Metro | People places. Open spaces.

Construction Excise Tax (CET) Performance Review

April 3, 2009

Background

Overview

Metro is the directly elected regional government that serves 1.4 million residents in Clackamas, Multnomah and Washington counties, and the 25 cities in the Portland metropolitan area. Metro is responsible, among other things, for regional land use and transportation planning.

In 2006, after consultation with a broad-based stakeholder committee, the Metro Council established a construction excise tax (CET) to fund planning activities in areas recently added to the Portland metropolitan region's urban growth boundary (UGB). Cities and counties lacked the resources to conduct concept planning in these areas, which is a prerequisite to development. More importantly, this initial planning work is critical to creating vibrant communities, a key goal of Metro's *Making the Greatest Place* initiative.

Making the Greatest Place goals:

VIBRANT COMMUNITIES: People live and work in vibrant communities where they can choose to walk for pleasure and to meet their everyday needs.

ECONOMIC PROSPERITY: Our Children and their children benefit from the region's sustained economic competitiveness and prosperity.

SAFE AND RELIABLE TRANS-PORTATION: People have safe and reliable transportation choices that enhance their quality of life.

SUSTAINABILITY: The region is a leader in sustainability and minimizing contributions to climate change.

CLEAN AIR AND WATER: Current and future generations enjoy clean air, clean water, and healthy ecosystems.

FAIRNESS AND EQUITY: The benefits and burdens of growth and change are distributed fairly and equitably.

The CET program has succeeded in raising revenues in a timely fashion to pay for planning work that could not have been funded otherwise. Metro, cities, and counties promptly established intergovernmental agreements. The collection and transfer of excise tax revenues by local governments has been straightforward. Metro has worked closely with grantees to track the achievement of milestones and the payment of grants by Metro to local governments has been timely and simple. As a result the vast majority of the planning work that Metro's CET program was established to carry out is now complete.

The construction excise tax is due to sunset when the total amount of $6.3 million has been levied (the amount required to fund new area planning activity), which is currently estimated to occur in the fall of 2009. This report provides an overview of how the CET program has performed during the past three years.

Planning Mandates

Metro is responsible for managing the UGB and is required, by state law, to maintain a 20-year supply of land for future residential development inside the boundary. Every five years, the Metro Council is required to conduct a review of the land supply and, if necessary, change policy inside the existing UGB, expand the UGB, or both, to meet that requirement.

From 1998 to 2005, Metro added more than 23,000 acres to the UGB. Title 11 of Metro's Urban Growth Management Functional Plan requires the city(ies) or county that will provide services for the new urban area to adopt comprehensive plan provisions concerning the future urbanization of the area. This must be completed before the land can be converted from rural to urban use. These comprehensive plan provisions must address issues like minimum residential density levels, diversity of housing stock, an adequate transportation system, protection of natural resource areas and needed school facilities.

"The Metro CET grant is a valuable asset for communities in the region to conduct planning work that is necessary for compliance with regional and state requirements. Our city has limited funding, staffing and expertise to develop these studies. The CET grant allowed our community to complete these in a comprehensive manner."

-Anita Yap, Damascus

Obstacle to Compliance

After these new areas were added to the UGB, it became clear that many of the jurisdictions responsible for the new area planning could not comply with planning requirements due to limited staff and a lack of resources. By 2007, less than 15 percent of the land added to the UGB since 1998 was planned and developed, turning Title 11 into what some call an "unfunded mandate". Identifying money to support these planning needs became an issue of regional importance.

A Regional Planning Solution

In 2005, Metro convened key stakeholders to discuss the challenge of paying for planning in expansion areas. Stakeholders included business, labor, development and environmental interests, as well as the Home Builders Association, local elected officials, and city and county planners. Early scoping and discussion with jurisdictions on the needs gap revealed that roughly $6.3 million was needed to fund planning for the UGB expansions[1] from 2002-2005. There was strong agreement among stakeholders that paying for planning in these areas was a significant regional need. In examining various finance mechanisms, an excise tax on building permits emerged as a preferred tool.

Following the stakeholder meetings, Metro established a Tax Study Committee to further explore and define the parameters for such a tax including tax base, rate, target revenues, duration, dedications, allocation criteria and oversight. The Committee was composed of eleven members that represented various interests including development, schools, land-use advocates, building trades, county and city policy makers, municipal planners, community development groups, and non-voting members of Metro.

After three months of study, discussions, and collaboration, the Tax Study Committee presented their finding and recommendations on the establishment of a CET to the Metro Council and the Metro Policy Advisory Committee (MPAC). MPAC approved the Committee's recommendation, and on March 23rd, 2006, the Metro Council enacted OR 06-1115 establishing the CET, effective July 1, 2006.

[1] This number reflects total cost estimates reported to Metro by the jurisdictions for the completion of new area planning.

Tax Structure

The CET applies to building permits issued within the Metro service district boundary. The purpose of the tax is to support new area planning required to make land ready for development after it is included in the UGB. The tax is assessed at 0.12 percent of the total value of the improvements for which a permit is sought.

Exemptions and Exceptions

Permits valued below $100,000, permits for affordable housing, and permits issued to 501(c)(3) nonprofits are exempt from the tax. Permits for construction valued at more than $10 million are assessed a flat fee of $12,000. There have been relatively few exemptions, mostly for qualifying low income housing projects. Metro staff works with the jurisdictions, and sometimes directly with the applicants, to evaluate exemption requests.

