Tax Increment Financing Project Analysis Review

– City of Federal Way –

October 12, 2023

Office of the Treasurer
State of Washington
Mike Pellicciotti

OFFICE OF THE TREASURER
STATE OF WASHINGTON
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Steve Groom, Finance Director
City of Federal Way
33325 8th Avenue South
Federal Way, WA 98003

Dear Mr. Groom:

This letter confirms the Office of the State Treasurer's ("OST") receipt and review of the City of Federal Way's (the "City") tax increment financing ("TIF") Project Analysis provided on July 19, 2023. OST and Montague DeRose and Associates, the state's municipal advisor, have reviewed the provided material. Based on our review, which is detailed in the sections to follow, we believe the City's Project Analysis generally addresses the topics listed in section 020(2) of RCW 39.114 (the "TIF Statute").

Please note, this review is based on the information, projections, and assumptions provided by the City and its consultants in the Project Analysis. OST has not independently verified the data or its accuracy or performed any feasibility analyses or projections of its own.

Executive Summary

According to the City, its downtown area, or "City Center," does not currently present an identifiable sense of an urban center. To improve this, the City is taking steps to transform its City Center into a walkable downtown and destination for the community. The City built the Performing Arts & Entertainment Center and the Town Square Park as initial cornerstone elements to the City Center. Additionally, a Sound Transit light rail station is scheduled to open in 2026, which will allow residents, employees, and visitors greater transit access to/from the City Center. The City's proposed tax increment area (the "TIA") will include 215 acres surrounding these three community improvements and will be generally bordered by I-5 to the east, South 312th Street to the north, Highway 99 to the west, and South 330th Street to the south.

The Project Analysis identifies a set of public improvement projects estimated to cost between $72 million and $170 million in total (2023 dollars). The City plans to fund these projects directly with tax increment revenues collected over time or in the near-term from the issuance of bonds to be repaid with tax increment revenues. The City specifically identified two high-priority projects requiring funding early in the life of the TIA in order to facilitate the Phase 1 development of a planned mixed-use development: a civic plaza estimated to cost $6.0 million and a public parking garage estimated to cost $30.0 million. Including the developer's contribution to the public improvements, the net funding requirement for these two public improvements is equal to $30.8 million and would be partially financed from the City's issuance of Limited Tax General Obligation Bonds in late 2024.

OST’s primary goal in our statutorily mandated review of the Project Analysis is to ensure that the Project Analysis addresses the topics listed in the TIF statute and that risks to the City that might result from the implementation of the project are adequately disclosed.

Our review of the Project Analysis found potential risks worth consideration. Most notably, after the issuance of bonds, the City will be obligated to pay any deficiency between tax increment revenues and debt service. The City anticipates issuing $29.6 million of tax-exempt bonds to finance the $30.8 million of Public Improvements at a true interest cost of 4.67%. In the Baseline Development Scenario, the City projects twelve years of annual deficiencies between tax increment revenues and debt service, averaging $1.0 million per year, resulting in an accumulated deficit of $12.1 million by 2036. The City expects to draw from general revenues and reserves to fund these annual shortfalls through 2036, and then reimburse itself over nine years from 2037-2045, when annual tax increment revenues are projected to exceed annual debt service.

Certain other factors, including the following, could negatively impact tax increment revenues, potentially causing them to be inadequate to fully reimburse the City for funds advanced to pay debt service on the Bonds: (1) increases in the cost of the Public Improvements; (2) delayed or less than expected private development within the TIA; (3) lower-than-expected future assessed values within the TIA; and, (4) higher than expected borrowing cost for the bonds issued to finance the Public Improvements.

Because of the project’s potential cost to the City’s general fund, it is essential that decision makers understand and accept the project’s risks and potential long-term costs in comparison to its benefits.

Statutory Role and Purpose of Review

As enacted by the 2021 Washington State Legislature, section RCW 39.114.020(7)(b) requires that prior to the adoption of an ordinance authorizing the creation of a TIA, the local government proposing the TIA must provide a project analysis to OST for review. OST must complete the review within 90 days of receipt of the project analysis. Upon completing the review, OST must promptly provide to the local government any comments regarding suggested revisions or enhancements to the project analysis that OST deems appropriate. OST received the City’s Project Analysis (dated July 18, 2023) on July 19, 2023.

