programs. The first annual report will be completed by July 2019 and is planned to be released in the first quarter of future years.

The proposed 2019-20 budget appropriated approximately $5.7 million of unanticipated excess SBT revenue to supplant General Fund (GF) monies for programs administered by the Department of Education and Early Learning, Human Services Department, and OSE, freeing up the GF for other purposes. Although the proposed spending aligned with SBT spending priorities, the Council's intent was for new revenues to be invested in the expansion of existing programs or creation of new programs in accordance with statute, rather than to maintain the same level of spending for programs such as food banks, child care vouchers, and the parent-child home program. This action raised concern among stakeholders, particularly the CAB and the Council, resulting in the request by the Council to establish a separate fund and strengthen the financial policies to prevent further use of SBT revenues to supplant the GF.

<u>Draft Legislation to Establish the SBT Fund and Amend Financial Policies</u>

Under the direction of Councilmember O'Brien, Central Staff drafted legislation that would establish a fund for SBT proceeds and modify the financial policies beginning in 2019.

The draft legislation for the SBT would:

1. Create an SBT fund to track revenues and expenditures by City departments;
2. Establish financial policies for use of SBT revenues to:
    a. Codify spending guidance for revenues included in Ordinance 125324 by adding a new section to Chapter 5 of the Seattle Municipal Code; and

b. Require that excess revenues be used solely for expanding existing programs or creating new programs that align with SBT spending guidance.

Council may want to consider including more specific guidance, and possibly more flexibility, for allocating excess revenues. For instance, some portion could be appropriated according to CAB-identified priorities, another for specific programs (e.g., food banks), and the remainder left to the discretion of the Executive.

Short-Term Rental Tax

Background

In November 2017, the Council adopted Ordinance 125422, that imposed a per night tax on each short-term rental operator in Seattle at a rate of $8 per night for a private or shared room, and $14 per night for an entire unit. The STR Tax was created to generate at least $5 million per year in ongoing funding to support community-initiated projects under the City's Equitable Development Initiative (EDI) program; support for affordable housing was secondary. Ordinance 125442 outlined the Council's intent for use of STR Tax revenues, as follows:

1. The first $5 million of net proceeds, after monies spent for implementation and administration, shall be applied to investments in community-initiated equitable development projects;
2. The next $2 million of net proceeds shall be applied to investments in affordable housing; and
3. The remainder of net proceeds shall be used to support community-initiated equitable development projects, including the affordable housing component of those projects.

In March 2018, the State Legislature adopted House Bill (HB) 2015, that extended the authority for the Convention and Trade Center Tax[3] to include short-term rentals. The state bill requires that any tax revenue generated from short-term rentals within Seattle be directed to the City provided that the City repeals any local tax that existed at the time HB 2015 was approved. In June 2018, the Council adopted Ordinance 125594, repealing Ordinance 125422. HB 2015 specifies that STR Tax revenue generated in Seattle is to be used by the City to support community-initiated equitable development projects and affordable housing programs. The Council's expectation was that the STR Tax revenue would be spent in a manner consistent with the intent outlined in Ordinance 125422.

The adopted 2019-2020 budget assumed that the STR Tax will generate $10.5 million in 2019 and in 2020 and proposed spending the $10.5 million of total forecasted STR Tax revenues as summarized in Table 2.

Table 2. Programming of Short-Term Rental Tax Revenues: 2019-2020 Budget

[3] Within King County, a lodging excise tax, often described as the Convention and Trade Center Tax, is imposed on lodging businesses that have 60 or more units. This tax is collected by the Public Facilities District that operates the Washington State Convention Center.

(Amounts in $1,000s)	2019 Adopted $	2019 Adopted %	2020 Endorsed $	2020 Endorsed %
Expenditures				
Office of Planning & Community Development - Equitable Development Initiative (EDI)				
EDI - Administration and Project Management (6 FTE)	(865)	8.2%	(869)	8.3%
EDI - Consultant Services	(200)	1.9%	(200)	1.9%
EDI - Project Awards	(3,935)	37.5%	(3,931)	37.4%
Human Services Department				
Permanent Supportive Housing	(3,737)	35.6%	(3,300)	31.4%
Homelessness Prevention - Seattle Rental Housing Assistance Pilot	(1,000)	9.5%	-	-
Finance General (Debt Service) (2018 Bond Issue)	(357)	3.4%	(1,355)	12.9%
Finance General (Debt Service) (2019 Bond Issue)	(406)	3.9%	(844)	8.0%
Total Expenditures	(10,500)	100%	(10,500)	100%

The spending plan in the 2019-2020 budget supported several Council priorities, broadly speaking, related to affordable housing and equitable development; however, it was not consistent with the Council's original intent for STR Tax revenues. As previously mentioned, this revenue source was primarily established to generate at least $5 million annually for EDI project grant; resources to pay the debt service on bonds issued for affordable housing projects and to support development of affordable housing generally were secondary.

The Mayor's proposed budget swapped STR Tax proceeds for the GF to fund the Office of Planning and Community Development (OPCD) staffing. The proposal to support staff and consultant resources for the EDI program, rather than grants to the community, and to support existing supportive housing programs and the Seattle Rental Housing Assistance pilot, rather than investments in new affordable housing projects, did not align with the Council's original intent. The Council was unable to find the ongoing resources to fully align the proposed spending plan with the original intent; however, through Green Sheet 29-2-B-3-2019, the Council ensured that in 2019 a full $5 million would be available for EDI grants by reallocating Community Development Block Grant funds.

Draft Legislation to Establish a STR Tax Fund and Financial Policies

Under the direction of Councilmember O'Brien, Central Staff drafted legislation that would establish a fund and financial policies for STR Tax proceeds that would go into effect in 2020. The draft legislation for the STR Tax would:

1. Create a STR Tax fund to track revenues remitted from the Washington State Convention Center Public Facilities District that is generated from short-term rental activity in Seattle, as well as track expenditures by City departments.

2. Establish financial policies to ensure that monies deposited into this fund are expended as intended by the Council. The draft legislation would require that STR Tax revenues are used as follows:
    a. The first $5 million of proceeds shall be directed to OPCD for grants made to organizations for investments in community-initiated equitable development projects;
    b. The next $2 million of proceeds shall be directed to the Office of Housing for investments in new affordable housing projects or directed to debt service payments on bonds issued for affordable housing projects; and
    c. The remaining proceeds shall be applied to grants made to organizations for investments in community-initiated equitable development projects, including the affordable housing component of those projects.

Council may want to consider modifications to financial policies included in the draft legislation for STR Tax revenues. Although the original intent for the STR Tax was to first establish an ongoing source of revenue for EDI grants, the Council may want to consider modifying the proposed policies to dedicate the first $2.2 million to pay the debt service on bonds for affordable housing and then the next $5 million for EDI grants. This would address concerns that (1) revenues could come in under what was assumed for the 2019 budget; and (2) at the direction of the Council, $29 million in bonds for affordable housing that requires $2.2 million to cover the annual debt service have already been issued regardless of STR Tax revenues, and the City is already obligated to pay that debt service. In addition, the Council could allow more flexible use of STR Tax revenues in 2020 to reflect the proposed spending in the 2020 endorsed budget and then, beginning in 2021, limit the use of this resource only for EDI grants and investments in new affordable housing projects.

Next Steps

Upon direction from the Council, legislation could be introduced immediately and taken up in committee for action by the Council in early Summer. Alternatively, Council could await transmittal of the Mayor's proposed 2020 budget.

cc: Kirstan Arestad, Central Staff Director