CITY OF KIRKLAND
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MEMORANDUM

To: Kurt Triplett, City Manager

From: Marilynne Beard, Assistant City Manager

Date: October 7, 2010

Subject: 2010 ANNEXATION THIRD QUARTER UPDATE

RECOMMENDATION

It is recommended that the City Council receives an update on the annexation-related activities and provide direction as needed.

BACKGROUND

This is the third quarterly report about the variety of activities underway in advance of the annexation effective date. Specifically, this report focuses on activities since the July study session.

QUARTERLY MEETING WITH KING COUNTY EXECUTIVE DOW CONSTANTINE (CONTACT: MARILYNNE BEARD, ASSISTANT CITY MANAGER)

On September 2, 2010, representatives from the Kirkland City Council and staff met with King County Executive Dow Constantine and senior County staff. The meeting was the second joint meeting to discuss progress on the implementation of the pending annexation. The meeting started with a summary of accomplishments to date including King County's approval of a fireworks ban, conceptual agreement and cooperation on a variety of development services transition issues, improvements made by King County to Edith Moulton Park and provision of financial data. City staff expressed their appreciation for the level of collaboration provided on these matters by King County.

Several outstanding issues were also discussed:

Big Finn Hill Park Property for Fire Station – King County agreed that this effort should go forward and directed their staff to work with the Fire District and the City on developing a critical path for completion.

Since then, staff from King County Fire District #41, the City and King County have continued to work toward the transfer of property from the County to the District for a new fire station. The fire station will consolidate two existing stations into one strategic location that will better serve residents of the District. King County has agreed to discuss the use of a portion of Big Finn Hill

Park for the fire station. A parcel would be identified and conveyed to the District and construction would proceed. In exchange for the conveyance of the property, the District will construct a twenty-stall parking lot adjacent to the fire station for park customers using the extensive bike trails in Big Finn Hill Park and in St. Edwards Park. A number of steps need to be taken including identification of the parcel to be conveyed. The parcel identification must take into account the area needed for the fire station, the parking lot and applicable zoning regulations.

At their September 28 meeting, Fire District #41's Board of Commissioners approved funding for an architectural plot plan drawing of the station and related parking area necessary in order to provide King County with a figure for the amount of land necessary for the transaction. County staff is also working with City staff working on the project to determine applicable zoning regulations and permitting requirements for the station based on whether the project will be permitted under the County or the City (the District may want to handle the project review in a similar fashion to the school district projects whereby the City conducts a preliminary review and issues the permit on June 1, 2011).

Once the parcel is identified, King County will order an appraisal of the property to determine its value compared to the value of the parking lot improvements and maintenance that are being provided to the County. Ultimately, an interlocal agreement between King County and the District will be developed that identifies the parcel and the conditions under which it is being conveyed to the District. The interlocal agreement is between King County and the Fire District and will require approval by the District commissioners and the King County Council. Although the City of Kirkland is not a party to the agreement at this point, the City will eventually own the property and the station after annexation. It is hoped that the property conveyance process can be completed as close to January 1, 2011 as possible so as to allow the District to proceed with development of detailed drawings.

Treasury Payment for 2011 Property Taxes – The City will not begin receiving regular property tax revenues from the annexation area until 2012. However, the 2011 County Road levy collected after the effective date of annexation and a share of the Fire District levies for 2011 will be available as one-time funds. The County Road Levy funds must be used for street purposes. To provide funding for General Fund activities in 2011, staff is recommending that the portion of the current property tax allocated to the Street fund be returned to the General Fund for 2011, with the Road Tax funds backfilling the Street fund needs.

In general practice, King County does not transfer these second half Road Tax funds until the beginning of the next fiscal year (2012); however, we are working with the County to receive the funds as collected in 2011 for cash flow purposes. The City received a commitment from the King County Executive that they will work with the City to provide a payment of the funds based on estimated collections before the close of 2011 to allow them to be recognized by the City as revenue in that year.

Surface Water Manhole Covers – In the course of evaluating the surface water system in the annexation area, City staff noted that some manhole covers had been paved over in the course of earlier street overlays. Generally, manhole covers are raised to the new pavement level to allow continued access after an overlay. King County agreed to address this issue prior to the effective date of annexation.

Since that time, the County began work on locating and raising manholes lids that have been paved over or buried. Early estimates indicated approximately 100 manhole lids that need to be located and raised. The City and County crews will continue to identify which manholes need to be raised and will work toward correcting the manhole lids before the effective date of annexation.

Annexation Census – Current state law requires that the City conduct a census of the annexation area immediately following the effective date of annexation. Because of the specialized and labor intensive nature of the work, it will be necessary to contract with a private firm to conduct the census. Based on the cost incurred by other cities, we estimated the Kirkland census will cost $225,000. An annexation service package was submitted to provide these funds. By early November, the Planning Department will be preparing a request for proposals (RFP) to solicit bids for the census.

At the same time, the City has been exploring ways to reduce the cost of the census. In particular, we would like to be able to use the 2010 federal census to the extent possible. If this were to be allowed, we would have to account for changes between April 2010 and June 2011 and we may have to conduct a partial census of portions of the annexation area that are within census blocks that cross annexation boundary. To date, state officials have not been responsive to this idea and that it would require state legislation. We will continue to work with our contract lobbyists to pursue this issue at the agency level (Office of Financial Management) and with our legislators with the intent of having the legislature adopt a bill early in the 2011 session. Given the timing of the annexation and the length of the legislative session, we may not be able to obtain a legislative fix quickly enough.

The City asked for King County's support for legislation or a request for administrative action at the State to allow less onerous and costly census requirements for annexations. King County agreed to support the City in this effort.

