

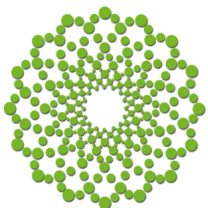


# FUNDING BUILDING DECARBONIZATION

POLICY OPTIONS FOR LOCAL GOVERNMENTS IN OREGON

by Cole Souder and Danny Noonan  
*with contributions from Amy Schlusser*

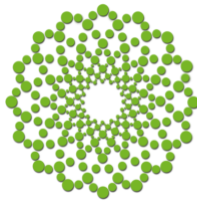
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## **Funding Building Decarbonization: Policy Options for Local Governments in Oregon**

Oregon cities wanting to do their part to combat climate change and deliver more affordable housing for their citizens need to look no further than their residents' usage of natural gas. Natural gas usage in residential, commercial, and industrial buildings contributes significant emissions to the atmosphere through combustion, which releases carbon dioxide, and leakage, which releases methane, a greenhouse gas over eighty times more powerful than carbon dioxide at trapping heat. In Oregon, and throughout the country, switching from gas to electric appliances reduces greenhouse gas emissions from the day of installation to the day of retirement.<sup>1</sup> Through an array of policy options working independently or in tandem, local governments can curb natural gas usage within their jurisdiction while generating funds for governmental decarbonization programs.

Oregon's local governments generally have broad authority to raise revenue through taxes and fees via their home rule powers. Unless otherwise limited by state or federal law, Oregon's local governments have authority to collect taxes and fees pursuant to the powers and authorities granted through their municipal charters. Oregon counties governed by home rule charters typically have broader authority to issue taxes and fees than counties that have not adopted home rule charters. Counties that are not governed by home rule charters must generally obtain voter approval to enact new taxes, and cities must get voter approval to increase taxes in certain circumstances.<sup>2</sup> Unless otherwise limited by their home rule charters, municipalities have authority to collect revenue through a variety of taxes, such as property taxes, income taxes, sales taxes, and privilege taxes. Municipalities also generally have authority to impose a variety of fees on individuals and businesses, such as service fees, license fees, permit fees, and franchise fees. Local governments may also collect revenue from excises or surcharges on privileges, activities, equipment, or services.<sup>3</sup>

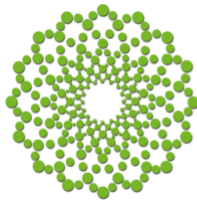
The policy options that follow fall into two broad categories: **revenue-generators** and **choice-modifiers**. Revenue-generators provide cities with funds to support the creation of a program or programs with far-reaching decarbonization goals. These policies could generate millions, if not tens of millions, of dollars for the purpose of decarbonizing residential and commercial spaces. Choice-modifiers change the economics between gas and electric appliances. By changing the comparative costs in favor of electrification, decarbonization goals can be achieved on an individual level as marginally more consumers choose to electrify their homes and businesses.

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<sup>1</sup> Lacey Tan and Jack Teener, "Now Is the Time to Go All In on Heat Pumps," RMI, (Jul. 6, 2023), available at: <https://rmi.org/now-is-the-time-to-go-all-in-on-heat-pumps/> (showing that, on average, replacing gas furnaces with electric heat pumps reduces space heating operational emissions in Oregon by 41 percent in year 1, and by 84 percent over the appliances 15-year lifespan).

<sup>2</sup> OR. REV. STAT. § 203.055(1); *see, e.g., id.* § 319.950 (requiring cities, counties, and other local government bodies to get voter approval to increase motor vehicle fuel taxes).

<sup>3</sup> A surcharge is a fee or tax that is added to the cost of a product or service. For example, the City of Portland levies a 1 percent Clean Energy Surcharge on large retailers in the city. City of Portland, *Clean Energy Surcharge*, <https://www.portland.gov/revenue/ces>.



These policies may also generate modest funds that could support more limited governmental decarbonization programs. Of course, the two categories are not mutually exclusive.

Each policy has its own benefits and drawbacks, legal and logistical. Some provide clear decarbonization benefits but are legally risky; others may be less effective at spurring the desired outcome in energy consumption but have few incidental downsides. Therefore, local governments should carefully design their policies to deliver meaningful decarbonization benefits in an equitable manner.