Collection

Metro has established intergovernmental agreements (IGAs) with each city and county for the collection of the CET, including the provision of a five percent administrative fee to the jurisdictions responsible for collecting the tax. This administrative fee is collected on site by the jurisdictions and is not part of the funds submitted to Metro quarterly.

Apart from Metro, school districts are the only other entities currently collecting an excise tax in the Portland metro region (under SB 1036, enacted in 2007). The administrative fee provided to jurisdictions under the school excise tax is one percent of total revenues.

> *"We found the process to be streamlined and easy to work with, and appreciate Metro's flexibility in working through CET milestones, deadlines and the invoicing process. "*
>
> -Michael Walter
> Happy Valley

Sunset

The CET ordinance included a sunset provision that limits collection of the tax to the last day of the month in which a total of $6.3 million has been collected. Metro must provide prompt written notice to collecting jurisdictions when the last of the funds are received and certified.

Metro Administration of CET

Review and Funding of Grant Applications

> *"The process was easy to understand and reimbursements followed in a timely fashion. The City has one more concept plan to prepare, for South End, and we look forward to continuing a positive relationship in that endeavor."*
>
> -Dan Drentlaw
> Oregon City

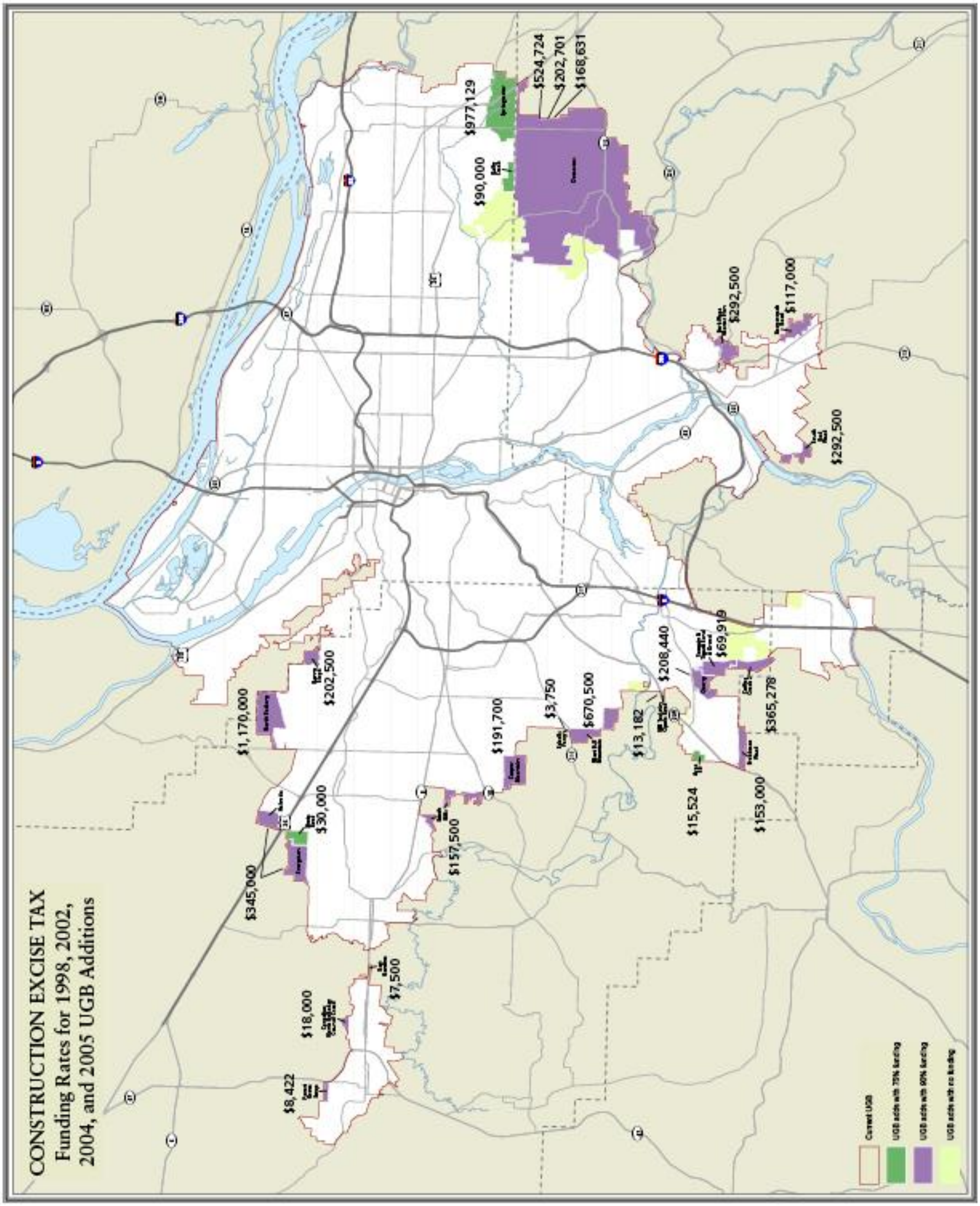
Metro worked with regional partners, the Tax Study Committee and MPAC to establish a process to distribute the $6.3 million that would be raised through the CET. Ultimately, Metro determined that a process of distribution through jurisdictional application was most equitable. Metro became responsible for reviewing applications based on their relevance to regional planning requirements.