Project Team

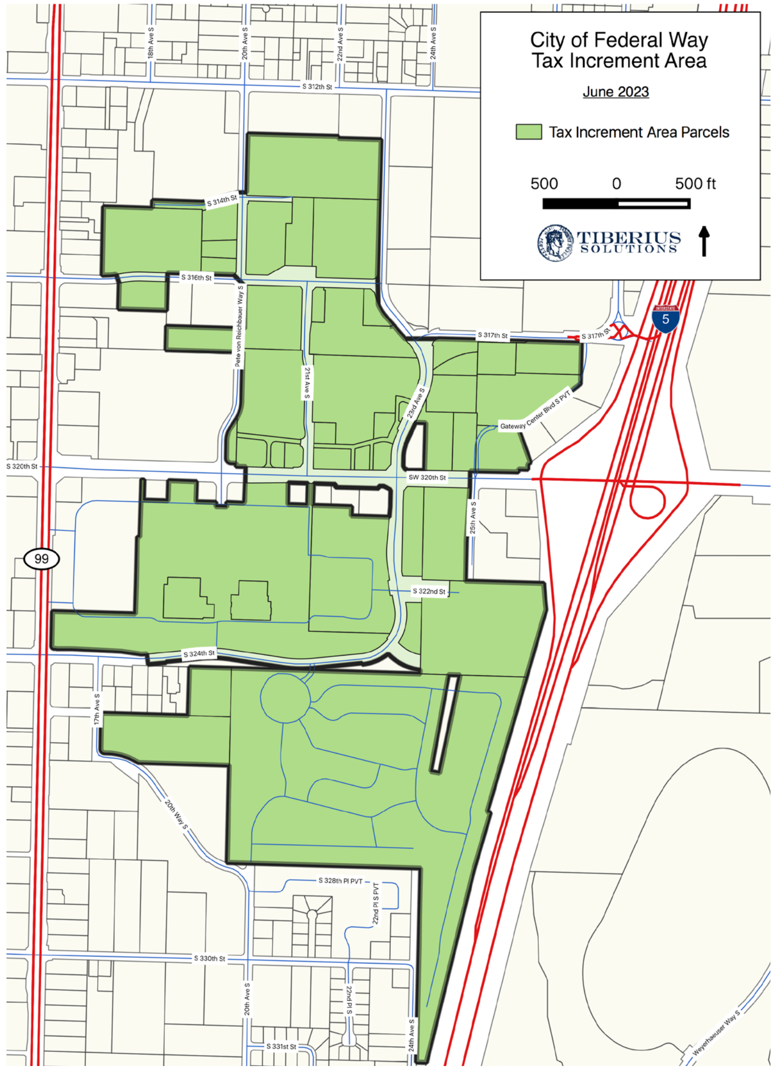
Jurisdiction: City of Federal Way	**County:** King County
Project Title: City Center TIA	**Development Areas:** The TIA boundary includes 215 acres and is generally bordered by I-5 to the east, South 312th Street to the north, Highway 99 to the west, and South 330th Street to the south.
City of Federal Way: Steve Groom, Finance Director	**Consultants:** Tiberius Solutions LLC Nick Popenuk, Principal PFM Financial Advisors LLC Duncan Brown, Director Matt Schoenfeld, Sr. Managing Director Foster Garvey PC Bill Tonkin

Proposed Tax Increment Area

Federal Way's TIA will include 215 acres and is generally bordered by I-5 to the east, South 312th Street to the north, Highway 99 to the west, and South 330th Street to the south. The City's downtown, or "City Center," does not currently present an identifiable sense of an urban center. To improve this, the City is taking steps to transform its City Center into a walkable downtown and destination for the community. The City built the Performing Arts & Entertainment Center and the Town Square Park as initial cornerstone elements aimed at defining the City Center neighborhood. A Sound Transit light rail station opening in 2026 will allow residents, employees, and visitors greater transit access to/from the City Center. Figure 1 below shows the boundary map for the TIA.

In tax year 2023, the 58 tax lots within the TIA had total taxable assessed value of approximately $195.8 million, compared to a total market value of $267.3 million. All parcels in the TIA are zoned City Center Core, City Center-Frame, Community Business, or Multi-Family Residential with respective 53%, 14%, 4% and 29% shares of the total 215 acres. Of the $195.8 million of total taxable assessed value, 62% is from the City Center Core parcels, 15% is from the City Center-Frame parcels, 2% is from the Community Business parcels and 21% from the Multi-Family Residential parcel.

Figure 1 – Map of the City Center TIA



Source: City of Federal Way

There are 17 taxing districts whose property tax levy would be directly impacted by TIA. These districts are: (1) County-wide regular levy (non-voted), (2) AFIS (Fingerprint ID) Lid Lift, (3) Parks Lid Lift, (4) Human Srvs/Vets Lid Lift, (5) Children/Family Justice Ctr. Lid Lift, (6) Best Start for Kids Lid Lift, (7) Radio Communications Lid Lift, (8) County-wide Transport levy, (9) County Cons. Futures, (10) County Flood Zone, (11) County Ferry District, (12) Port General Fund, (13) EMS (voted), (14) Sound Transit, (15) City General Fund, (16) Library General Fund and (17) Fire 39 General Fund. The levy rate for each of these jurisdictions will be applied to the increased assessed valuation within the TIA and remitted to the City to pay debt service on the bonds.

Project Description

Public Improvements within the TIA

The Project Analysis identifies numerous public improvement projects related to public parking, recreation, mobility, community building, public safety, and placemaking which are estimated to cost between $72 million and $170 million in total (2023 dollars). The City plans to fund these projects directly with tax increment revenues collected over time or in the near-term from the issuance of bonds to be repaid with tax increment revenues.

