SEATTLE CITY COUNCIL | POSITION 8

COUNCILMEMBER TERESA MOSQUEDA

Date: July 10, 2018
To: Council Member Teresa Mosqueda
From: Michael Maddux, Legislative Assistant
Subject: Impact of SHB 2382 on ability for SCL/SPU to dispose of properties below fair market value for the purposes of production of affordable housing.

Below is an analysis of SHB 2382, the lack of applicability of *Okeson I, II,* and *Lane*, the authority derived from *Okeson III*, and the implications of *Freeman*:

I. The Ryu Legislation (SHB 2382)

City of Seattle supported this legislation in a move to create new opportunities to better utilize surplus and underutilized properties for the purposes of production of affordable housing. As passed, this would include disposition of certain properties that were required to be sold for "Fair Market Value" (FMV) at a lower rate, as low as $0 (much like what was allowed/required of Sound Transit as part of the ST3 legislation). This is important to reduce the cost of land associated with property transfers to affordable housing developers, or with other covenants that impact the ability to produce more affordable homes for low-income families.

II. *Okeson I, II,* and *Lane* are not applicable

As a starting point, it is important to review three well-known utility cases that make very clear that utilities can only charge for providing the service to the customer ("proprietary function"). Where a department collects revenue through fees, it must be used to provide and/or improve the service of that utility. Revenue collected through fees that are spent to provide a service that should otherwise come from the general fund (being a "general government function") is a tax, and absent express Legislative authorization, is an unconstitutional tax. A brief summary of the jurisprudence of these cases:

a. *Okeson I*

The first in the series came about following Seattle City Light using ratepayer dollars to fund operation and maintenance for street lights. Using the *Covell* factors (*Covell v. City of Seattle*, 127 Wash.2d 874, 879, 905 P.2d 34 (1995)), the Court found that the charges associated with funding streetlights through City Light were a tax, not a fee. Absent express authority to impose a tax of this nature (*Hillis Homes, Inc. v. Snohomish County*, 97 Wash.2d 804, 809, 650 P.2d 193 (1982)), the Court found it unconstitutional. Further, *even if* the Council Ordinance was enough to authorize the City Light tax, it was found to have violated the 6% statutory limit.

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The case next turned to whether RCW 35.92.050, amended in 2002 to expressly allow for streetlights to be incorporated into the general rate structure of utilities, could have authorized such an action. The Court rejected this concept, again turning to the notion that providing streetlights is a general government function, not a proprietary function, and thus shifting the charge for maintaining streetlights ultimately amounted to a tax, noting that "[t]here is also no relationship between the electricity used by a City Light customer and the energy used by streetlights." *Okeson I* at 558. Further, the amendment did not expressly authorize such a utility tax for the stated purpose, failing the constitutional requirement. *Id.*

Okeson was decided in 2003, and authored by Justice Fairhurst, with Chief Justice Alexander and Justices C. Johnson, Madsen, Sanders, Ireland, Bridge, Chambers, and Owens concurring.

b. *Okeson II* & *Lane,*

Following *Okeson I*, Seattle implemented its Arts in Public Works Construction ordinance, which essentially required 1% of all capital costs go toward arts, including for City Light. This was challenged, and the Court of Appeals found that using ratepayer funds to pay for arts was not paying for providing the electric service, and thus a violation of *Okeson*. *Okeson v. City of Seattle*, 130 Wn.App. 814 (Div I, 2005). Also known as *Okeson II*, this case further clarified the notion that using ratepayer funds for anything *other than* providing the electric service was essentially an unlawful tax.

This line of reasoning was furthered and clarified, as much as it can be, in *Lane v. City of Seattle*, 164 Wash.2d 875 (2008). Here, the Court found that providing fire hydrants is a government function, and thus ratepayers could not be directly charged, rejecting Lake Forest Park's argument that Seattle Public Utilities should pay for fire hydrants in LFP. At the same time, it upheld the tax increase the City of Seattle levied on SPU, increasing the utility tax from 10 to 14%, in order to pay for fire hydrants in Seattle, a tax that was ultimately passed through to ratepayers. Because the imposition of the tax followed statutory limits and constitutional provisions, it was deemed lawful, and distinguished from *Okeson I*.

Lane was decided in 2008, and authored by Justice J.M. Johnson, with Chief Justice Alexander, and Justices C. Johnson, Madsen, Sanders, Chambers, Owens, Fairhurst, and Stephens concurring.

c. These Cases are *Not Applicable*

These cases all answer the question of whether spending ratepayer dollars on general government functions is legal, the answer clearly being "no." However, none address the issue presented with implementation of SHB 2382. The question that we are considering now is whether properties that are "not required for the needs of or the discharge of the responsibilities of the…municipality, or political subdivision," pursuant to Chapter 217, 2018 Laws, can be disposed of for below-fair-market-value for production of affordable housing.

There are specific actions that are authorized under the RCW for how to spend ratepayer dollars, particularly for providing a service. *See* RCW 35.92.050 as an example. Disposition of real

property originally acquired to provide a service that is "not required for providing continued public utility service" has been subject to limitations requiring a public hearing and vote, as well as fair market value or rent or consideration to be paid for the property being disposed or leased. RCW 35.94.040. SHB 2382 amended RCW 35.94.040 to include reference to RCW 39.33.015, which is the new section that allows disposal, down to $0, for affordable housing for households that are "low income" and/or "very-low income" as defined in RCW 43.63A.510 (50% and below AMI and 50-80% AMI, where the housing is built, respectively).