## **REVENUE-GENERATORS**

### *1. Taxes on Business Income*

In 2018, Portland passed the Portland Clean Energy Community Benefits Initiative, creating the Portland Clean Energy Fund (PCEF). In order to provide a long-term funding source for climate action projects, a “Clean Energy Surcharge” is imposed on businesses with more than \$1 billion in total retail sales (also known as “gross income” “gross revenue” or “gross receipts”) nationally and more than \$500,000 of retail sales in Portland.<sup>4</sup> Those “Large Retailers” pay a one percent surcharge on retail gross revenue within the city’s limits.<sup>5</sup> Sales of groceries, medicine, health care, and other services are exempt.<sup>6</sup> Funds raised are then used for grants supporting one of six types of project that support renewable energy, energy efficiency, and the reduction of greenhouse gas emissions.<sup>7</sup>

#### Taxes vs. Fees

- **Taxes**
  - Government levy imposed for the purpose of raising revenue
  - Revenues raised can be used for any governmental purpose
- **Fees**
  - Charge imposed on a person who directly benefits from a government service
  - Revenue raised generally must be used for a purpose related to the fee.
- The label a government body places on a levy is not conclusive of the nature of the levy. Courts instead look at the function of the levy to determine if it is a “tax” or a “fee.”

Automobile Club of Oregon v. State, 314 Or. 479 (1992)

The funding mechanism supporting the PCEF has been tremendously successful. The Clean Energy Surcharge has raised between \$40–60 million per year—substantially more than the forecasted \$30 million per year—and revenue has continued to increase.<sup>8</sup> PCEF’s most recent

<sup>4</sup> PORTLAND, OR. CITY CODE ch. 7.02.500(f), 7.02.100(n).

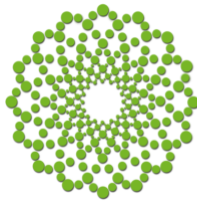
<sup>5</sup> *Id.* ch. 7.02.500(f)(2).

<sup>6</sup> *Id.* ch. 7.02.500(f)(3).

<sup>7</sup> *Id.* ch. 7.07.060. The six categories are: 1) Renewable energy and energy efficiency; 2) Climate jobs training; 3) Regenerative agriculture and green infrastructure; 4) Transportation decarbonization; 5) Organizational capacity building; and 6) Other projects that reduce or sequester greenhouse gases.

<sup>8</sup> Gosia Wozniacka, “Portland clean energy fund’s staggering windfall spurs money grab, threatens climate justice ambitions,” THE OREGONIAN (Feb. 29, 2024), available at:

<https://www.oregonlive.com/environment/2024/02/portland-clean-energy-funds-staggering-windfall-spurs-money-grab-threatens-climate-justice-ambitions.html>.



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recommended portfolio of grants in response to its 2023 Request for Proposal would fund 71 projects totaling \$91,916,334.<sup>9</sup> \$51 million would go to clean energy projects, \$12 million to transportation decarbonization, \$11.6 million for regenerative agricultural and green infrastructure, and \$10 million to workforce and contractor development.<sup>10</sup> The fund also remains extremely popular with Portland voters, with recent polling indicating two-thirds of voters feel favorable, and only 17 percent feel unfavorable, towards the PCEF.<sup>11</sup>

Citizens of Denver, Colorado approved a similar program in 2020, the Climate Protection Fund, which is supported by a .25% sales tax, generating about \$40 million a year.<sup>12</sup> Like the PCEF, the Climate Protection Fund can also be used for one of six purposes: job creation and workforce training in renewable technology; investments in renewable energy; neighborhood-based environmental and climate justice programs; adaptation and resiliency programs for communities vulnerable to climate change; programs supporting affordable, clean, and safe transportation options; and energy efficiency.<sup>13</sup>

Local governments in Oregon are now preempted from creating funding structures identical to the one Portland created for the PCEF.<sup>14</sup> HB 3427, the “Student Success Act,” institutes a state-wide tax on commercial activity and routes the funds to the Department of Education. “Commercial activity” is defined as the total amount realized in the regular course of business *without deduction for expenses*—functionally, revenues.<sup>15</sup> The law states that local governments may not impose a tax on commercial activity unless the tax was already in place in March 2019.<sup>16</sup> Indeed, during a work session on the final version of the bill, Representative Nancy Nathanson stated that “we have received a number of questions and comments on [the subject of preemption]. This bill preempts establishing only one type of tax, a commercial activity tax, and does not prohibit local government from changing or adopting other types of taxes. . . as long as commercial activity, as defined in this bill, is not the basis of the tax the tax is not preempted.”<sup>17</sup>