The City specifically identified a civic plaza estimated to cost $6.0 million and a public parking garage estimated to cost $30.0 million as two high-priority projects requiring funding early in the life of the TIA to facilitate the Phase 1 development of the One Trent project (an apartment and condominium development).. The City's Project Analysis assumes One Trent will pay the City $10.0 million to acquire the City-owned Town Center property located within the TIA, with $4.8 million of the $10.0 million being used to repay an interfund loan on the property. The net funding requirement for these two public improvements of $30.8 million would be financed from the City's issuance of Bonds in late 2024.

Private Development within the TIA

There are currently no projects in the TIA under construction or with approved permits for construction. The City-owned property within the boundary is anticipated to be the site best situated for new private construction. The City is negotiating an agreement with One Trent, a Seattle-based real estate developer, for the execution of four-phase development project on 10.6 acres of the TIA to construct apartments and condominiums with an expected taxable assessed value of $472.5 million in 2023 dollars and $923.7 million in nominal dollars. Table 1, as prepared by the City, shows the expected phasing of the One Trent Development Plan from 2027 through 2032. The

City's tax increment revenue projections anticipate that One Trent will apply for the City's Multifamily Tax Exemption (MFTE) exempting new construction projects located in designated areas with at least 16 multifamily units from property taxes for an eight-year period. For phases 1, 2, and 3 of the development, over 95% of total taxable value is assumed to be eligible for the MFTE exemption, with phase 4 assumed to be not MFTE eligible.

Table 1 – One Trent Development Plan (in $ 2023)

Phase	Development Type	Completion Year	Taxable Value of Development (2023 $)	MFTE-Eligible Value	Non MFTE-Eligible Value
Phase 1	Apartments	2027	$ 179,827,337	$ 172,312,858	$ 7,514,479
Phase 2	Apartments	2028	$ 110,900,540	$ 107,920,895	$ 2,979,645
Phase 3	Apartments	2030	$ 118,393,420	$ 115,507,471	$ 2,885,949
Phase 4	Condos	2032	$ 63,355,171	$ -	$ 63,355,171
Total			**$ 472,476,468**	**$ 395,741,224**	**$ 76,735,244**

Source: City of Federal Way

A market analysis identified speculative development opportunities for properties located in the TIA but not associated with One Trent. These potential developments are expected to occur in the TIA after construction begins on One Trent and the bond-financed civic plaza and public parking garage. Of the 9.4 million square feet of potentially developable properties in the TIA, the market analysis estimated 17% would experience new development over the 25-year forecast period, resulting in a total of 5,300 new housing units with $1.6 billion in speculative new taxable assessed value (2023 dollars). The analysis assumed that 80% of new value would be multifamily properties, with 100% of this value eligible for the 8-year MFTE, reducing the taxable assessed value from $1.6 billion to $1.2 billion. Table 2, as prepared by the City, forecasts the baseline scenario of private development projected to occur in the TIA both from One Trent and speculative development.

Table 2 – Projected Increased Real Property in the TIA (in $ 2023)
Baseline Development Scenario

Year on Tax Roll	OneTrent Development	Speculative Development
2028	$ -	$ 14,819,826
2029	$ 7,514,479	$ 14,819,826
2030	$ 2,979,645	$ 14,819,826
2031	$ -	$ 14,819,826
2032	$ 2,885,949	$ 14,819,826
2033	$ -	$ 14,819,826
2034	$ 63,355,171	$ 14,819,826
2035	$ -	$ 14,819,826
2036	$ -	$ 74,099,129
2037	$ 172,312,858	$ 74,099,129
2038	$ 107,920,895	$ 74,099,129
2039	$ -	$ 74,099,129
2040	$ 115,507,471	$ 74,099,129
2041	$ -	$ 74,099,129
2042	$ -	$ 74,099,129
2043	$ -	$ 74,099,129
2044	$ -	$ 74,099,129
2045	$ -	$ 74,099,129
2046	$ -	$ 74,099,129
2047	$ -	$ 74,099,129
2048	$ -	$ 74,099,129
2049	$ -	$ 74,099,129
Total	**$ 472,476,468**	**$ 1,155,946,409**

Source: City of Federal Way

In its Project Analysis, the City prepared an Alternate Development Scenario which retains the anticipated taxable value of the One Trent project but excludes all speculative development. In the Alternate Development Scenario, the City issues bonds only to finance the $6.0 million cost of the civic plaza, not the $24.8 million cost of the public parking garage, as existing surface parking capacity is deemed adequate to support the One Trent development.

Assessed Value of the TIA

The assessed valuation of the TIA for the 2023 tax year is approximately $195.8 million, below both statutory limits of $200 million in assessed valuation and 20% of the City's total assessed valuation of $17.3 billion ($3.5 billion). The TIA's 2023 assessed value represents 1.1% of the City's total assessed valuation.

The magnitude and timing of real property development in the TIA will drive growth in incremental assessed value and therefore tax increment revenues. For the two development scenarios provided by the City, the incremental taxable assessed value of the TIA is estimated by assigning market-based improvement prices reflecting the land use, size of the proposed development and the City's Multifamily Tax Exemption. The City assumed the TIA base value and the assessed values of newly developed properties both increase by 5.1% annually. This assumption uses long-term historical trends for per-capita personal income growth for King County as the basis for forecasting appreciation of existing assessed values and employs forecasts of population growth as the basis for projecting the increase in assessed value from new construction.

