



# POLICY BRIEF

## **An Overview of Initiative 747** *“The Right to Vote on Property Taxes Initiative”*

By  
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### **I. Introduction**

Initiative promoter Tim Eyman is at it again. The populist tax reformer has garnered the 197,734 valid signatures needed to place Initiative 747 on the November ballot. The measure seeks to limit the annual rise in regular property tax collections to 1%, unless voters approve a higher increase.

That Mr. Eyman senses the widespread appeal of another tax limitation measure is not surprising. The people of Washington are frustrated with rising property taxes. In recent years, whenever a proposal to control spending, reduce taxes or slow the rate of tax increase has come before the voters, it has passed, as attested by the electoral success of Initiative 601, Referendum 47, Initiative 695 and Initiative 722. The action of the courts in overturning some of these measures accounts for much of the ongoing discontent over the growing property tax burden.

All residents are affected by property taxes, as owners, renters or consumers. Property ownership forms the basis of our free economy and taxes on property are passed on to consumers in the form of higher prices on goods and services. The result is to create significant upward pressure on the cost of living. In high-tax areas like Seattle and other cities, levies on property contribute to the lack of affordable housing and make it harder for low-income families to make ends meet.

Although property owners feel the effects of the property tax most directly, non-owners sometimes see the tax as well. For example, the owner of one four-unit apartment building in Seattle mails copies of his yearly property tax bill to tenants. Attached is a statement showing their increased monthly rent, each tenant being assigned one quarter of the tax increase. While this building owner openly explains higher taxes to his customers, all businesses must accommodate property tax increases in their pricing structure or go under.

The property tax is the oldest in Washington, older even than statehood.<sup>1</sup> In a state without an income tax, it is a major source of funding for counties, cities and some 1,740 smaller tax districts around the state. All citizens rely on local government to provide police, firefighters, social safety-net programs and a host of other basic services. Any decision by the voters to implement further tax limitation will have a profound effect on local government finances in the near term and for years to come.

For the last four years the Washington Policy Center has published annual reports on property tax trends. To help inform voters about how Initiative 747 would work, we have compiled this Policy Brief. This study presents a brief analysis of the initiative text, discusses recent trends in property tax increases and examines alternative sources of property tax revenue local leaders may look to should this initiative become law.

## II. What Initiative 747 Would Do

Current law, as amended by passage of Referendum 47 in 1997, says that elected officials may not increase regular property tax collections by more than inflation (2.61% in 2001) unless they can identify a “substantial need” to raise taxes higher. The “substantial need” clause allows elected officials to increase collections by 6%.<sup>2</sup> They may also draw on “banked” taxing authority from past years to enact even larger increases.

In essence, Initiative 747 would make a single change in the law, lowering the limit on annual increases in regular property tax collections from 6% to 1%. The ability of elected officials to tap banked taxing authority would remain unchanged, so higher increases would be possible. The text of the initiative contains six sections, which are briefly summarized here.

Section 1 gives a general description of the proposal and states its intent: “This measure would limit property tax increases to 1% per year unless approved by the voters.”<sup>3</sup> It should be noted that the limit applies only to *regular* property tax collections. Alternative sources of property tax revenue would remain unaffected, as will be discussed in a later section.

Also, the limit applies to the *total* dollar amount a taxing jurisdiction may take from citizens in any given year. Increases in individual property tax bills would still vary according to assessed valuations. The overall effect would tend to ease increases in tax bills for *all* property owners, because the total amount taken would be less, although some individual owners (those with properties that are rapidly increasing in value) could still see significant tax increases, as the lower overall tax burden is distributed according to changes in assessed valuations.

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<sup>1</sup> A property tax was included in the Organic Act of 1853, which organized Washington as a U.S. territory. Tax Reference Manual, Washington State Department of Revenue, January 1999, p. 127.

<sup>2</sup> See Revised Code of Washington 84.55.010. Our Policy Brief “Is Referendum 47 Working?” published in July 1998, contains a plain-English summary of how this part of the property tax code works. See the publications section at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

<sup>3</sup> Initiative 747, Section 1 “Policies and Purposes.”

Section 1 also cites the state constitution's provision that all taxes levied on property shall not exceed 1% of true and fair market value.<sup>4</sup> The initiative states that in enacting a new limit on tax increases it "matches this principle."<sup>5</sup> Apart from the use of the 1% number, though, there is no relation between this constitutional limit and the limit Initiative 747 would impose on increases in total collections.