Because the preemption clause is written narrowly, covering only taxes on commercial activity (revenues), local governments may be able to create programs with similar, albeit lesser, revenue streams as the PCEF by taxing corporate profits instead. The preemption statute likely would not cover taxes on net income, adjusted net income, or “gross profits” (i.e., gross revenues with

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<sup>9</sup> 2024 RFP 3 Funding Recommendations, PORTLAND CLEAN ENERGY COMMUNITY BENEFITS FUND 11 (Aug. 28, 2024), available at <https://efiles.portlandoregon.gov/record/16985076>.

<sup>10</sup> *Id.*

<sup>11</sup> Kevin Hanley, “Portland Voters Are Ready to Vote Climate Leaders Into Office This November,” DATA FOR PROGRESS, (Oct. 29, 2024), available at: <https://www.dataforprogress.org/blog/2024/10/29/portland-voters-are-ready-to-vote-climate-leaders-into-office-this-november>.

<sup>12</sup> DENVER, CO. CODE OF ORDINANCES, sec. 53-56(l).

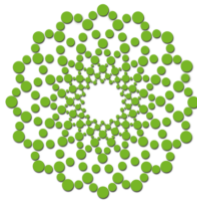
<sup>13</sup> *Id.* sec. 2-406(a).

<sup>14</sup> ORS § 317A.158(1).

<sup>15</sup> ORS § 317A.100(1)(a)(A).

<sup>16</sup> ORS § 317A.100(2).

<sup>17</sup> HB 3427 Work Session, Joint Committee on Student Success 7:02–8:29 (April 29, 2019), available at <https://olis.oregonlegislature.gov/liz/mediaplayer/?clientID=4879615486&eventID=2019041007>.



deductions for costs) because they involve deductions from revenues and therefore would not fall under the definition of “commercial activity”—the main takeaway is simply that cities cannot exactly copy Portland’s funding scheme for the PCEF. But, given that the Clean Energy Surcharge has brought in an unexpectedly large amount of money,<sup>18</sup> taxing a less bountiful source at a similar or slightly higher rate could still result in substantial funds dedicated to decarbonization efforts.

Cities will also have to determine the most effective levels at which companies become subject to the tax. Portland, for example, only subjects companies with \$1 billion in total revenues and \$500,000 in Portland-based revenues to the Clean Energy Surcharge.<sup>19</sup> Portland set these levels to ensure that only the largest 500 companies, rather than local small businesses, pay the surcharge. Other cities may want to set their own levels to best balance capturing enough companies to properly fund a decarbonization program without setting the level so low as to harm local businesses. Equitable concerns should also be front of mind in developing a policy. Programs funded by such a tax should be designed to deliver dollars to disadvantaged communities, through community renewable projects, weatherization, and electrification of low-income housing, and target clean jobs training programs.

Lastly, cities should consider how best to use the generated funds. As noted above, both Portland and Denver allow the funds to be used for six loosely defined purposes, covering the gambit from direct electrification actions like heat pump installations, to more indirect (but nonetheless important) actions like green jobs training. Specifying the available uses in definite terms could forgo future disputes if revenues exceed expectations. In Portland, for example, the success of the Clean Energy Surcharge has led some city council members to push for the funds to be diverted to other city purposes.<sup>20</sup> Local governments hoping to maximize their decarbonization efforts should ensure revenue raised, then, is protected for that specific purpose.

## 2. Taxes on Natural Gas Usage

Local governments can tax natural gas usage directly to fund programs that provide electrification services and other benefits to low-income communities. Governments that decide to go this route will first have to determine if they would like to structure the policy as a tax or a fee. Taxes are “any contribution imposed by government upon individuals for the use and service of the state.”<sup>21</sup> Fees, on the other hand, are levied against a person who directly benefits from a government service when the revenues received go towards a similar purpose for which the fee

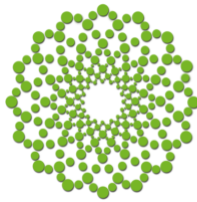
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<sup>18</sup> Forecasts in 2023 predicted the fund would collect \$540 million more than expected in the next five years. Monica Samayoa, “Portland city commissioner proposes \$540M of climate action funds toward city bureaus,” OR. PUB. BROADCASTING, (Dec. 13, 2023), available at <https://www.opb.org/article/2023/12/13/portland-city-commissioner-proposes-540m-of-climate-action-funds-toward-city-bureaus/>.