Tax Increment Revenue Projections

The TIA is expected to take effect on June 1, 2024, and 2025 will be the first year that the TIA will receive tax increment revenues. The term of the TIA is assumed at 25 years (the maximum allowed) with 2049 as the final year the TIA will receive tax increment revenues. The City estimated the 2024 tax increment base assessed value at $205.8 million and prepared the Baseline Development Scenario with $6.2 billion of additional assessed value added to the TIA between 2025 and 2049 through new construction and appreciation. Under the Baseline Development Scenario, $68.9 million of tax increment revenues are projected to be collected over the 25-year term of the TIA. See Table 3 – Tax Allocation Revenues of the TIA (Baseline Development Scenario).

Table 3 – Tax Allocation Revenues of the TIA (Nominal $)
Baseline Development Scenario

Tax	Assessed Value				Tax Allocation
Year	Total	Base Value	Increment	Levy Rate	Revenues
2023	$ 195,802,900	$ -	$ -	$ -	$ -
2024	$ 205,788,848	$ 205,788,848	$ -	$ -	$ -
2025	$ 216,284,079	$ 205,788,848	$ 10,495,231	$ 3.290400	$ 34,533
2026	$ 227,314,567	$ 205,788,848	$ 21,525,719	$ 3.012200	$ 64,839
2027	$ 238,907,610	$ 205,788,848	$ 33,118,762	$ 2.895700	$ 95,901
2028	$ 269,174,210	$ 205,788,848	$ 63,385,362	$ 2.651100	$ 168,039
2029	$ 311,542,953	$ 205,788,848	$ 105,754,105	$ 2.548600	$ 269,522
2030	$ 351,421,265	$ 205,788,848	$ 145,632,417	$ 2.450100	$ 356,808
2031	$ 390,336,150	$ 205,788,848	$ 184,547,302	$ 2.355300	$ 434,672
2032	$ 436,602,762	$ 205,788,848	$ 230,813,914	$ 2.264200	$ 522,608
2033	$ 482,057,730	$ 205,788,848	$ 276,268,882	$ 2.176600	$ 601,321
2034	$ 635,199,468	$ 205,788,848	$ 429,410,620	$ 2.092300	$ 898,476
2035	$ 693,208,380	$ 205,788,848	$ 487,419,532	$ 2.011500	$ 980,454
2036	$ 863,162,204	$ 205,788,848	$ 657,373,356	$ 1.933700	$ 1,271,146
2037	$ 1,377,615,782	$ 205,788,848	$ 1,171,826,934	$ 1.859000	$ 2,178,386
2038	$ 1,813,096,405	$ 205,788,848	$ 1,607,307,557	$ 1.787500	$ 2,873,039
2039	$ 2,061,826,488	$ 205,788,848	$ 1,856,037,640	$ 1.718600	$ 3,189,718
2040	$ 2,587,219,174	$ 205,788,848	$ 2,381,430,326	$ 1.652100	$ 3,934,363
2041	$ 2,891,774,698	$ 205,788,848	$ 2,685,985,850	$ 1.588400	$ 4,266,440
2042	$ 3,220,665,528	$ 205,788,848	$ 3,014,876,680	$ 1.527000	$ 4,603,647
2043	$ 3,575,581,717	$ 205,788,848	$ 3,369,792,869	$ 1.467900	$ 4,946,590
2044	$ 3,958,322,406	$ 205,788,848	$ 3,752,533,558	$ 1.411100	$ 5,295,382
2045	$ 4,370,802,557	$ 205,788,848	$ 4,165,013,709	$ 1.356600	$ 5,650,136
2046	$ 4,815,060,087	$ 205,788,848	$ 4,609,271,239	$ 1.304100	$ 6,010,966
2047	$ 5,293,263,427	$ 205,788,848	$ 5,087,474,579	$ 1.253700	$ 6,377,987
2048	$ 5,807,719,537	$ 205,788,848	$ 5,601,930,689	$ 1.205200	$ 6,751,314
2049	$ 6,360,882,392	$ 205,788,848	$ 6,155,093,544	$ 1.158500	$ 7,130,790
Total					**$ 68,907,079**

Source: City of Federal Way

As noted above, the City prepared an Alternate Development Scenario which retains the anticipated taxable value of the One Trent development but excludes all speculative development. With the Alternate

Development Scenario, $2.2 billion of assessed value is added to the TIA between 2025 and 2049 through new construction and appreciation. Under the Alternate Development Scenario, $30.9 million of tax increment revenues are projected to be collected over the TIA term. See Table 4 – Tax Allocation Revenues of the TIA (Alternate Development Scenario).