Though many jurisdictions had not yet begun any planning in new areas, some had already completed or commenced the work. To recognize the effort made by the latter jurisdictions, it was decided to partially reimburse them. To account for total grant requests that exceeded the available funds, a formula for granting awards was developed that paid out grants at two different rates. Jurisdictions which had not completed or undertaken any planning received 90 percent funding of their grant requests. Jurisdictions that had already completed their new area planning were reimbursed at 75 percent of their total grant requests. Metro was responsible for providing the up-front financing of approved grant requests as CET was collecting revenue. Map 1, on the next page, displays the expansion areas that received CET grants along with the amount of each grant.

Payments of grants and reimbursements are not made in one lump sum. With each planning milestone met in the IGA timeline, such as substantial progress towards completion of a concept plan and eventually adoption of a comprehensive plan amendment, jurisdictions receive a partial payment or reimbursement. If a jurisdiction anticipates that a due date for a milestone will not be met, it must inform Metro in writing no later than ten days prior to the due date. Metro and a jurisdiction must mutually revise the milestones in the IGA's.

Metro collected no administrative fee or reimbursement for the development or administration of the CET program. Revenues collected were fully allocated to grant distribution and local administrative costs.

Map 1


CONSTRUCTION EXCISE TAX
Funding Rates for 1998, 2002, 2004, and 2005 UGB Additions
$8,422
$18,000
$7,500
$345,000
$30,000
$1,170,000
$202,500
$157,500
$191,700
$3,750
$670,500
$13,182
$208,440
$69,919
$15,524
$153,000
$365,278
$90,000
$977,129
$524,724
$202,701
$168,631
$292,500
$117,000
$292,500

Performance

Collections

Original Tax Study Committee estimates, based on historical construction activity in the region, concluded that the target collections of $6.3 million could be collected in approximately three years by imposing an excise tax of 0.12 percent on the value of construction permits (including specified exceptions and exemptions). According to this estimate, the target collections would be met by June/July 2009. Figure 1 shows cumulative yearly totals of revenues through the second quarter of FY 2009. After two-and-a-half years of collection, $5.2 million has been received. However, receipts have slowed during the first two quarters of FY 2009, compared to 2006/2007.

Figure 1

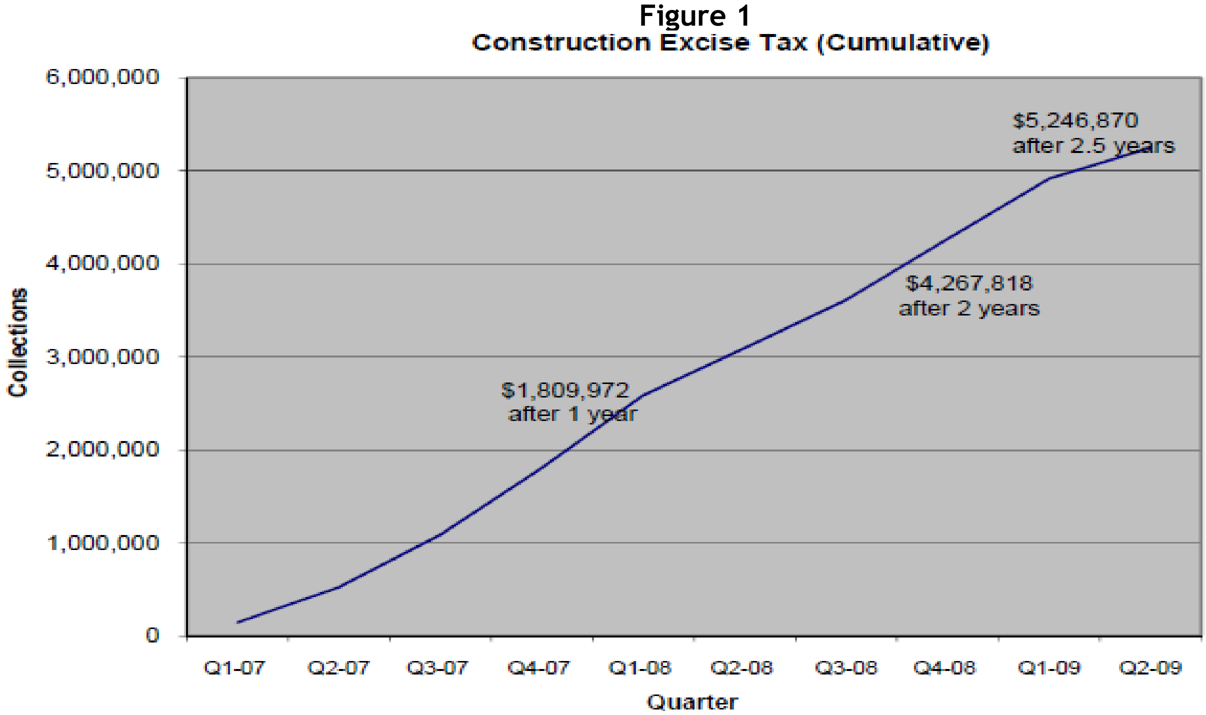
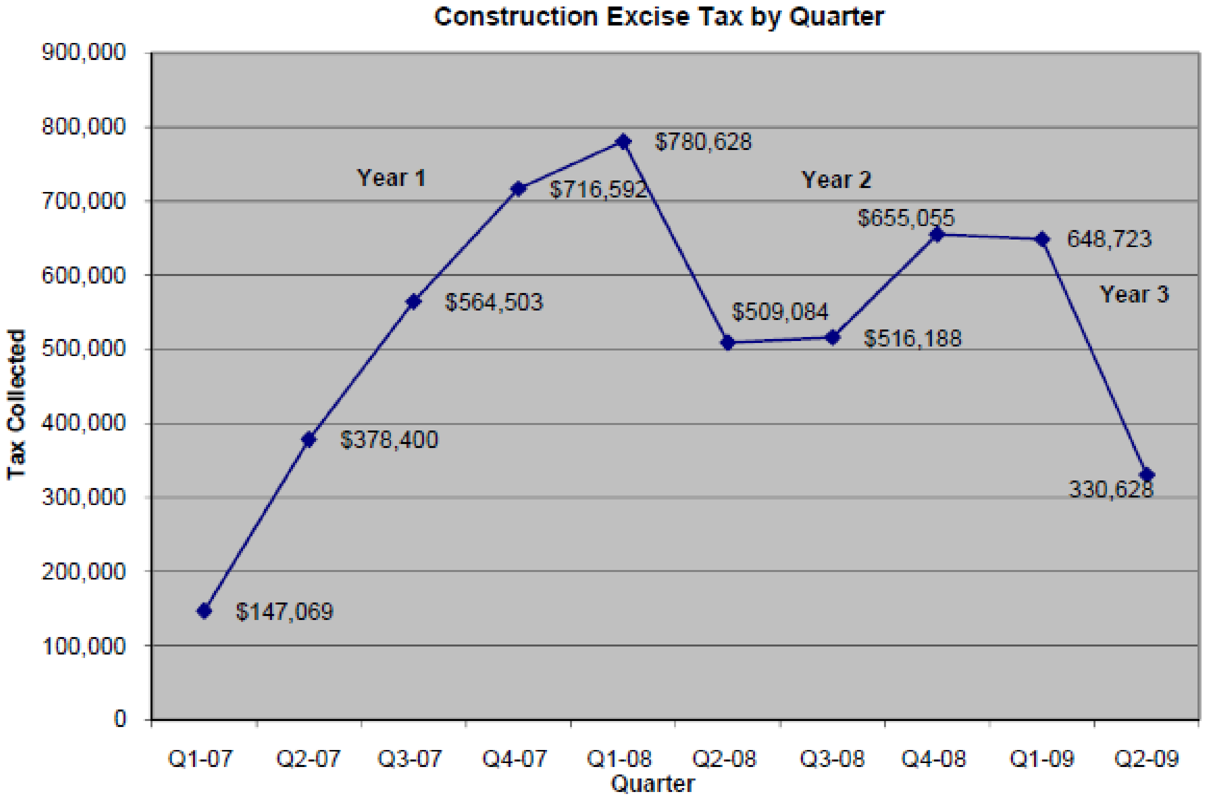