Annexation of Wild Glen Condominiums – The City has continued to pursue options for annexing the Wild Glen condominiums located north of the approved Finn Hill, Kingsgate and North Juanita annexation. Unless annexation of the parcel occurs, the condominium complex will be the only remaining property within Fire District #41. The desire is to have the area annex on June 1, 2011, when the larger annexation takes effect. Wild Glen property owners are supportive and are ready to sign annexation petitions. However, the King County Boundary Review Board (BRB) has refused to accept the Notice of Intention to Annex for Wild Glen until after it is contiguous with the enlarged city limits. This would cause hardships for both the Fire District and City during the interim period while the annexation is being processed.

King County agreed to have their legal staff work with the Kirkland City Attorney to draft an interlocal agreement. The County and City are now exploring an alternative method of annexation that can be accomplished by interlocal agreement and will not require approval by the BRB. The agreement will need to be approved by the City, County and Fire District. We have discussed this with County and Fire District officials and have received positive feedback.

If details can be worked out, we will submit an agreement for approval by the City Council, County Council and Fire Commissions as soon as possible.

Interjurisdictional Staff Team Meetings – The City and County agreed to continue regular staff level meetings so as to ensure timely resolution of implementation issues.

The next quarterly meeting with the King County Executive will be scheduled for late in 2010 and will be held in Kirkland.

SALES TAX CREDIT CLARIFICATION (CONTACT: TRACEY DUNLAP, DIRECTOR OF FINANCE AND ADMINISTRATION

The availability of the state sales tax credit revenue is key to the City's ability to fund annexation costs for the first ten years. As noted in the last report, the City has been seeking clarification on two aspects of the Annexation Sales Tax Credit: one related to the gambling tax provisions and the other specific to how costs prior to the effective date factor into the accumulated shortfall.

The legal opinion that has been provided by Foster Pepper, which also includes a detailed description of both issues, is included as Attachment A. In addition, staff met with Representative Ross Hunter (sponsor of the legislation) and he has provided a letter clarifying the legislative intent on both items that we believe supports the City's position (Attachment B). Staff believes that both of these items will help support our interpretation of the statute during future audits.

WOODINVILLE FIRE & RESCUE INTERLOCAL AGREEMENT (CONTACT: KEVIN NALDER, FIRE CHIEF)

An interlocal agreement between Woodinville Fire & Rescue and the City of Kirkland, which was drafted by the Kirkland City Attorney's Office, was presented and approved by the Woodinville Fire & Rescue Commissioners at their September meeting. The only modification to the document presented by the City of Kirkland was changing the names and number of Woodinville Fire Commissioners' signatures. The interlocal agreement prescribes that within 30 days of the execution date of this agreement, Woodinville Fire & Rescue will send a letter to the City indicating its plans regarding hires, separations, terminations and any other changes in employment that are a direct consequence of the annexation. This impact letter accompanied the signed interlocal agreement.

The City of Kirkland has 30 days to respond to the impacts once the interlocal agreement is executed by both parties. An analysis of the district's impact letter and the City's proposed response will be presented to the Kirkland City Council on the November 1 agenda. A resolution will also be presented for consideration authorizing the City Manager to execute the interlocal agreement.

ANNEXATION AREA POLICE RECRUITMENT (CONTACT: CAPTAIN GENE MARKLE, POLICE DEPARTMENT)

As in past updates the Police Department's primary effort is focused on hiring police officers that need to attend the Basic Law Enforcement Academy, Criminal Justice Training Center (CJTC). The state has made several cuts to the academy's budget which has necessitated adjustments to the original hiring timeline. The Police internal annexation team with assistance from the Finance Department worked to revise the hiring plan with regard to the number of new officers versus lateral officers from other departments. Fewer new officers and more lateral officers may be hired over the next 4-6 months. By contract, lateral officers start at a higher salary. However, because their training period is shorter they can start a little later in the process and allow us to stay within budget.

One consideration of hiring more lateral officers is that officers may have been trained differently. With extensive backgrounds and testing we should be able to minimize this impact but it will be important to train all new personnel to Kirkland's standards.

Given current economic conditions and the impact on public safety budgets, Kirkland has a large pool of lateral candidates from other local departments. The annexation team is receiving calls from departments losing officers through budget cuts to see if Kirkland can pick up these officers for the annexation hiring. We currently have applications from Lynnwood, Federal Way and Monroe Police Departments, and our most recent addition is the King County Sheriff's Department.

There is currently a combination of fifteen new and lateral annexation officers hired. These officers are in various stages of training. The majority of these officers are currently attending the Basic Academy and are due to graduate the end of 2010 or early 2011. These officers will then enter the field training program which should put them onto the street as solo patrol just before the annexation.

The second of two Police Training Officers (PTO) classes is taking place in October. This will complete the training of Kirkland officers needed to train the new officers as they come out of the academy and the lateral officers as they are hired. As we reach the first quarter of 2011 virtually every patrol officer working the street will have a trainee assigned to them for several months.

One challenge for the police annexation team is that the 2011-2012 budget reductions haven't been presented to or considered by the City Council. Any reductions in current staffing levels will affect the number of annexation staff to be hired in 2011 and 2012. Reductions in existing police staff may translate to a current police FTE's becoming annexation positions. If positions are not cut and until December 2010, there could be a very short timeline to hire and train officers to meet the identified timelines in annexation.

The annexation team is still working through the timing of ordering of equipment, training and certifications while continuing to support the current police department staff. Another ongoing issue is the availability of a firing range for current police and corrections officers. This is becoming extremely challenging as we bring on more and more staff that requires weapons qualification twice a year. The department has been able to contract with Issaquah Police for the use of their range but this is becoming increasingly difficult to schedule due to other agencies competing for the same range time and our increasing staff. The proposed Public

Safety Building complex includes a potential firing range facility to possibly address this need in the long-term. More detailed cost/benefit analysis needs to be done before a final decision in made on whether to include the firing range with the project. Staff is exploring interim alternatives until a new facility is available.