Section 2 comprises the heart of the measure. It changes the "limit factor," the amount of increase allowed, to 101% of the previous year's collection. In practice this means that if a taxing district collected, for example, \$100,000 in regular property taxes from citizens in 2001, it would be allowed to collect \$101,000 in 2002. If inflation is lower than 1%, then it becomes the limit factor. As in current law, taxing districts with populations under 10,000 (which includes four counties<sup>6</sup>) would be exempt from the inflation limit requirement, although the 1% limit would still apply to them.

Section 3 provides that the limit factor applies "unless an increase greater than this limit is approved by voters at an election..."<sup>7</sup> Sponsors draw from this section the subtitle, "The Right to Vote on Property Taxes Initiative," used in their promotional material. Consistent with current law, there would be no limit on voter-approved tax increases under Initiative 747.

Sections 4 and 5 provide that the terms of the initiative are to be "liberally construed" by the courts, and that if one provision of the initiative is found invalid the others remain in effect.

Section 6 expresses the people's legislative intent in passing the initiative. It says that, "The people have clearly expressed their desire to limit taxes through the overwhelming passage of numerous initiatives and referendums."<sup>8</sup> This section does not change policy, but a judge would look to it as one source of guidance if asked to rule on the meaning of the initiative.

This section also expresses some of the tax limitation supporters' frustration with what they feel is the disappointing impact of past initiatives. It states that "Politicians are an employee of the people, not their boss"<sup>9</sup> and follows this with a promise of further ballot measures if Initiative 747 is thwarted in its purpose; "Any property tax increase which violates the clear intent of this measure...will increase the likelihood of future tax limitation measures."<sup>10</sup>

### **III. Recent Trends in Regular Property Tax Increases**

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<sup>4</sup> Constitution of Washington State, Article VII, Section 2.

<sup>5</sup> Initiative 747, Section 1, "Policies and Purposes."

<sup>6</sup> These counties are Columbia, Ferry, Garfield and Wahkiakum.

<sup>7</sup> Initiative 747, Section 3.

<sup>8</sup> Initiative 747, Section 6, "Legislative Intent."

<sup>9</sup> Ibid, Section 6 (3).

<sup>10</sup> Ibid, Section 6 (4).

Initiative 747 is not the first effort to limit annual property tax increases. Five years ago voters passed Referendum 47, requiring tax districts to hold yearly increases to the rate of inflation unless they identified a “substantial need” to raise taxes higher.

To measure the effectiveness of Referendum 47 the Washington Policy Center, has conducted a survey of all 39 Washington’s counties and the 22 major cities each year the measure has been in effect. We found that while largely ignored by local leaders in the first few years, Referendum 47 has recently been more successful in holding tax increases to inflation. In 2001, 34 counties and 17 major cities complied with the inflation limit of 2.61%.

Part of the reason for the increase in compliance was the passage last November of Initiative 722. Later struck down by the courts, Initiative 722 sought to limit increases in regular property taxes to 2%. Fully 13 of the counties and nine of the cities imposed increases of exactly 2%.

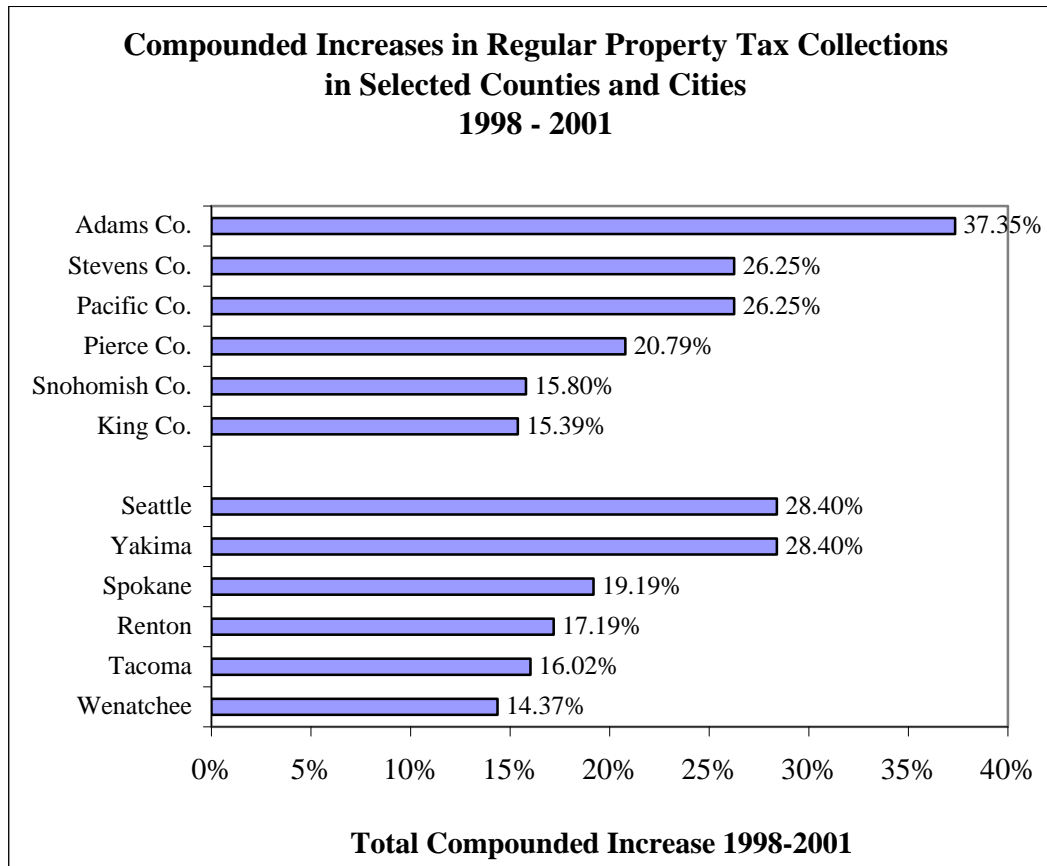
While the yearly trend in tax increases is flattening, survey results revealed that over four years regular property tax increases imposed by most counties and cities far exceeded the inflation rate. In some cases, the tax burden rose over three times faster than inflation.