Figure 2 reflects total revenues collected by quarter. The first five quarters represent the highs of the real estate market. The dips in the second and third quarters of FY 2008 coincide with the cyclical dips of construction during cold wet months, while the fourth quarter of FY 2008 and the first quarter of FY 2009 reflect the surge of construction that occurs during the warmer months. Most notable however, is the steep decline in revenues in the second quarter of FY 2009. While this period does coincide with the beginning of the cold season, the decline also shows the impacts of the current recession on the construction and real estate markets. With the economy not predicted to begin stabilizing until mid-2010, it is likely that average CET revenues will be lower than average throughout the 2009 calendar year, affecting the timing of the CET sunset, which is connected to the collection of total target revenues ($6.3 million).

Figure 2



The figure in Appendix A displays the *total value* of CET permits by type, commercial or residential, from July 2006 through September 2008.[i] The commercial category includes everything except residential development (industrial, commercial, etc.). As shown, for jurisdictions other than Portland and Fairview, the total value of permits for residential development has been greater than for commercial. These numbers attest to not only the real estate market peak, but also the increase in population and demand for housing on the region. Though residential permits greatly outnumbered those for commercial use, a few particularly expensive commercial projects in the cities of Portland and Fairview brought the total value of commercial permits to exceed that of residential.

Appendix B displays all new residential units throughout the region subject to the Construction Excise Tax separated out by the number of units per permit from 2006 to 2008. The map illustrates that the majority of residential permits subject to the CET were for single-family residential developments. Permits for residential developments of 35 units or more were rare throughout the region. The majority of these multi-family developments are concentrated in Portland but a few are also found in the Beaverton, Hillsboro, and Wilsonville areas.

Appendix C displays all new commercial units throughout the region subject to the Construction Excise Tax separated by the value of the permit from 2006 to 2008. The map shows that the majority of the permits subject to CET were in the range of one to 30 million, with a few permits having a value of 30 million and greater. The spatial display of these permits reveals clusters of commercial permits in Portland's city center as well as smaller clusters in Hillsboro and the Clackamas County 2040 regional center.