ANNEXATION NEIGHBORHOOD BOUNDARIES (CONTACT: JEREMY MCMAHAN, PLANNING SUPERVISOR)

The City Council requested that the Annexation Area neighborhood boundaries be reviewed for purposes of neighborhood planning, neighborhood service program delivery, and community organizing. The Council approved the following general process for deciding neighborhood boundaries for the AA:

- Identify community leaders in each neighborhood and meet to discuss process and boundaries (spring, 2010)
- Go on a listening tour to review boundaries and gather input (summer, 2010)
- Review boundaries with Planning Commission (summer, 2010)
- Planning Commission recommends boundaries to City Council as part of 2010 Comprehensive Plan amendments (fall, 2010)
- City Council decides on boundaries (December, 2010)

Staff has now completed the community involvement process with the following series of meetings and workshops:

- March 25, 2010: Juanita Neighborhoods Association briefing & discussion
- April 13, 2010: Annexation Area leaders discussion
- April 21, 2010: Totem Lake Neighborhood Association briefing & discussion
- April 22, 2010: Denny Creek Neighborhood Alliance briefing
- May 12, 2010: Kirkland Alliance of Neighborhoods briefing
    - ***May: Initial options mapped***
- May 13, 2010: Planning Commission study session
- May 18, 2010: City Council briefing
- June 29, 2010: Annexation Area leaders workshop
    - ***August: Additional Workshop Options mapped***
- August 5, 2010: Finn Hill Park and Recreation District briefing
    - ***August 20-September 30: Online survey of boundary preferences (336 responses)***
- September 16, 2010: Kingsgate Community workshop (hosted by Totem Lake Neighborhood Association)
- September 20, 2010: North Rose Hill Neighborhood briefing
- September 22, 2010: Finn Hill Community workshop (hosted by Denny Creek Neighborhood Alliance and Finn Hill Park and Recreation District)
- September 23, 2010: North Juanita Community workshop (hosted by Juanita Neighborhoods Neighborhood Association)
- October 4, 2010: Finn Hill Annexation Area leaders debriefing

Key General Issues

In addition to the neighborhood-specific issues discussed below, two general issues have been identified through the community process:

1. Should the Totem Lake Neighborhood continue to exist as a neighborhood or be divided between adjoining neighborhoods as a business district (similar to the 85th Street Corridor)?

   Discussion: *This concept emerged early in the communication process, with advocates noting that Totem Lake has a small residential base that makes it difficult to foster a neighborhood organization. Feedback in the online survey and from community meetings has been mixed, but a majority of participants identified preferences for those boundary options that did not divide Totem Lake. While a number of pros and cons to this approach have been identified, staff is recommending to the Planning Commission that the Totem Lake Neighborhood be left intact as an independent neighborhood. The Totem Lake neighborhood has a clear community vision and is a resource that belongs to the City as a whole. Dividing that resource into four or five subareas will not make that common purpose any stronger. At the same time, interest has been expressed to include multifamily residential complexes at the north edge of Totem Lake to the Kingsgate neighborhood. A similar shift could occur between Totem Lake and South Juanita with the multi family complexes along NE 124th St. west of I-405.*

2. Size of existing and future neighborhoods. The particular areas of concern identified are:

   - The challenge of cycling through neighborhood plan amendments in a timely manner.

     Discussion: *While there are currently 13 neighborhoods in the City, the trend has been to combine neighborhoods for purposes of concurrently processing neighborhood plan amendments. The Market, Norkirk, and Highlands neighborhood plans were updated concurrently in 2007. The City is currently working on the updating the Lakeview and Houghton neighborhood plans. South Rose Hill and Bridle Trails are next on the cycle for neighborhood plans. Although processed concurrently, the process still works with each neighborhood to develop an independent neighborhood plan.*

     With annexation, at least two new neighborhoods will be added to the City (assuming the North Juanita annexation neighborhood is merged with Kirkland's North Juanita neighborhood). Depending on the outcome of the annexation neighborhood boundary process, those neighborhoods could be further divided. Given the impact of additional neighborhoods on the neighborhood plan amendment cycle, it may be prudent at a minimum to combine neighborhoods into "planning units". Attachment C illustrates one approach of identifying 10 planning units based on past practice and the geography of existing neighborhoods. Additional efficiencies in the neighborhood plan process may still be merited to deal with a larger City. It should be noted that consolidations to create greater equity in population would be

more challenging. However, in deciding consolidations, population is likely less of an important than the complexity of the issues facing each area.

- The inequity of neighborhood services resource allocation based on neighborhoods rather than population. For example, should a neighborhood with a population of 1,300 receive the same resources as a neighborhood of 15,300?

  Discussion: *The disparity in neighborhood size has become magnified with the annexation neighborhoods. Staff is working with KAN and neighborhood leaders to develop options for addressing this concern in the 2011/2012 biennial budget.*

Key Neighborhood Issues

As residents of the annexation area began to identify options for mapping their neighborhood boundaries, the key decisions for each area came in to focus. These decisions points served as the basis for the September community meetings and will be the decision points to guide the Planning Commission and City Council process.

Kingsgate

1. Should the neighborhood be divided into two or kept as a single neighborhood?
2. If the neighborhood is divided, then where is the appropriate boundary?
3. Should the condominiums in the north of Evergreen Hospital in the Totem Lake neighborhood be merged into the Kingsgate neighborhood(s)?
4. Should the commercial and light industrial areas of Kingsgate be merged into the Totem Lake neighborhood?