Residents in 28 counties are today shouldering a tax burden that rose significantly faster than called for by Referendum 47. In seven counties tax collections have gone up more than three times faster than the compounded rate of inflation. In Pierce County, for example, the burden increased 20.79% in four years, while inflation over the same period rose less than 7%. The chart below (Figure 1) shows the four-year increase in the regular property tax burden for a sampling of counties and major cities. Complete results can be found in our most recent study of county and city property tax increases.<sup>11</sup>

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<sup>11</sup> See “Hearing the Voters: Growing Compliance with Referendum 47 Tax Limitation,” by Paul Guppy, Washington Policy Center, August 2001.

Figure 1.



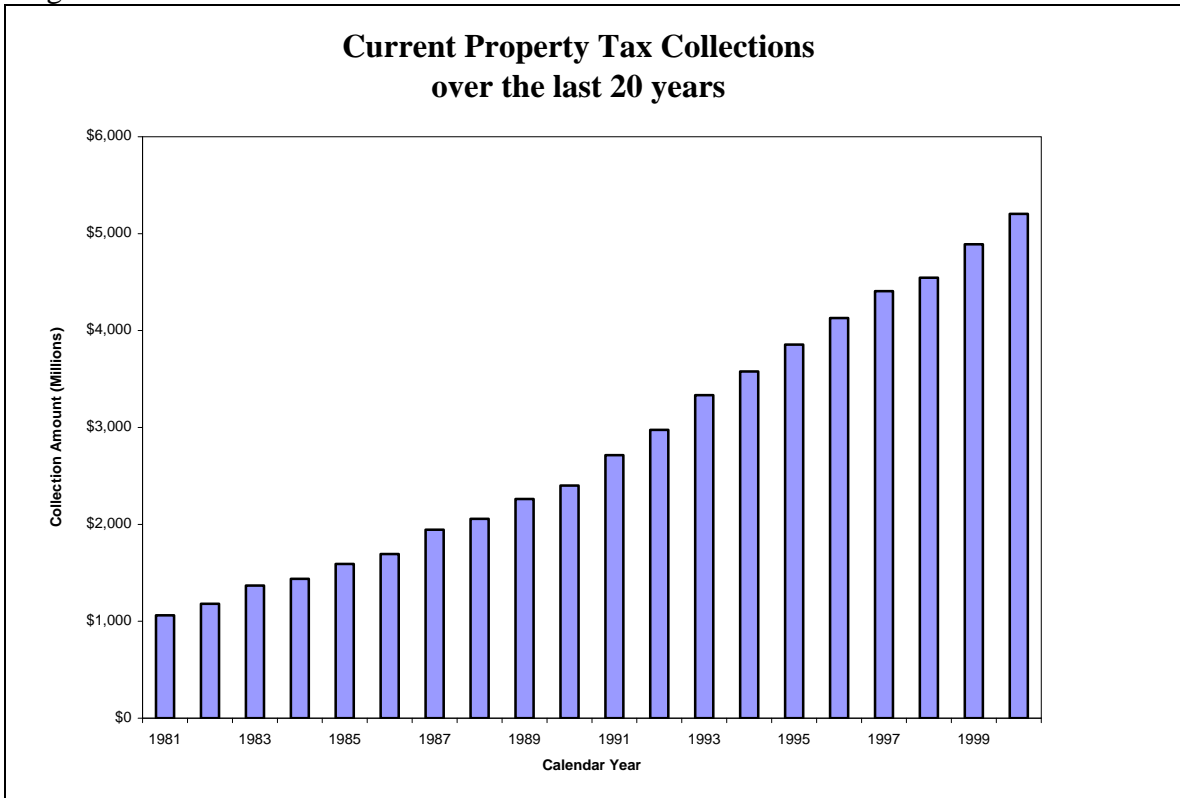
Another contributor to voter frustration over the high cost of property taxes are the increases imposed by hundreds of smaller taxing districts across the state. While a detailed survey of all these districts is not practical, a new study of tax increases imposed by the 18 largest port districts found that a majority had never complied with the inflation limit, and some had imposed increases of more than four times the rate of inflation.<sup>12</sup>