Table 1 - New Area Planning Progress and Funding

Lead Jurisdiction	Subarea for Planning	CET Funding Rate	Total CET Grant Allocation	New Planning Completed	New Planning Underway	Reimbursement Issued	Planning & Reimbursements not Yet Started
Beaverton	Scholls Ferry (portions of Bull Mtn/Area 64)	75%	$3,750			x	
Clackamas Co.	Damascus/ Boring	75%	$202,701			x	
Cornelius	E. Baselin (Area 77)	75%	$7,500			x	
Cornelius	Cornelius/ N. Holladay/ Council Creek	90%	$18,000				x
Damascus	Damascus Concept	90%	$524,724		x		
Forest Grove	Forest Grove Swap	90%	$8,422				x
Gresham	Springwater (Areas 6 & 12)	75%	$977,129			x	
Gresham	Kelly Creek (Area 13)	75%	$90,000		x		
Happy Valley	Happy Valley Comp.	90%	$168,631	x			
Hillsboro	South Hills (Areas 69 & 71)	90%	$157,500		x		
Hillsboro	Shute Rd	75%	$30,000			x	
Hillsboro	Helvetia and Evergreen	90%	$345,000	x			
Multnomah Co.	Bonny Slope (Area 93)	90%	$202,500		x		
Oregon City	Park Place Master Plan	90%	$292,500	x			
Oregon City	Beavercreek Rd. & Area 26	90%	$117,000	x			
Oregon City	South End Rd (Area 32)	90%	$292,500				x
Sherwood	Brookman Rd	90%	$153,000		x		
Sherwood	Area 59	75%	$15,524			x	
Sherwood	Quarry (portions of Areas 48 & 49)	90%	$208,440		x		
Tualatin	SW Implementation Plan	90%	$30,907				x
Tualatin	NW ans SW Tualatin Plans	75%	$52,194			x	
Washington & Clackamas Counties or Tualatin or Wilsonville	Coffee Creek 2/ portions of Areas 47 & 49	90%	$365,278				x
Washinton Co.	Bull Mountain (Areas 63 & 64)	90%	$670,500		x		
Washinton Co.	Cooper Mountain (Area 67)	90%	$191,700				x
Washinton Co.	N. Bethany	90%	$1,170,000		x		
			$6,295,400				

CET Grant Distribution

Table 1 displays the jurisdictions and plans that have been allocated CET funds to conduct expansion area planning. The four columns on the right-hand show the progress of planning efforts as of March 2009. Eleven plans have been completed, eight are in progress, and six are yet to be commenced. Projects that have not been started were either awaiting other decision-making processes (for example, on the I-5/99W Connector) or were part of a series of plans being completed in phases by a jurisdiction (e.g. Washington County and Oregon City). The *New Planning Completed* and *New Planning Underway* columns refer to areas that received funds at a rate of 90 percent of the amount requested. The *Reimbursement Issued* column refers to sites that were funded at a rate of 75 percent, and have completed their required planning. The last column, *Planning & Reimbursements not yet Started*, refers to areas that have not yet commenced planning, or have not collected their reimbursements for planning completed or underway. Appendix D displays total CET collections and recipients by jurisdiction.

Next Steps

Measuring Success

The purpose of the construction excise tax was to secure funding for the planning required under Title 11 for areas added to the UGB from 2000-2005. The program has and continues to be successful in accomplishing this goal. More than half of new area plans identified by the stakeholder group are now complete, another third are progressing towards completion, and the remaining plans will be commenced soon.

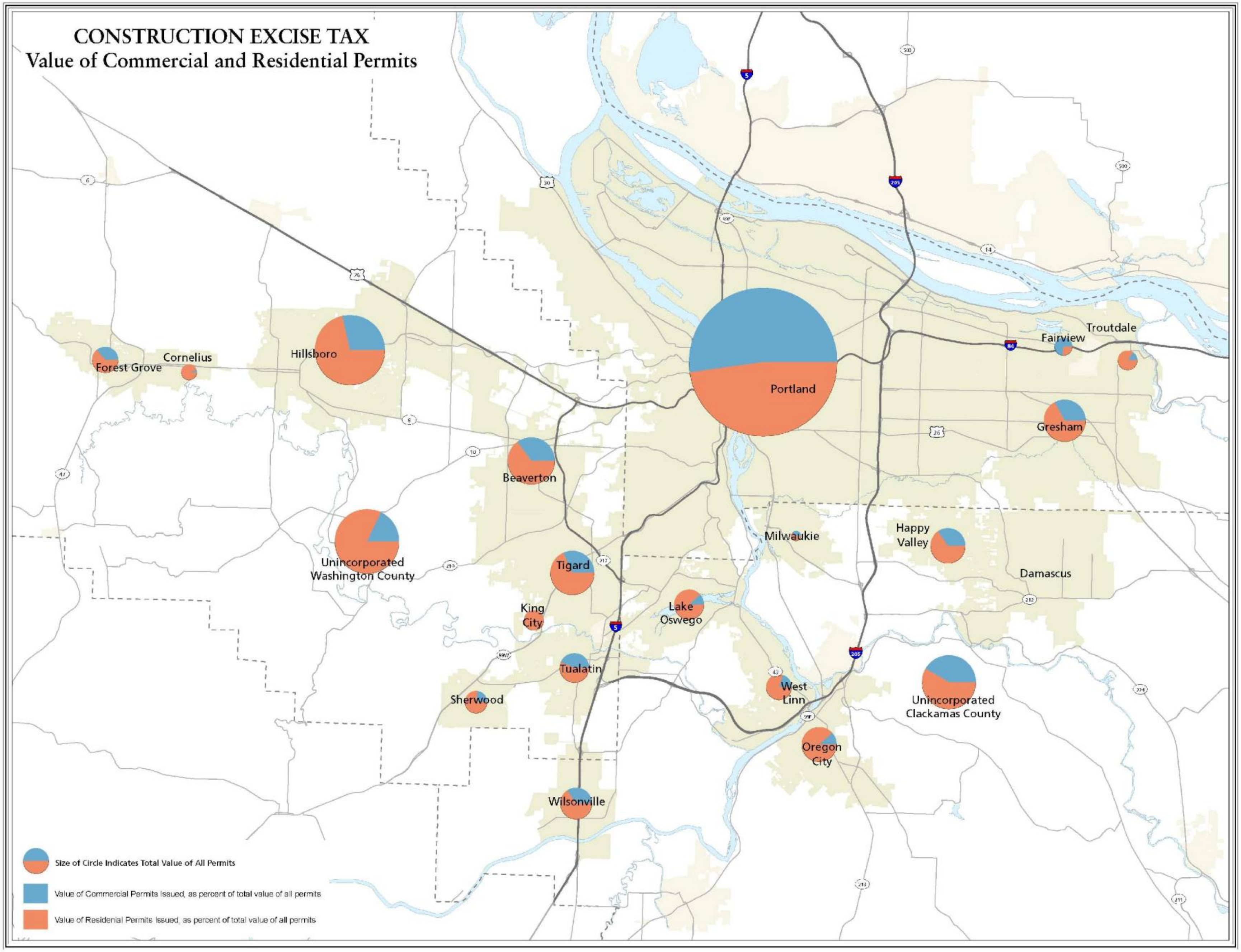
Stakeholders who convened to establish the CET program recognized that planning is necessary, but not sufficient to accomplish the region's growth and development goals. There was a shared understanding that to actualize the type of development these new area plans call for, the greater issues of infrastructure and basic service delivery must be addressed. Identifying a strategy to fund local and regional infrastructure is critical to accomplishing the various planning goals throughout the metropolitan area.