North Juanita

1. Should the neighborhood be merged with Kirkland's North Juanita Neighborhood?
2. Should the Goat Hill area and the base of the slope along the west side of 100th be in Finn Hill or North Juanita?

Finn Hill

1. Should the neighborhood be divided or kept as a single neighborhood?
2. If the neighborhood is divided, then where is the appropriate boundary?
3. If the neighborhood is divided, then are two or three neighborhoods appropriate?
4. Should the Goat Hill area and the base of the slope along the west side of 100th be in Finn Hill or North Juanita?

The Planning Commission will be discussing this subject at its October 14 meeting. Key recommendations include:

- Consolidation of the annexation area North Juanita Neighborhood and Kirkland's North Juanita Neighborhood including the Wild Glen annexation parcel into one consolidated North Juanita Neighborhood.
- Shifting the light industrial and commercial areas at the southeast corner of the annexation area from the Kingsgate Neighborhood into the Totem Lake Neighborhood.
- Shifting of the apartments south of NE 124th St. at the southeast corner of the annexation area from the Kingsgate Neighborhood into the North Rose Hill Neighborhood.

- Shifting of the residential parcels northeast of Evergreen Hospital from the Totem Lake Neighborhood into the Kingsgate Neighborhood.

Given the number and complexity of the issues surrounding the annexation neighborhood boundaries, staff also recommending continuing the remainder of the decisions for approximately six months to allow additional community outreach by residents of the Finn Hill and Kingsgate neighborhoods. At the October 19 Council meeting, staff will be able to update the Council on the Planning Commission's discussion. A formal recommendation from the Planning Commission will be transmitted to the Council in November. No action by the Council is requested until then.

PROPOSED ORDINANCE RESTRICTING CELL TOWERS AND BILLBOARDS (CONTACT: ERIC SHIELDS, PLANNING DIRECTOR)

City staff assisted King County staff in preparation of an ordinance for consideration by the King County Council to place interim restrictions on the construction of large cell towers and billboards similar to Kirkland's regulations. The Proposed Ordinance was introduced by Councilmember Hague on September 30, 2010 (Proposed Ordinance No. 2010-0552). The first reading of the Ordinance was on October 4, 2010 and City staff anticipates final adoption by the King County Council later this month.

In August, the City received notice of an application with the County to erect a billboard along the south side of NE 124th St. just east of the current City limits. City staff has commented on the application, expressing concerns. A decision on the application has not yet been made. We will report on the outcome.

INTERLOCAL AGREEMENT ON PERMIT PROCESSING (CONTACT: ERIC SHIELDS, PLANNING DIRECTOR)

City and County staff are working on an interlocal agreement to specify numerous details in the processing of development permits started but not completed in the County on the effective date of annexation. The County originally submitted a draft agreement to the City based on agreements the County has had with other cities. Our staff reviewed the agreement, and suggested conceptual changes, which were agreed to by the County. County staff provided a draft agreement to the City on October 1. Highlights of the preliminary agreement summarized below:

- Building permits issued by the County prior to annexation shall be completed by the County under County codes.
- Building permit applications received by the County but not yet issued prior to annexation shall be forwarded to the City for issuance and completion under County codes.
- Proposed variances to County road or drainage standards will be decided by Kirkland.
- Land use permit applications submitted but not concluded prior to annexation shall continue to be processed by the County; however, after annexation, hearings will be conducted by Kirkland Hearing Examiner and decisions will be made by Kirkland officials under County codes. Some application fees will be provided to Kirkland to cover costs.
- King County will provide City with files and records for permits subject to the ILA.

- Kirkland will be the SEPA lead agency and will hear SEPA appeals; King County will provide technical assistance.
- Financial guarantees for issues reviewed by the City will be turned over to City;
- Many King County fees are based on hourly staff time. The County would like to be reimbursed for time spent over and above the fees collected directly by the County. City staff is reviewing authority needed for the City to recoup the added fees from the customers once the City has taken over the process.
- The City will adopt an ordinance allowing King County to charge fees for applications processed by County.
- King County agrees to provide the City with lists of active applications and code enforcement cases.
- Agreement valid until December 31, 2014.

The development services interlocal agreement will be part of the master agreement to be approved by the City Council prior to the effective date of annexation. As specific language is developed, it will be presented to City Council for review.

SOLID WASTE (CONTACT: RAY STEIGER, INTERIM PUBLIC WORKS DIRECTOR)

At the July 20, 2010 City Council study session, staff requested and received Council approval to enter into negotiations with Waste Management, Inc. (WMI) on a new long-term solid waste contract. The rates and services in any new contract will apply and be provided to post-annexation Kirkland residents and businesses upon the effective date of the 4-Way Agreement on July 1, 2011. A series of negotiation sessions with WMI have been scheduled over the course of the next three months and both parties have committed to substantially completing the expedited negotiation process by the end of 2010.

In 2011, City staff in cooperation with Waste Management will begin contacting residents in the annexation area that currently elect to self-haul their own garbage in lieu of subscribing to curbside garbage service through their current service provider, Allied Waste Services. Upon the effective date of annexation approximately 1,200 annexation area residents without curbside garbage service will be required to subscribe to service in accordance with Kirkland Municipal Code Section 16.08.030. Residents without curbside service will be encouraged to consider the convenience and financial incentives of curbside garbage and recycling service. The monthly cost of curbside garbage service is typically equal to or less than the cost of self-hauling garbage to King County transfer stations. Staff anticipates that many residents that currently do not subscribe to curbside service will voluntarily subscribe to a minimum service. Waste Management will also conduct a windshield survey of the area to determine where access issues can be addressed for residents needing assistance in using curbside services (e.g. long steep driveways). Compliance with mandatory curbside service will be achieved over time and take into consideration individual customer needs.