III. *Okeson III*

Okeson v. Seattle, 159 Wn.2d 436, 445 (2007) (*Okeson III*) has set the parameters by which we can consider implementation of SHB 2382. Here, the Court invalidated a Seattle ordinance as applied to City Light that required the utility to pay for a greenhouse gas emissions offset program. The Court initiated a two-step analysis to evaluate the powers granted in statute to a municipal utility. *Id*. (1) whether the legislature has expressly authorized municipal utilities to engage in the action; and (2) whether, in the absence of express legislative authority, such an action is impliedly authorized by the statutes or essential to the utility's authorized function. The Court, in a 5-4 decision, found that there was not the express authority, nor was there implied authority or a causal relation to providing the utility for this action.

SHB 2382 was crafted with this decision in mind, ensuring that there was express authority to engage in the action of disposing properties below fair market value, so long as the purpose was production of affordable housing for low-income and very-low-income households. Pursuant to *Okeson III*, the legislation being considered by Council would clearly meet the first prong of the test, and absent ratepayer funds, would unlikely implicate *Okeson I, II,* or *Lane.*

IV. *Freeman v. State of Washington* as a Cautionary Case

In 2013, the Supreme Court considered a similar change-of-use issue with respect to gas tax revenue, state highways, and light rail across I-90. *Freeman v. State*, 178 Wn.2d 387 309 P.3d 437 (2013) held, *inter alia*, that if a highway is deemed to be "no longer required," then, so long as the Motor Vehicle Fund (MVF) were repaid, the lanes could be used for a non-highway purpose (in this instance, light rail).

The appellants also disputed *who* can determine whether lands are presently needed. They attempted to rely on *Sperline v. Rosellini*, 64 Wn.2d 605, 392 P.2d 1009 (1964), to which the Court noted the issue was not about *who* makes the determination, but simply that it must be made before the conveyance of real property. Essentially, the Court found that so long as the determination of "not presently required" is made prior to disposition, either through a clearly defined statutory process, or implied discretionary powers granted to a department director pursuant to *State ex rel. Agee v. Superior Court*, 588 Wn.2d 838, 839, 365 P.2d 16 (1961)), then a transfer may be constitutional.

Freeman was decided in 2013, and authored by Chief Justice Madsen, with Justices Stephens, Owens, Wiggins, Fairhurst, González, and Gordon-McCloud concurring. Justice J.M. Johnson dissented, joined by Justice C. Johnson.

V. The Implications of *Freeman*

As an initial matter, only Justices Madsen, Fairhurst, and C. Johnson from *Okeson I* are still on the Court, with both Madsen and Fairhurst part of the *Freeman* majority. This is an important part of any potential challenge to implementation of SHB 2382 in that the current majority – including those part of the *Okeson* majority – have concluded that, so long as a restricted fund is repaid, and a specific parcel is "not presently needed" for the purposes associated with its original purchase/construction, consideration need only be repaying the fund.

The Constitutional requirement that MVF funds only be used for the purposes of building and maintaining highways is similar to the statutory requirement that ratepayer dollars only be used for purchasing and maintaining properties and facilities necessary to provide the utility service. This is why I do not believe that disposition of utility properties below original purchase price would be legal. Such a move could trigger *Okeson I* limitations around how ratepayer funds are spent with respect to original purchase of the parcel (with the understanding that any improvements would have been made for the purposes of providing the service, and are unlikely to be what is actually being purchased at disposition).

The Legislature has granted express authority for the utility to dispose of property that is "no longer needed" for the purposes of affordable housing. In consideration of the implied need to "make whole" a limited-use fund which purchased any real property, along with the makeup of the Court (three of the five justices in *Okeson III* are no longer on the Court, and of the two who are – Fairhurst and C. Johnson – one joined the majority in *Freeman*), implementing that express authority, but going no lower than the original amount paid by ratepayers for a parcel of property purchased for the purposes of providing a utility service, would likely satisfy the test in *Okeson III*, and the limitations likely applicable contemplated for the MVF in *Freeman*.

VI. Our Proposals

Our set of bills would allow for the transfer of surplus properties for below fair market value, all of the way down to original cost with respect to utility properties. In addition, combined with existing authority granted to Office of Housing (OH), a transfer to OH could theoretically occur for OH to hold the parcel pending ability to transfer for development, or SCL could lease the air rights for below-market value, maintaining ownership of the parcel itself.

In this instance, the *Covell* factors **do not apply**, in that there isn't a special rate increase for the purchase of properties – these are existing properties purchased lawfully with ratepayer dollars to provide a service that are no longer needed to provide that service. *Okeson I* and *II* & *Lane* are **not applicable** insofar as, again, there is not the collection of rates to pay for these parcels, rather they are being purchased from the utility once they are no longer needed.

Okeson III requires that there be **express legislative authority** for certain actions involving utilities; here, that express authority has been granted by the Legislature.

Finally, *Freeman* suggests, as persuasive authority, that where a distinct and restricted fund has been used that is limited in how it can be spent to purchase or create a property – the MVF in that instance – so long as that specific fund is replenished when a property is transferred, with express legislative authority to make that type of transfer, then it comports with the constitution (in that instance), which I believe would extend the statutory framework around utilities, while not necessarily triggering the constitutional taxation question that was raised in *Okeson I*.

VII. Conclusion

It is my opinion that *Okeson I, II,* and *Lane* are not on point with the specific legislation being considered by Council. Rather, *Okeson III*'s test must be satisfied (express permission) for our legislation to be legal. SHB 2382 is crystal clear in that it provides the express permission to engage in disposition below fair market value, down to $0.00, so long as it is for the purposes of production of affordable housing for households below 80% Area Median Income.

Freeman presents a cautionary tale, suggesting that "making whole" the fund which purchased the original parcel would be required, and that, absent that payment, *Okeson I* may be triggered for any funds not repaid on the original real property purchase price. This should be considered if these policies are adopted at the time of any ordinance allowing a transfer for SCL properties.