State CET Preemption

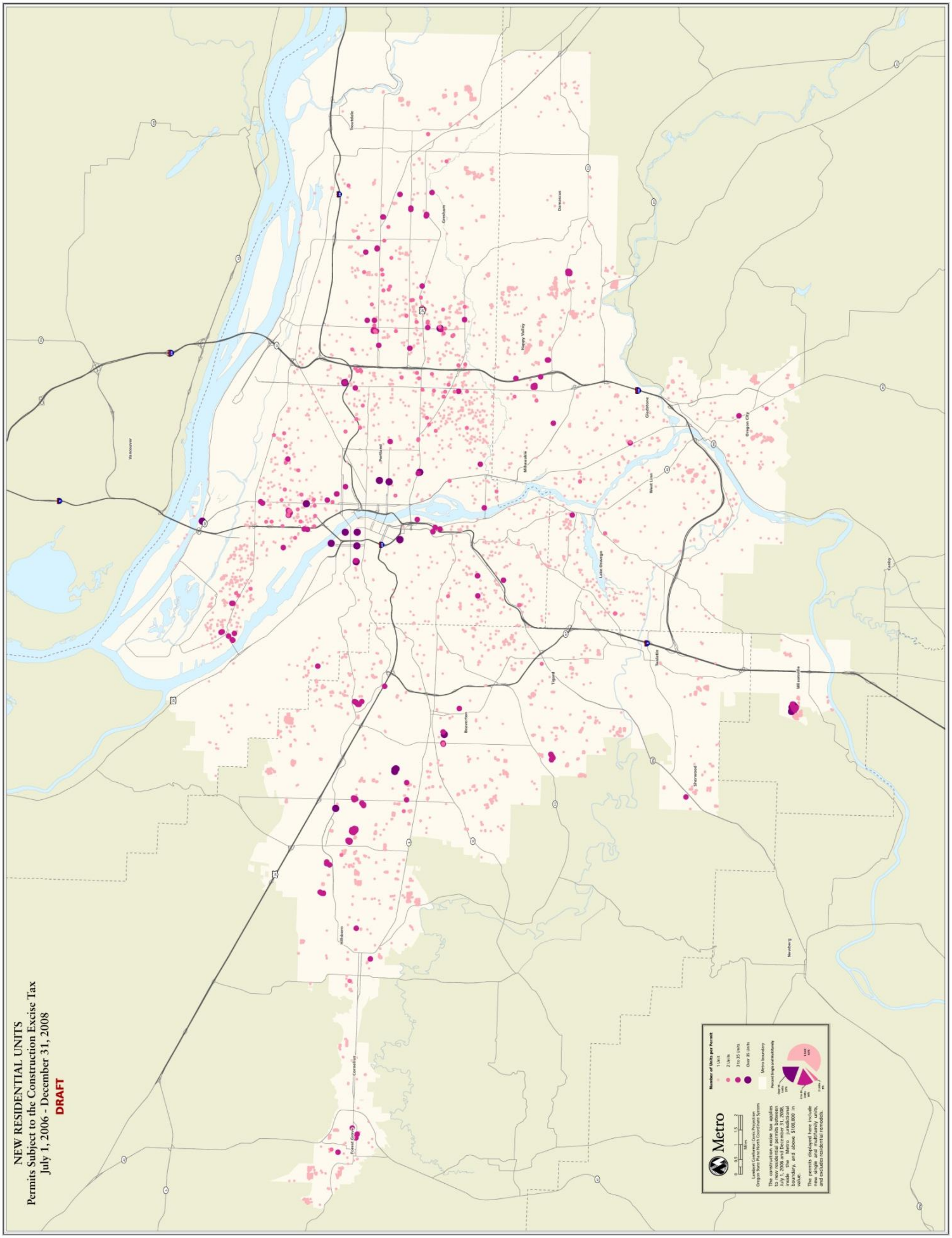
Since the Metro CET was established in 2006, state law regarding local taxing authority has changed, limiting local government's authority to levy excise taxes on construction. In 2007, the Oregon Legislature enacted Senate Bill 1036, which authorized school districts to levy a construction excise tax on new residential, commercial, and industrial construction to pay for school facility construction. However, the bill also prohibited the establishment of new construction excise taxes by other local governments. The state preemption expires in 2018. Existing CETs are "grandfathered" in – the local preemption does not apply to any tax "that is in effect as of May 1, 2007, or to the extension or continuation of such a tax, provided that the rate of tax does not increase from the rate in effect as of May 1, 2007". Thus, state law allows Metro to continue levying a CET so long as the rate does not change. However, if the tax is allowed to sunset, SB 1036 would prohibit the re-institution of an excise tax until 2018.