SURFACE WATER (CONTACT: RAY STEIGER, INTERIM PUBLIC WORKS DIRECTOR)

The Kirkland Surface Water Maintenance and Operations Division are working with the King County Surface Water Division to correct surface water maintenance issues in the annexation area. The following areas issues are currently being addressed:

Surface Water Detention Ponds: The County has been asked to clean the public detention ponds before they are transferred to the City of Kirkland. County crews have recently been cleaning and clearing brush from the ponds. The City's Surface Water Division will continue to work with the County Surface Water Division to make sure the detention ponds are fully maintained to the best of the existing resources before the effective date of annexation.

Aging Surface Water Infrastructure: During field mapping of the surface water system in the annexation area, some maintenance issues with the surface water system were noted. Most of the issues are primarily linked to the aging surface water infrastructure in this area; much of the storm system in annexation area was built in the 1960's and 1970's when large subdivisions were under construction. That same storm system is now 50-60 years old and the maintenance and replacement needs are apparent. The Surface Water Division will attempt to have known maintenance issues corrected by the County before the effective date of annexation. After annexation, maintenance issues will be identified and prioritized in the same manner that they are today with our existing surface water system.

COMMUNITY CELEBRATION (CONTACT: MARIE STAKE, COMMUNICATIONS PROGRAM MANAGER)

Following its March retreat, City Council members expressed interest in hosting an Annexation Celebration as a way to welcome new residents to the City. Staff seeks guidance from the Council on planning for a community celebration and offers the following as "food for thought"

- When to have the event
- Where to have the event
- What should happen at the event
- How to advertise the event

When to Hold an Event

The City Council may want to consider two or three separate events to mark the annexation.

The annexation takes effect at midnight on Wednesday, June 1, 2011. The City Council may want to consider a ceremonial "ribbon cutting" at multiple street entries from the annexation area to the City at midnight. One idea is to identify seven locations for a brief ribbon cutting.

The month of the event may dictate the appropriate place. Since it is often difficult to plan an outdoor event for early June due to the spring rains, the City Council may want to consider an additional celebration later in July or August such as hosting an event at the re-opening of Juanita Beach Park. Additionally, parks within the annexation area that make good candidates as venues include 132nd Square Park, O.O. Denny Park (owned by the City of Seattle and maintained by the Finn Hill Park & Recreation District), and Big Finn Hill Park (a regional park funded by King County).

If it is preferred to have an event in June, the City Council may wish to invite residents to an open house at City Hall in early June to meet city staff and familiarize themselves with city services. The City's community centers, City Hall and Maintenance Center are viable venues as they offer indoor and outdoor venues. If the event is to be held outside, then any one of the City's many flagship and waterfront parks would be excellent candidates.

Possible Event Activities

The celebration is intended to welcome Kirkland's new residents in a festive, yet informative way. It is hoped annexation residents will personally meet their elected and appointed officials, learn about their new government, meet other residents, and enjoy some food and activities. Possible activities include:

- Welcome remarks from City Council members
- Informational booths about city services and programs (displays and handouts)
    - Welcome Kiosk
    - City Council
    - Public Safety
        - Crime Prevention
        - Emergency Preparedness
        - Fire Safety
    - Development Services, including Green Building Design & Construction
    - Volunteer Program
    - Neighborhood Services Program
- Interactive and educational activities
    - Police vehicle display
    - Police K-9 demonstration
    - Police SWAT demonstration
    - Fire Ready Trailer
    - Fire Truck and Aid Car display
    - Environmental education activity
    - Voter registration
    - Pet Licensing
    - E-gov services demo (allow for online registration to city information and services)
    - GIS maps
- Other
    - Local food vendors
    - Business vendors
    - Community organizations (e.g. Kirkland Heritage Society, Chamber of Commerce, Rotary Club)

Planning and coordinating the event

Staff from the Parks & Community Services Department and the City Manager's Office will work together to plan and coordinate the event. Annexation neighborhood leaders and Kirkland Alliance of Neighborhood (KAN) members will be involved as well.

Marketing and advertising the event

The City would use its usual means to advertise the event:

- City Update newsletter
- Webpage announcements
- List serv announcements
- News releases
- Currently Kirkland television show

If the annexation service package for communications is approved as part of the 2011-2012 Budget, funding would be available to print and mail an informational portfolio to annexation residents and to place paid advertising in local newspapers. These would be additional ways to promote the event.

SUMMARY

While this memo does not address all of the activities taking place, it highlights key accomplishments and challenges. At this time, Council direction is needed regarding the timing, location and format for a community celebration.

FOSTER PEPPER PLLC

Memorandum

To:	Tracey Dunlap, Director of Finance & Administration Robin Jenkinson, City Attorney City of Kirkland
From:	Foster Pepper PLLC
Date:	September 16, 2010
Subject:	Annexation Taxes

I. INTRODUCTION

Background. Kirkland will be annexing three neighborhoods to its north, effective June 1, 2011. This will add approximately 32,000 residents and will increase the City's geographic area by about 50%. The City estimates that its costs to undertake these annexations, incurred prior to the annexation effective date during calendar years 2010 and 2011 (excluding accumulated costs before 2010) will equal about $2.5 million in calendar year 2010 and $3.5 million in calendar year 2011.

In this context, the City has asked for an analysis of certain tax incentives created by the Legislature in recent years, which encourage cities to annex areas within their urban growth boundaries by providing additional revenues to offset annexation-related costs.