Total state and local property tax levies collected in 2000 amount to \$5.2 billion, an increase of \$312 million, or about 6%, over amounts collected in 1999.<sup>13</sup> The total amount of property taxes paid by Washington residents has been steadily growing over the last 20 years, often rising faster than the annual rate of inflation. The amount of property tax paid each year by Washington residents since 1981 is shown in Figure 2.

<sup>12</sup> See "Tax Increase Trend of Washington Ports," by Paul Guppy and Jason Smosna," Washington Policy Center Policy Brief, September 2001.

<sup>13</sup> Property Tax Statistics, Revenue Research Report, Department of Revenue, Olympia, Washington, August, 2001, p. 1.

Figure 2.<sup>14</sup>



*Total property taxes paid by Washington residents has been steadily growing over the last 20 years, often rising faster than the annual rate of inflation.*

#### **IV. Revenue Sources Not Affected by Initiative 747**

In addition to the regular property tax, cities and counties receive revenue from other property tax sources. These additional sources are unaffected by Referendum 47 and would be outside Initiative 747's 1% limit if it becomes law. They are:

1. New construction
2. Improvements to property
3. Increases in the value of state-assessed property
4. "Levy lid lifts" approved by voters
5. "Banked" taxing authority available from past years
6. The Real Estate Excise Tax (REET) charged on the value of property when it is sold.<sup>15</sup>

The additional revenue a city or county receives from new construction and improvements to existing property is substantial. The City of Kennewick collected

<sup>14</sup> "Property Tax Statistics 2001," Table 2, Washington State Department of Revenue, Olympia, Washington, August, 2001, p. 3.

<sup>15</sup> While some regard the REET as a sales tax rather than a property tax, the distinction is irrelevant for this discussion. The purpose here is to identify sources of additional tax revenue based on property.

\$217,000 this year from “new construction and other increases.”<sup>16</sup> This amount is more than the \$138,000 it took in from its increase in the regular property tax. Ellensburg collected an additional \$29,130 in taxes on new construction in 2001, also an amount greater than the increase it collected through the regular property tax.<sup>17</sup>

Bellevue has imposed no increase in its regular property tax collections for four years running, yet the city did gain \$1,098,245 in additional revenue in 2001 from other property tax sources.<sup>18</sup> Federal Way’s revenue increases from annexations and new construction brought an additional 1.9%, or \$138,000, into city coffers this year, on top of funds collected through the regular property tax.<sup>19</sup> The City of Yakima collected \$92,282 more in property tax revenue from new construction.<sup>20</sup>

None of these alternative revenue sources would be subject to the 1% limit proposed in Initiative 747, and they may serve to cushion the reductions in expected tax increases should the 1% cap become law. These examples are summarized in Figure 3.

Figure 3.

<b>Examples of Increases in Non-Regular Property Tax Collections For Selected Cities -- 2001</b>	
Bellevue .....	\$1,098,245
Ellensburg .....	\$29,130
Federal Way .....	\$138,000
Kennewick .....	\$217,000
Shoreline .....	\$450,561
Yakima .....	\$92,282

*Cities and Counties receive property tax revenues in addition to funds collected through the regular property tax. These revenue sources would not be affected by Initiative 747.*

Using “Banked” Taxing Authority

State law allows local officials to tap unused taxing authority from past years. The ability to draw on this “banked” taxing authority will vary with each tax district, depending on how much a district has increased taxes in past years. The governing boards of some districts have levied maximum or near maximum increases each year, so their level of unused taxing authority will be close to zero. Examples of such districts are Pacific, Whitman and Mason counties, the cities of Seattle, Spokane and Yakima, and the ports of Camas, Friday Harbor, Pasco and Walla Walla.<sup>21</sup> The latitude of districts like

<sup>16</sup> Ordinance 3960, Section 1, “General Operating Levy,” City of Kennewick, passed November 21, 2000.