As the CET sunset approaches, Metro and its regional partners are considering the value of extending the tax to support a broader spectrum of planning needs throughout the region. If the tax sunsets, the tool will not be available again until 2018. Starting in April 2009, Metro will convene an advisory group whether to retain this taxing authority and discuss the range of options available for the CET, and make recommendations to Metro's Chief Operating Officer on what types of planning to support and how to distribute funds.

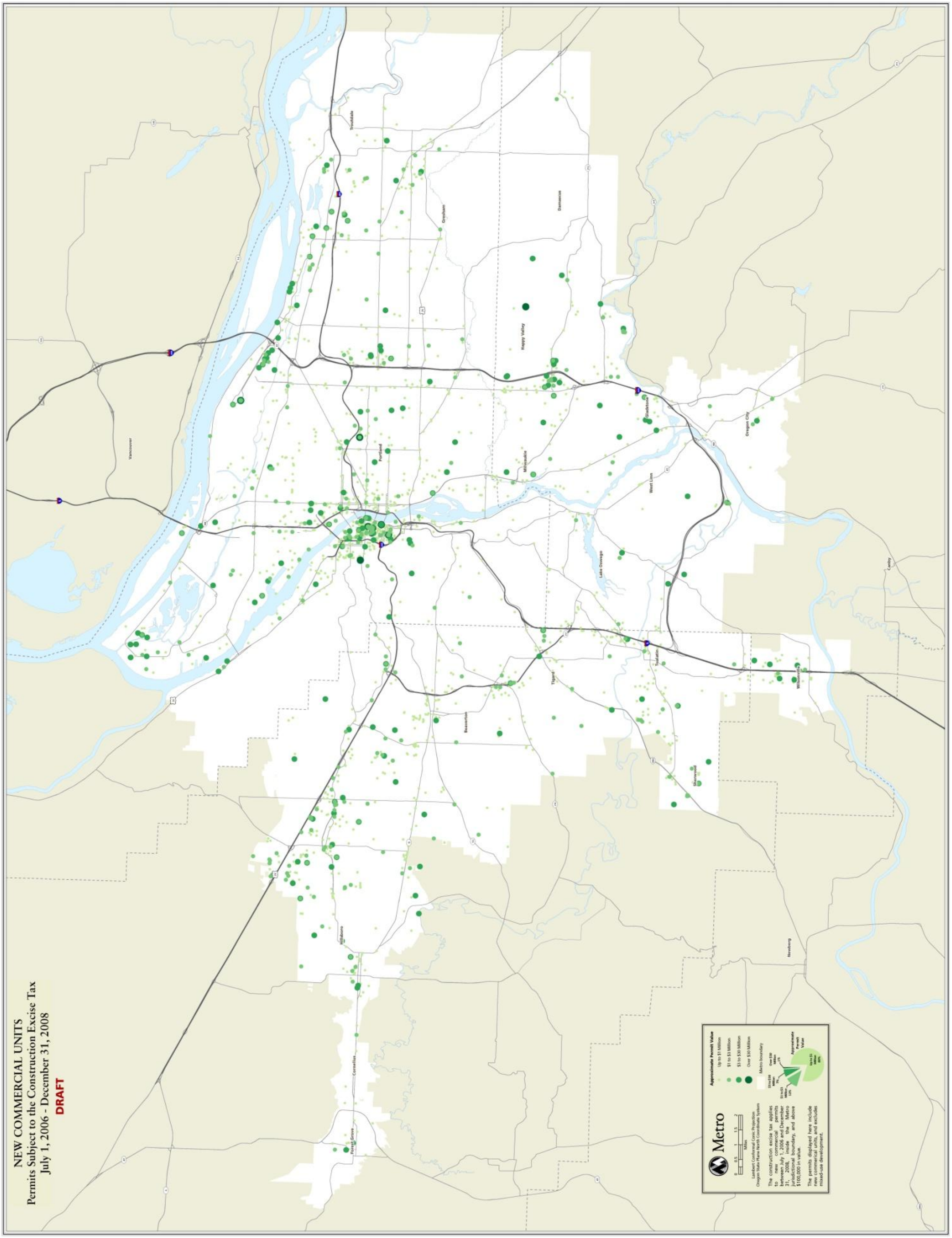
Appendix A


CONSTRUCTION EXCISE TAX
Value of Commercial and Residential Permits
Portland
Troutdale
Fairview
Gresham
Happy Valley
Damascus
Milwaukie
Unincorporated Clackamas County
West Linn
Oregon City
Lake Oswego
Tigard
King City
Tualatin
Sherwood
Wilsonville
Beaverton
Unincorporated Washington County
Hillsboro
Cornelius
Forest Grove
Size of Circle Indicates Total Value of All Permits
Value of Commercial Permits Issued, as percent of total value of all permits
Value of Residenial Permits Issued, as percent of total value of all permits