Table 4 – Tax Allocation Revenues of the TIA (Nominal $)
Alternate Development Scenario

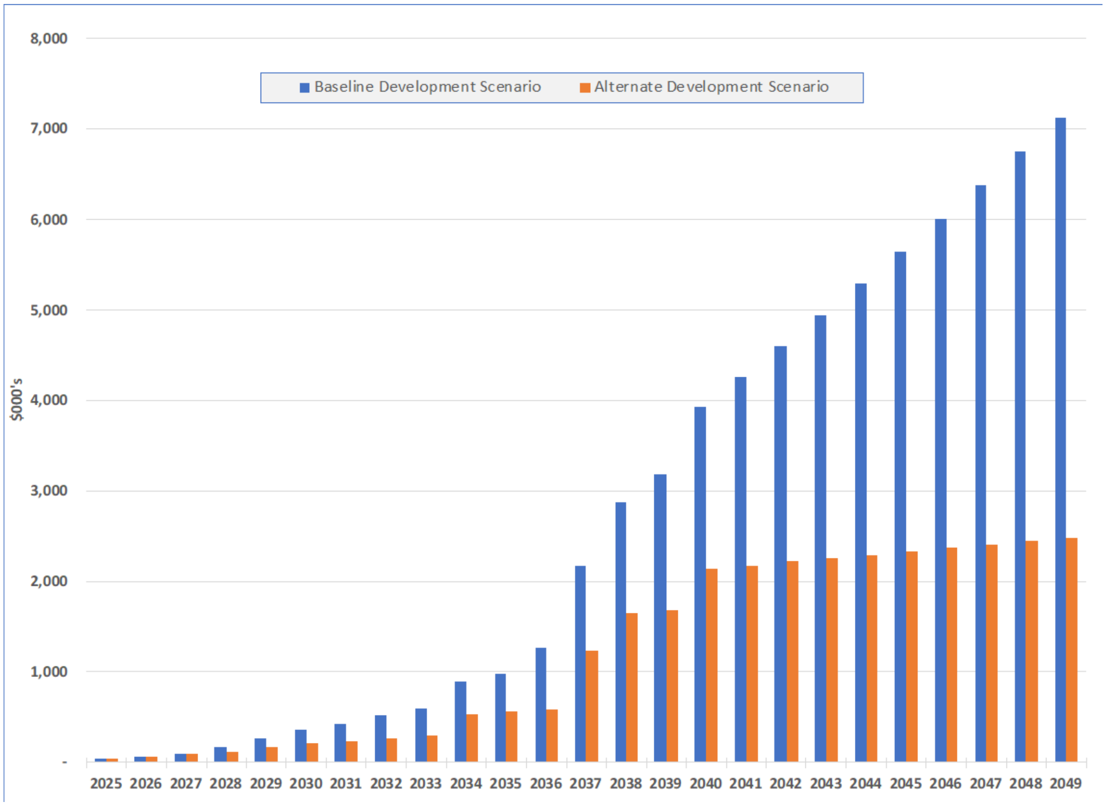
Tax Year	Assessed Value Total	Assessed Value Base Value	Assessed Value Increment	Levy Rate	Tax Allocation Revenues
2023	$ 195,802,900			$ 3.730590	$ -
2024	$ 205,788,848	$ 205,788,848		$ 3.487226	$ -
2025	$ 216,284,079	$ 205,788,848	$ 10,495,231	$ 3.290391	$ 34,533
2026	$ 227,314,567	$ 205,788,848	$ 21,525,719	$ 3.012184	$ 64,839
2027	$ 238,907,610	$ 205,788,848	$ 33,118,762	$ 2.895675	$ 95,901
2028	$ 251,091,898	$ 205,788,848	$ 45,303,050	$ 2.651069	$ 120,102
2029	$ 273,533,933	$ 205,788,848	$ 67,745,085	$ 2.548528	$ 172,650
2030	$ 291,500,045	$ 205,788,848	$ 85,711,197	$ 2.449975	$ 209,990
2031	$ 306,366,547	$ 205,788,848	$ 100,577,699	$ 2.355220	$ 236,883
2032	$ 326,287,697	$ 205,788,848	$ 120,498,849	$ 2.264036	$ 272,814
2033	$ 342,928,370	$ 205,788,848	$ 137,139,522	$ 2.176389	$ 298,469
2034	$ 464,603,684	$ 205,788,848	$ 258,814,836	$ 2.092129	$ 541,474
2035	$ 488,298,472	$ 205,788,848	$ 282,509,624	$ 2.011276	$ 568,205
2036	$ 513,201,694	$ 205,788,848	$ 307,412,846	$ 1.933408	$ 594,354
2037	$ 868,342,479	$ 205,788,848	$ 662,553,631	$ 1.858555	$ 1,231,392
2038	$ 1,129,170,653	$ 205,788,848	$ 923,381,805	$ 1.786943	$ 1,650,030
2039	$ 1,186,758,356	$ 205,788,848	$ 980,969,508	$ 1.717900	$ 1,685,207
2040	$ 1,503,291,030	$ 205,788,848	$ 1,297,502,182	$ 1.651328	$ 2,142,601
2041	$ 1,579,958,873	$ 205,788,848	$ 1,374,170,025	$ 1.587535	$ 2,181,543
2042	$ 1,660,536,776	$ 205,788,848	$ 1,454,747,928	$ 1.526015	$ 2,219,967
2043	$ 1,745,224,151	$ 205,788,848	$ 1,539,435,303	$ 1.466879	$ 2,258,165
2044	$ 1,834,230,583	$ 205,788,848	$ 1,628,441,735	$ 1.410034	$ 2,296,158
2045	$ 1,927,776,343	$ 205,788,848	$ 1,721,987,495	$ 1.355392	$ 2,333,968
2046	$ 2,026,092,936	$ 205,788,848	$ 1,820,304,088	$ 1.302868	$ 2,371,615
2047	$ 2,129,423,675	$ 205,788,848	$ 1,923,634,827	$ 1.252379	$ 2,409,119
2048	$ 2,238,024,283	$ 205,788,848	$ 2,032,235,435	$ 1.203846	$ 2,446,499
2049	$ 2,352,163,521	$ 205,788,848	$ 2,146,374,673	$ 1.157151	$ 2,483,679
Total					**$ 30,920,161**