As background, it is important to consider the legislative history and policy rationale behind these incentives. One of the major reasons that cities may be reluctant to annex unincorporated areas is that the cost to provide services at the level provided to the rest of the city outweighs the tax revenues that can be normally be generated within that area. In addition to normal operational costs, start-up or ramp-up costs are incurred to increase staffing and infrastructure so that services provided in the annexation area meet the City's desired levels of service. Unless otherwise provided for, these costs must be borne by the pre-annexation taxpayers, who do not benefit from the additional services to be provided to the annexation area. The goal of these tax incentives is to offset this burden with additional new revenues spread over a ten-year period.

Brief Summary. This memorandum examines two such incentives:

(1) Sales and use tax credit (RCW 82.14.415). You have asked whether the annexation sales tax legislation permits the City, when calculating the *threshold amount*, to include annexation costs incurred prior to the annexation's effective date on a rolling basis, allowing the City to recover those costs over the ten-year period of the tax. Briefly, this approach to recovering those expenses is consistent with the plain language and legislative intent.

(2) Gross receipts tax on house-banked social card games (RCW 9.46.110, .113 and .295). You have asked whether the City must demonstrate that the gambling tax receipts provide an annual offset to the annexation sales tax credit. The short answer is that the statute does not require annual matching of the offsets against the annexation sales tax credit reduction.

II. ANALYSIS

1. The Annexation Sales and Use Tax Credit

(a) Legislative Framework and Intent

The annexation sales tax credit under RCW 82.14.415 is a credit against the state sales and use taxes (generically, "sales tax") collected within an annexing city.[1] The annexing city imposes an additional local sales tax, which is offset by a reduction in the State sales tax. The net result is a transfer of revenues from the State to the annexing city, with no increase to the taxpayer. The tax may only be imposed beginning on the first day of a State fiscal year (July 1) and revenues must be used "solely to provide, maintain and operate municipal services for the annexation area."[2]

As with other "state-shared" sales taxes, the Legislature has imposed a limit on the maximum amount that a city may receive. Under the legislation, the City establishes a forward-looking *threshold amount* at the level "which the city deems necessary" to offset its annexation-related costs, based on those costs and the projected annexation area revenues for the year.[3] Any amounts collected above the *threshold amount* during a State fiscal year belong to the State:

> (7) The revenues from the tax authorized in this section may not exceed that which the city deems necessary to generate revenue equal to the difference between the city's cost to provide, maintain, and operate municipal services for the annexation area and the general revenues that the cities would otherwise expect to receive from the annexation during a year. If the revenues from the tax authorized in this section and the revenues from the annexation area exceed the costs to the city to provide, maintain, and operate municipal services for the annexation area during a given year, the city shall notify the department and the tax distributions authorized in this section shall be suspended for the remainder of the year.[4]

Thus, the *threshold amount* caps the amount the city may recover in a given year, regardless of how much revenue is generated by the tax. RCW 82.14.415(9) describes how this cap is implemented:

> (9) The tax shall cease to be distributed to the city for the remainder of the fiscal year once the threshold amount has been reached. No later than March 1st of each year, the city shall provide the department with a certification of the city's true and actual costs to provide municipal services to the annexed area, a new threshold amount for the next fiscal year, and notice of any applicable tax rate changes. Distributions of tax under this section shall begin again on July 1st of the next fiscal year and continue until the new threshold amount has been reached or June 30th, whichever is sooner. Any revenue generated by the tax in excess of the threshold amount shall belong to the state of Washington. Any amount resulting from the threshold amount less the total fiscal year distributions, as of June 30th, shall not be carried forward to the next fiscal year.

Under the statutory framework, to begin receiving funds, the annexing city must (prior to March 1) calculate a forward-looking *threshold amount*, certify expenditures on a backward-looking basis, and set the tax rate for the local tax that is to be deducted from the State tax. The backward-looking

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[1] Substitute Senate Bill 6686 (2006 Session) was amended in the 2009 Session by Engrossed Substitute Senate Bill 5321.

[2] RCW 82.14.415(5) and (6).

[3] RCW 82.14.415(7) and (11).

[4] RCW 82.14.415(7) (emphasis added).

certification is a simple reporting requirement, showing an accounting of "the city's true and actual costs to provide municipal services to the annexed area" and establishing a running total of the annexation-related costs that have been incurred.

(b) Recovery of Pre-Effective Date Annexation Costs

The question that has arisen is whether, in calculating the *threshold amount* for any given year, the City may include a portion of annexation-related expenses incurred prior to the annexation's effective date, on a rolling basis, effectively spreading recovery of the expenses over the ten-year period of the tax.

In interpreting a statute, the legislative intent should be considered and the statute should be read as a whole. Reading the statute as a whole reveals the following:

- First, under RCW 82.14.415(7), quoted above, the City is responsible for calculating the threshold amount at a level "which the city deems necessary" to recover "the city's cost to provide, maintain and operate municipal services for the annexation area" over and above the projected revenues from the annexation area during a given year. Significantly, the phrase "during that year" modifies only the clause relating to the revenue projections; the Legislature did not similarly limit which costs the City may include in its calculation. It follows, therefore, that the City may claim proper annexation-related costs in any year in which the accumulated expenses exceed the revenues projected for that year from the annexation area.
- Second, the limitation in RCW 82.14.415(9) encourages the City to set relatively low *threshold amounts* and spread its cost recovery over time. The last sentence of RCW 82.14.415(9), quoted above, states that "[a]ny amount resulting from the threshold amount less the total [State] fiscal year distributions…shall not be carried forward to the next [State] fiscal year." Under this limitation, if the actual distributions to the City during any State fiscal year do not reach the *threshold amount* set by the City (given the City's chosen tax rate), the City may not recover the deficit as part of the next fiscal year's distributions. This encourages the City to be conservative in its revenue projections but, by its plain language and context, does not restrict which costs the City may include in calculating the *threshold amount* in the first place. So long as a previously-incurred cost was not previously been included in calculating a *threshold amount*, the City should be able to include it in a future *threshold amount* calculation.
- Third, as discussed above, the evident legislative intent was to encourage annexations by offsetting the costs to the existing city taxpayers of taking on large annexations. It is consistent with this intent to allow a City to recover any cost incurred by the City in "providing, maintaining or operating" municipal services. Limiting the recoverable costs to expenses projected to be incurred in a particular year would undermine this legislative goal and could encourage a slow phase-in of municipal services to match with the ability to recover the costs. This absurd result is contrary to the statutory framework and legislative intent.