<sup>17</sup> Ordinance No. 4257, Section 2, City of Ellensburg, passed November 20, 2001.

<sup>18</sup> Ordinance No. 5256, City of Bellevue, Washington, passed December 4, 2000.

<sup>19</sup> Ordinance No. 00-378, City of Federal Way, Washington, passed November 21, 2001

<sup>20</sup> Ordinance No. 200-50, Section 1(c), City of Yakima, passed November 14, 2000.

<sup>21</sup> For more on property tax increases imposed by major ports, see “Tax Increase Trends of Washington Ports,” Policy Brief, Washington Policy Center, Seattle, September 2001.



these to raise regular property tax revenues by more than 1% will be severely restricted, if not non-existent.

Officials in other jurisdictions will have more leeway. By imposing modest or zero increases in the past they have more “banked” authority on hand today. Cities like Bellevue, Ellensburg and Kirkland have held property tax increases nearly flat for the last four years. Spokane, Pend Oreille and Whatcom counties have exercised similar restraint, as have the ports of Seattle and Longview. Elected leaders in these districts will have the ability, if they choose, to significantly exceed Initiative 747’s 1% limit. It is reasonable to expect, however, that the political forces in play in these districts which have restrained tax increases so far will continue to do so in the future, regardless of how Initiative 747 fares at the polls.

### Revenue from the Real Estate Excise Tax

The Real Estate Excise Tax (REET) is levied when ownership of property changes hands. The most common rate is 1.53% on the full selling price of the property, although in some areas of the state the rate is higher. This is a significant revenue source for both state and local government. In 1997, for example, the state collected a total of \$301,444,000 through the REET, while counties took in \$38,871,800 and cities \$43,249,200 from the same source.<sup>22</sup> Recent examples of how much some cities collect through the REET include Everett (\$1,958,539), Olympia (\$956,457) and Spokane (\$2,636,802).<sup>23</sup>

## **V. Conclusion**

There is concern that Initiative 747 goes too far. Some fear that by imposing a firm 1% limit on the growth of yearly tax increases the measure will deprive local governments of the revenues they need to provide essential services. This concern is heightened in light of the terrorist attacks of September 11, when more emphasis is being placed on police, firefighting and emergency medical services. Voters may conclude that existing property tax limitation is taking hold (albeit four years late) and that further restrictions are not needed.

While these concerns are valid, predictions about the devastation Initiative 747 would inflict on local services may be exaggerated. Similar dire predictions were made in 1999 about Initiative 695 (\$30 car tabs) and our follow-up research a year later found that these predictions proved to be untrue. Local police, fire, public health and emergency services were not disrupted as opponents had foretold.<sup>24</sup>

Further, voters may decide to reinforce the tax-limit message and pass Initiative 747 regardless of the performance of past reforms. This may be especially true since Initiative 747 does not enact a tax cut as Initiative 695 did, but only caps the rate of future

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<sup>22</sup> Tax Reference Manual, Washington State Department of Revenue, January 1999, p. 166.

<sup>23</sup> All figures are for 2000. Based on interviews with Snohomish County Treasurer’s Office, City of Olympia Administrative Services and Spokane County Treasurer’s Office, October 2001.

<sup>24</sup> See “Initiative 695 One Year Later, The Sky Didn’t Fall,” by Paul Guppy, Policy Brief, Washington Policy Center, December 2000, at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

property tax increases. Voters may conclude that responsible local officials can set new spending priorities if revenues do not rise as fast as they expected, and make the needed budget adjustments so that essential public services receive adequate funding.

Whether Initiative 747 is necessary tax reform or a restrictive measure that goes too far is a matter of judgment. On election day the people of Washington will decide which alternative they believe is best for our state.

## About the Author

**Paul Guppy** is a graduate in Liberal Arts of Seattle University and holds a Master of Arts degree in American government and public policy from Claremont Graduate University, and a Master of Science degree in political science from the London School of Economics. He completed higher education programs at The Sorbonne, Paris and at Gonzaga University in Florence, Italy. He served for 12 years in Washington D.C., most of that time as a Legislative Director in the United States Congress, before joining the Washington Policy Center in 1998 as Vice President for Research. He is the author of previous Policy Center studies on civil rights, labor policy, telecommunications, insurance regulation and health care reform.

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