Source: City of Federal Way

Under the TIF Statute, only certain regular tax levies are available to the TIA. The taxes applied with regular levies must conform with the constitutional 1% limit as well as the $5.90 aggregate limits. Both parts of the State School levy, local school district excess levies, voted bond levies, and levies of port districts for bond payments are excluded from the TIA levy rate. The TIA's annual levy rate may change from one year to the next based on factors including future incremental assessed value of the TIA, future assessed values of the taxing districts, and relevant levy limits. For the two development scenarios, the City's analysis calculated the levy rate for each of these jurisdictions and applied the levy rates to the incremental assessed valuation within the TIA.

The City created a multi-year cash flow model to estimate the annual tax increment revenues for the two development scenarios; Figure 2 below provides a visual comparison. Collection of tax increment revenues is projected for the 2025-2049 period, with total revenues for the Baseline Development and Alternate Development scenarios at $68.9 million and $30.9 million, respectively. The total tax increment revenues of the Alternate Development Scenario are equivalent to 45% of the total for the Baseline Development Scenario.

Figure 2 – Projected Tax Increment Revenues
Baseline and Alternate Development Scenarios



Source: City of Federal Way

Financing Plan for Public Improvements

As stated in the Project Analysis, because of their general obligation pledge, the City will be required to pay the full debt service due on the Bonds from available resources, regardless of the amount of tax increment revenues generated within the TIA. The City acknowledged that tax increment revenues early in the life of the TIA are projected to be insufficient to fully cover debt service payments in both development scenarios.

In the Baseline Development Scenario, the City anticipates issuing $29.6 million of tax-exempt bonds in December 2024 to finance the $30.8 million of Public Improvements. The City's structure for the bonds assumes interest rates as of July 12, 2023, plus a 0.50% cushion, resulting in a true interest cost of 4.67%. In this scenario, total principal and interest is projected to be $62.0 million. The City plans to structure its bonds with interest-only payments from 2025 through 2039 to better align debt service payments with anticipated tax increment revenues, and to minimize the amount of general fund resources that the City will need to use to pay debt service in full each year. From 2040 through 2049, annual debt service payments are projected to escalate from $2.4 million to $5.6 million.

In the Baseline Development Scenario, the City projects twelve years of annual deficiencies between tax increment revenues and debt service, averaging $1.0 million per year, resulting in an accumulated deficit of $12.1 million by 2036. The City expects to draw from general revenues and reserves to fund these annual shortfalls through 2036, then reimburse itself over nine years from 2037-2045, when annual tax increment revenues are projected to exceed annual debt service by $6.9 million. The City indicated it may apply the $6.9 million surplus to fund additional public improvement projects within the TIA.

Regarding the City's projected annual shortages between tax increment revenues and debt service costs, the Project Analysis notes: (1) the City maintains reserve fund balances in 14 funds in addition to its general fund; (2) the City's current fund balance policy requires transferring the subsequent year's debt service payment into the debt service fund during the current year; and (3) the City has a separate Strategic Reserve Fund of $3 million to accommodate unexpected operational changes, legislative impacts, or other economic events affecting the City's operations which could not have been reasonably anticipated at the time of budget preparation.

In the Alternate Development Scenario, the City reduces its bond issuance to $6.0 million to finance the cost of the civic plaza (roughly 19.5% of the $30.8 million), excluding the $24.8 million cost of the public parking garage. This approach would allow the City to retain flexibility to adjust the amount of debt to better reflect the amount of actual development during the first few years of the TIA. In our cash flow analysis, we applied the 19.5% share to the Baseline Development Scenario's $62.0 million in total debt service, maintaining the same amortization structure as the larger bond issue. The total amount of principal and interest due under this scenario totals $12.1 million to finance the $6.0 million in civic plaza improvements.