Given these observations, consistent with underlying intent and reading the statute's plain language as a whole, the legislation should be interpreted to permit the City to include proper annexation-related expenses at any point over the ten-year life of the annexation sales tax, provided that no expense is included in more than one year's *threshold amount* calculation.

2. Gross Receipts Tax on House-Banked Social Card Games

In order to provide an additional annexation incentive, the Legislature in 2009 amended RCW 9.46.295 to provide for the continuation of certain licenses for "house-banked social card

games" upon annexation into a city or town that otherwise prohibits such gambling activities.[5] RCW 9.46.295 provides:

> (2) A city or town with a prohibition on house-banked social card game licenses that annexes an area that is within a city, town, or county that permits house-banked social card games may allow a house-banked social card game business that was licensed by the commission as of July 26, 2009, to continue operating if the city or town is authorized to impose a tax under RCW 82.14.415 and can demonstrate that the continuation of the house-banked social card game business will reduce the credit against the state sales and use tax as provided in RCW 82.14.415(7). A city or town that allows a house-banked social card game business in an annexed area to continue operating is not required to allow additional house-banked social card game businesses.

Allowing the continuation of such card games in the annexation area creates an annexation incentive because it can be expected to provide additional revenues to the city or town from the gambling tax that may be imposed under RCW 9.46.110 and .113.[6]

RCW 9.46.110 permits a maximum local tax on house-banked social card games equal to 20% of the gross revenues from such games. RCW 9.46.113 states that "Any county, city or town which collects a tax on gambling activities authorized pursuant to RCW 9.46.110 must use the revenue from such tax primarily for the purpose of public safety."[7] The word "primarily" in this statute has been interpreted to mean that the city or town must apply the revenues first to the statutorily specified purpose, but may thereafter use the additional revenues for any general governmental purpose.[8]

The question that has arisen in this context is how the city or town can "demonstrate that the continuation" of the licensed gambling activities will "reduce the credit" provided under the annexation sales tax credit described earlier in this memo, and whether an annual matching of the reduction in the credit is required. One possible reading is that there must be city gambling tax revenues in each year sufficient to offset a portion of the annexation sales tax credit; another possible reading is that, over the life of the annexation sales tax credit, the total amount of the credit from the State would be reduced by some amount.

The statutory language quoted above does not provide specific direction about how or when to measure this reduction, and is therefore an area in which the agency applying the statute must develop guidance or rules for applying it. Requiring an exact match between the amount produced by the gambling tax and the amount by which the annexation sales tax credit would be reduced is impracticable and inconsistent with the overall statutory framework of the annexation sales tax. As discussed above, the annexation sales tax: (a) caps the distributions to the City based on the city-estimated *threshold amount*, and (b) does not require an annual matching between the City's costs and the distributions to the City. Moreover, to read into the gambling tax provisions a requirement for an annual match is both impracticable and inconsistent with legislative intent behind the gambling tax provisions. In this case, the intent is to allow the continuation of a business activity that produces revenue for both the State and the city or town. It would be inconsistent with this goal

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[5] RCW 9.46.295 permits a city or town that otherwise prohibits gambling activities to allow certain "house-banked social card games" to continue to operate in an annexation area and permits the city to collect tax revenues and licensing fees from such operations.

[6] We note that by allowing the gambling businesses to continue operations, this also preserves the gambling tax revenues that the State receives from these gambling operations.

[7] As amended in 2010 by Engrossed Substitute House Bill 3179 (ch. 127, Laws of 2010).

[8] *American Legion Post No.32 v. City of Walla Walla*, 116 Wn.2d 1 (1991).

to interpret and apply the statute in such a way that produces the opposite result: the shutting down of such businesses.

Because this statute does not contain the forward- and backward-looking reporting requirements of the annexation sales tax legislation, it appears that this provision requires only a forward-looking projection by the City demonstrating that it expects to receive an amount of revenue from the operation of such licensed gambling businesses over the life of the tax credit that will ultimately reduce the total amount of the annexation tax credit to be paid by the State to the City by some amount, which need not necessarily be commensurate with the gambling tax revenues.

III. CONCLUSION

The Legislature has provided several incentives for cities to annex the unincorporated areas within their urban growth boundaries. As with any tax legislation, the Department of Revenue will have to interpret and apply these statutes and should do so in a manner that is consistent with legislative intent.

In this case, it is consistent with legislative intent: (1) to apply the annexation sales tax statute to permit the City to include any previously-incurred annexation-related costs in its calculation of the *threshold amount* until all such costs have been included; and (2) to apply the gambling tax and related provisions in a manner that does not undermine the legislation's intent. As to the annexation sales tax provision, permitting the City to include previously incurred annexation costs in calculating a *threshold amount* is the only interpretation consistent with an intent to allow the City to recover those costs over the ten year period of the tax. As to the gambling tax provision, it would be both impracticable and inconsistent with the overall framework and legislative intent to require an annual matching between the amount of city gambling tax revenues and the amount by which the annexation sales tax credit is reduced.