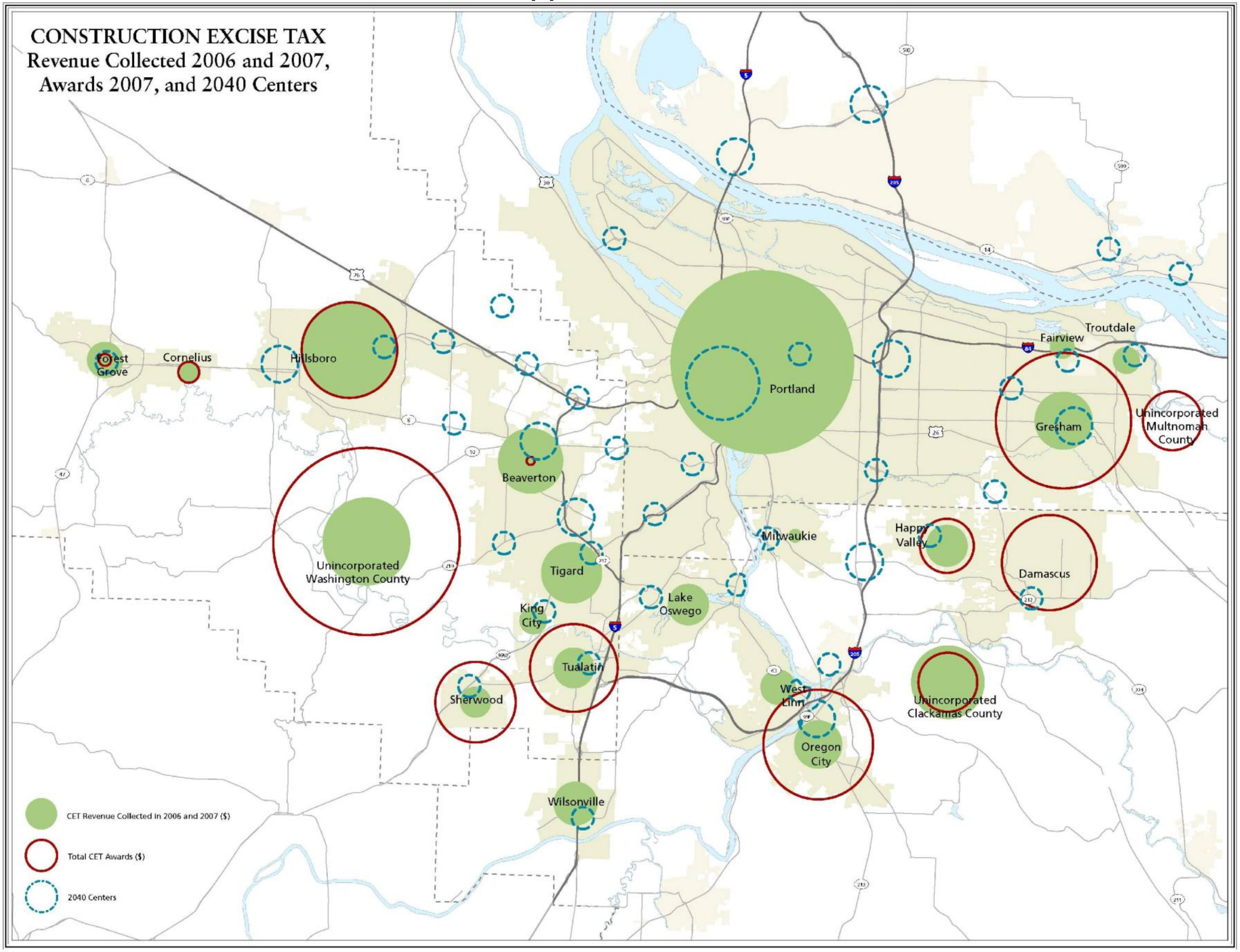
Appendix B


NEW RESIDENTIAL UNITS
Permits Subject to the Construction Excise Tax
July 1, 2006 - December 31, 2008
DRAFT
Metro

Appendix C


NEW COMMERCIAL UNITS
Permits Subject to the Construction Excise Tax
July 1, 2006 - December 31, 2008
DRAFT
Metro

Appendix D


CONSTRUCTION EXCISE TAX
Revenue Collected 2006 and 2007,
Awards 2007, and 2040 Centers
Forest Grove
Cornelius
Hillsboro
Beaverton
Unincorporated Washington County
Tigard
King City
Tualatin
Sherwood
Wilsonville
Lake Oswego
Portland
Milwaukie
West Linn
Oregon City
Happy Valley
Damascus
Unincorporated Clackamas County
Fairview
Troutdale
Gresham
Unincorporated Multnomah County
CET Revenue Collected in 2006 and 2007 ($)
Total CET Awards ($)
2040 Centers

[i] Disclaimer for Appendices A,-D: The information used to create these appendices was gathered from Construction Monitor and processed by Metro staff. Because this is third party data, not produced by Metro, it should only be used for general approximations. Metro staff cannot guarantee full accuracy of Construction Monitor data. The data reflect the total values of permits issued within the Metro service district for July 2006 through 2008 which were subject to CET. In addition, it should be noted that those permits which received exemptions for affordable housing and 501c(3) status have NOT been excluded from this analysis.