In the Alternate Development Scenario, the City projects eight years of insufficient tax increment revenues compared to debt service, averaging $138,000 per year, resulting in an accumulated deficit of $1.1 million by 2032. The City expects to cover these annual shortfalls with City general revenues and reserves through 2032, then reimburse itself over five years from 2033-2037 as total tax increment revenues are projected to exceed total debt service by $18.8 million.

Debt Capacity

Based on the City's total 2023 assessed value of $17,270,222,086, the City has $259,053,331 in total non-voted debt capacity (1.5% of 2023 AV). The City currently has $27,983,000 in outstanding non-voted debt, leaving sufficient non-voted debt capacity of $231,070,331 before issuing the $29,630,000 of bonds described in the Baseline Development Scenario in December 2024. See Table 5 – Debt Capacity in 2023.

Table 5 – Debt Capacity in 2023

2023 Assessed Valuation	$17,270,222,086
Non-Voted Debt Capacity (1.5% of AV)	259,053,331
Less: Outstanding Non-Voted Debt	(27,983,000)
Remaining Non-Voted Debt Capacity	231,070,331
Less: Financing Proposed	(29,630,000)
Projected Remaining Non-Voted Capacity	**$201,440,331**
Projected Remaining Non-Voted Capacity %	**77.8%**

Source: City of Federal Way

Projected Debt Service Coverage

Tables 6 and 7 below summarize the total tax increment revenues, revenue shortfalls and debt service coverage for the two development scenarios.

- In the Baseline Development Scenario, the City would be required to fund a portion of the annual debt service payments from general revenues or reserves due to insufficient tax increment revenue from 2025 through 2036. Full reimbursement of the $12.1 million cumulative shortfall is projected by 2045.
- In the Alternate Development Scenario, the City would be required to fund a portion of the annual debt service payments from 2025 through 2032, with a cumulative shortfall of $1.1 million, and full reimbursement anticipated by 2037.

Table 6 – Summary of Tax Increment Revenue Shortfalls and Average Debt Service Coverage

Development Scenario	First Year Tax Increment Revenues Exceed TIF Debt Service	Year That Tax Increment Revenues Fully Reimburse Debt Service Shortfalls	Total Projected Tax Increment Revenue ($MMs) [1]	Total Projected Debt Service ($MMs)	Projected Cumulative Shortfall ($MMs)	Total Surplus/ (Shortfall) ($MMs)	Aggregate Debt Service Coverage Ratio
Baseline	2037	2045	$68.907	$62.016	($12.080)	$6.892	1.11x
Alternate	2033	2037	$30.920	$12.081	($1.101)	$18.839	2.56x

1. Projected over the term of repayment of the Bonds, 2025-2049

Table 7 – Annual Tax Increment Revenue Shortfalls and Average Debt Service Coverage

	Baseline Development Scenario ($Ms)					Alternate Development Scenario ($Ms)				
Year	Tax Increment Revenues	Debt Service on Bonds	Surplus (Shortfall)	Cumlative Surplus (Shortfall)	Debt Service Coverage	Tax Increment Revenues	Debt Service on Bonds	Surplus (Shortfall)	Cumlative Surplus (Shortfall)	Debt Service Coverage
2024	0	0	0	0	--	0	0	0	0	--
2025	35	1,482	(1,447)	(1,447)	0.02x	35	289	(254)	(254)	0.12x
2026	65	1,482	(1,417)	(2,864)	0.04x	65	289	(224)	(478)	0.22x
2027	96	1,482	(1,386)	(4,249)	0.06x	96	289	(193)	(671)	0.33x
2028	168	1,482	(1,313)	(5,563)	0.11x	120	289	(169)	(839)	0.42x
2029	270	1,482	(1,212)	(6,775)	0.18x	173	289	(116)	(955)	0.60x
2030	357	1,482	(1,125)	(7,899)	0.24x	210	289	(79)	(1,034)	0.73x
2031	435	1,482	(1,047)	(8,946)	0.29x	237	289	(52)	(1,085)	0.82x
2032	523	1,482	(959)	(9,905)	0.35x	273	289	(16)	(1,101)	0.95x
2033	601	1,482	(880)	(10,785)	0.41x	298	289	10	(1,091)	1.03x
2034	898	1,482	(583)	(11,368)	0.61x	541	289	253	(838)	1.88x
2035	980	1,482	(501)	(11,869)	0.66x	568	289	280	(559)	1.97x
2036	1,271	1,482	(210)	(12,080)	0.86x	594	289	306	(253)	2.06x
2037	2,178	1,482	697	(11,383)	1.47x	1,231	289	943	690	4.27x
2038	2,873	1,482	1,392	(9,991)	1.94x	1,650	289	1,361	2,051	5.72x
2039	3,190	1,482	1,708	(8,283)	2.15x	1,685	289	1,397	3,448	5.84x
2040	3,934	2,417	1,518	(6,765)	1.63x	2,143	471	1,672	5,120	4.55x
2041	4,266	2,750	1,517	(5,248)	1.55x	2,182	536	1,646	6,766	4.07x
2042	4,604	3,089	1,515	(3,734)	1.49x	2,220	602	1,618	8,384	3.69x
2043	4,947	3,428	1,519	(2,215)	1.44x	2,258	668	1,590	9,974	3.38x
2044	5,295	3,781	1,515	(701)	1.40x	2,296	737	1,560	11,534	3.12x
2045	5,650	4,131	1,520	819	1.37x	2,334	805	1,529	13,063	2.90x
2046	6,011	4,491	1,520	2,339	1.34x	2,372	875	1,497	14,560	2.71x
2047	6,378	4,861	1,517	3,855	1.31x	2,409	947	1,462	16,022	2.54x
2048	6,751	5,234	1,518	5,373	1.29x	2,446	1,020	1,427	17,449	2.40x
2049	7,131	5,612	1,519	6,892	1.27x	2,484	1,093	1,390	18,839	2.27x
Total	68,907	62,016	6,892			30,920	12,081	18,839		