We trust that this memo is helpful to you and look forward to assisting you further in this matter. If you have follow-up questions or would like additional clarification, please contact either Alice Ostdiek (ostda@foster.com, 206/447-4663).

ATTACHMENT B

September 14, 2010

The Honorable Joan McBride
Mayor, City of Kirkland
123 Fifth Avenue
Kirkland, WA 98033

Dear Mayor McBride,

I am writing you to clarify my intent as the state legislator who did most of the work on the annexation tax credit for cities in King County. In many cases, a situation turns out to be more complex than originally imagined and we try to write language that is flexible enough to resolve unforeseen situations. I believe the bill meets that criteria here. Specifically:

The intent of the credit is to allow a city to offset the costs incurred in the early years of doing an annexation where the tax revenue from the annexed region does not provide enough funds to cover the level of services that need to be provided. In large annexations where a substantial number of new police officers or firefighters have to be hired, cities will clearly need to be brought up to speed before the annexation revenue is realized. The training costs will be substantial and asynchronous with the revenue stream.

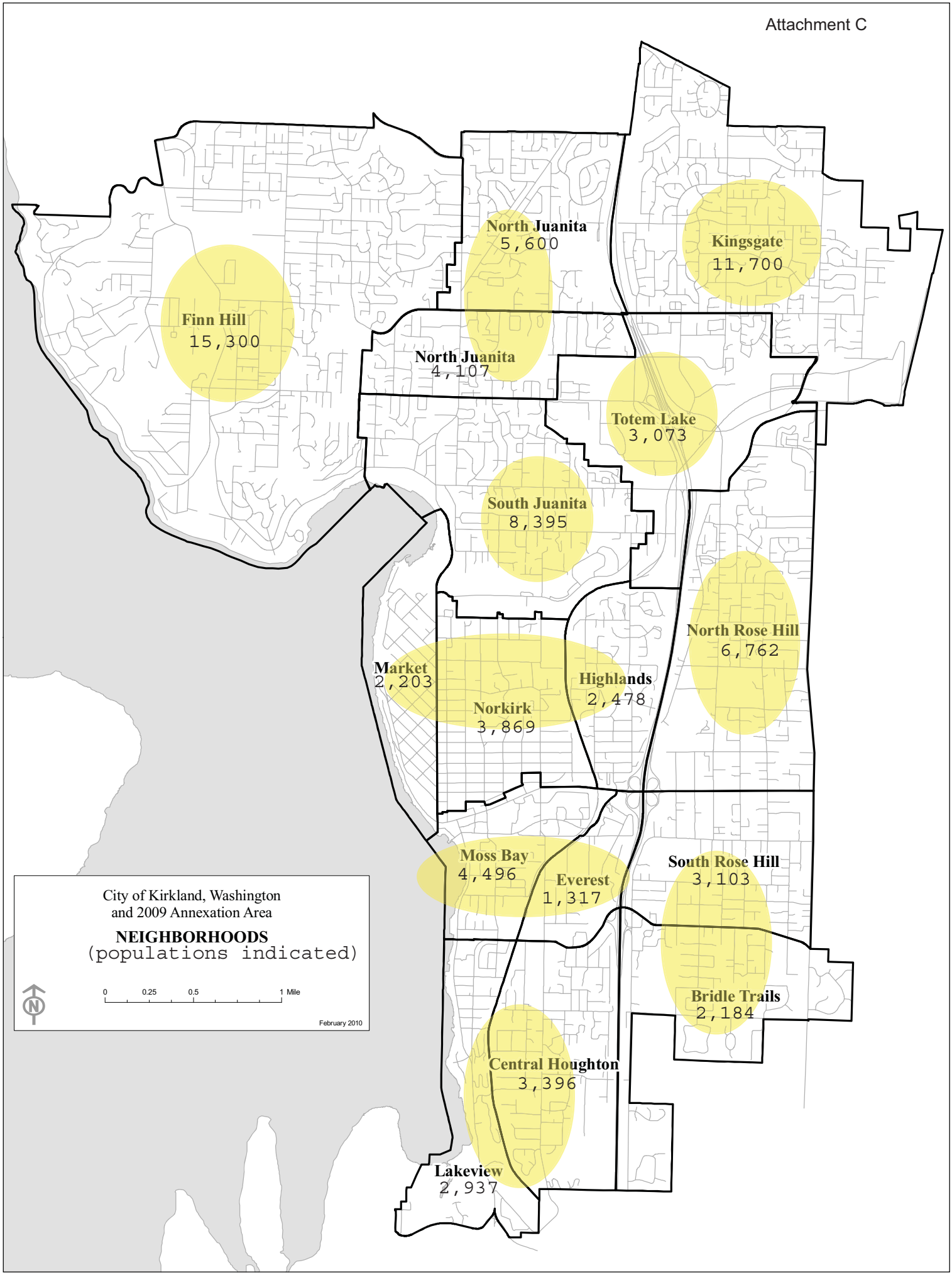
My intent was that those costs be covered, and allowing the costs to be carried forward until they are paid for is a reasonable implementation of this intent and I believe covered by the statute.

Similarly, in terms of the provision in the statute allowing the card room business to remain in operation post annexation, it seems that an annual certification of savings should not be required, given that no offset may occur in the early years and a dollar for dollar offset is not contemplated over the ten-year horizon for the credit.

Please let me know if there is further clarification I can offer.

Sincerely,

Ross Hunter
State Representative
48th Legislative District

Cc: Erin Leonhart
Majken Ryherd

Attachment C