Key Risks to the City

From our review of the Project Analysis, it appears that the anticipated Public Improvements and economic development will provide significant benefit to the City. Nonetheless, the financial plan comes with certain risks and costs to the City, primarily related to the projected annual tax increment revenues being insufficient to fully pay the debt service due on the bonds the City plans to issue to finance a portion of the Public Improvements, especially in the early years of the project.

During years with revenue shortfalls, the City will be required to pay any difference between the debt service due and tax increment revenues collected using general City resources. While the City plans to reimburse itself for debt service payments made from general City revenues and reserves, it is important for decision makers to be aware of the potential magnitude and timing of such payments and reimbursements. Since the TIF legislation limits the ability to collect tax increment revenues to a period of not more than 25 years, delays could reduce the City's ability to fully reimburse itself from tax increment revenues. Additional factors that could impact the amount of tax increment revenues collected are described below:

> *Escalation of Project Costs:* With the Public Improvements projected to be completed over a number of years, inflation could have a significant impact on the final cost. The City did not disclose if a construction cost inflator was included in its cost range for the Public Improvements.
>
> *Economic Conditions*: Growth in the TIA's assessed value could be negatively impacted by a downturn in the economy. A variety of economic factors could negatively impact the timeline and ultimate demand for development, jeopardizing the rate and scale of private development, potentially reducing tax increment revenues.
>
> *Permits*: Unforeseen delays in permits could negatively impact the construction of private developments within the TIA. Such delays could negatively impact the timing and/or amount of tax increment revenues generated by the TIA.
>
> *Construction Delays*: Any delay in the construction timelines of the private development projects could reduce the amount of tax increment revenues produced by the TIA. Similarly, any delay by the City in completing the planned Public Improvements could delay private developers' abilities to complete their private developments, potentially reducing the amount of tax increment revenues.
>
> *Assessed Valuations*: As private developments are completed, tax increment revenues may be lower than projected if the assessed values of the projects are lower than expected or take more time to be reflected on the county's tax rolls than expected.
>
> *Interest Rate Risk*: The City is exposed to interest rate risk until its bonds are sold. The Project Analysis assumes interest rates as of July 12 plus a 0.50% cushion, resulting in a true interest cost of 4.67%. However, between July 12 and September 25, tax-exempt interest rates rose by an average of 0.60% in the 2025-2049 maturity range expected for repayment of the bonds. The current borrowing cost for the bonds is higher than the 4.67% true interest cost assumed in the Project Analysis.

Risk Summary: The general impact to the City from any of the risk factors outlined above could be lower than projected tax increment revenues and a greater than expected reliance on the City's general revenues and reserves to pay the debt service due on the bonds issued to fund the Public Improvements in the TIA. If tax increment revenues are lower than expected, it will force the City to apply more of its available funds towards repayment of the bonds, reducing the City's ability to allocate those funds to other projects or operations.

Recommendations

To help ensure the financial success of the project and to minimize unanticipated costs, we recommend the City consider the following measures:

1. Prior to approving the TIA, we recommend that the City discuss and establish a policy regarding how much debt service it is willing to pay from City general revenues and reserves on an annual basis to offset years of tax increment revenue shortfalls.

2. We recommend that the City conservatively budget for and set funds aside to cover any projected tax increment revenue shortfalls.

3. Prior to approving the TIA, we recommend that the City coordinate closely with other taxing districts impacted by the project, and the County Assessor's Office, to ensure that all parties have an accurate understanding of how the TIA will impact them, and to provide sufficient time to work through any concerns.

4. As the project moves forward, we recommend that the City coordinate closely with the County Assessor's Office to help ensure that the tax increment revenue projections match the County's assessment process and are as accurate as possible.

5. The City's interest rate assumptions for its planned 2024 Bond issuance are below current tax-exempt interest rates. We recommend that the City consider using more conservative interest rate assumptions.

6. We recommend the City revisit public improvement cost projections frequently and utilize a publicly recognized inflation index to inform inflation projections.

Thank you for the opportunity to review the City's Project Analysis. Based upon the information provided to date in connection with this project, this concludes our review. If there are material changes in the scope, timing, or cost of the project, please let us know. We wish the City all the best with the project.

Respectfully,

Mike Pellicciotti
Washington State Treasurer

Jason Richter
Deputy Treasurer