<sup>19</sup> PORTLAND, OR. CITY CODE ch. 7.02.500(F)(1).

<sup>20</sup> Gosia Wozniacka, *supra* note 8.

<sup>21</sup> *Automobile Club of Oregon v. State*, 314 Or. 479, 485 (1992) (citing Black’s Law Dictionary 1457 (6th ed 1991)).



was collected.<sup>22</sup> Although taxes provide local governments more flexibility in the use of the revenues generated, they also are subject to more legal barriers.

In response to the Ninth Circuit overturning the city’s ban on natural gas hookups in new construction, citizens of Berkeley, California put on the ballot Measure GG, the “Large Buildings Fossil Fuel Emissions Tax,” which would have established a tax on natural gas usage in buildings larger than 15,000 square feet.<sup>23</sup> Buildings of that size make up less than two percent of the city’s building stock, but account for 23 percent of the city’s emissions.<sup>24</sup> The building stock in Oregon cities have a similar dynamic. A Department of Energy analysis of buildings in Portland, Salem, and Medford showed that buildings greater than 50,000 square feet make up only 14 percent of the building stock but account for 49 percent of building-related emissions.<sup>25</sup>

The proposal used the social cost of carbon, emissions factors, and leakage factors, to come to a taxable rate of about \$2.96 per therm of natural gas consumed,<sup>26</sup> which would have generated \$26.7 million dollars in the first year. After administrative costs of up to three percent are removed, 90 percent of the remaining funds would be used to perform electrification retrofits in low-rise residential buildings and restaurants.<sup>27</sup> The remaining 10 percent fund jobs would facilitate the electrification program.<sup>28</sup>

A similar tax in Oregon would have to survive state constitutional hurdles. Art. IX, sec. 3b and art. VIII, sec. 2(1)(g) of the Oregon Constitution set a cap on the level of any tax measured by the extraction, production, storage, use, sale, distribution, or receipt of natural gas and earmark the funds of any such tax for the Common School Fund.<sup>29</sup> Facially the text of the provisions seems to indicate that they apply to any tax on natural gas. But the context, legislative history, and contemporary news reports indicate that the limitation on natural gas taxes was only meant to apply to natural gas produced in Oregon. And because Oregon produces only .01 percent of the natural gas used in the state, the provisions would have essentially no effect if they apply only to Oregon-produced gas.<sup>30</sup>

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<sup>22</sup> *Rogue Valley Sewer Services v. City of Phoenix*, 357 Or. 437, 446–47 (2015).

<sup>23</sup> Akielly Hu, “Berkeley’s gas ban was blocked in court. Now a new plan has emerged,” CANARY MEDIA (Sept. 4, 2024), available at <https://www.canarymedia.com/articles/carbon-free-buildings/berkeley-pioneering-gas-ban-was-blocked-in-court-its-got-a-new-plan>.

<sup>24</sup> Crystal Bailey, “Measure GG: Berkeley’s battle between economy and environment,” KTVU FOX 2 (Oct. 25, 2024),

<sup>25</sup> 2024 Biennial Report, OR. DEPT. OF ENERGY 74 (Nov. 2024), available at <https://www.oregon.gov/energy/Data-and-Reports/Documents/2024-Biennial-Energy-Report.pdf>.

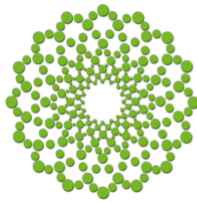
<sup>26</sup> *Id.*; BERKELEY, CA, Ballot Measure GG (2024), sec. 7.77.040(C), available at [https://acvote.alamedacountyca.gov/acvote-assets/02\\_election\\_information/PDFs/20241105/en/Measures/25%20-%20Measure%20GG%20-%20City%20of%20Berkeley%20-%20Fossil%20Fuel%20Tax.pdf](https://acvote.alamedacountyca.gov/acvote-assets/02_election_information/PDFs/20241105/en/Measures/25%20-%20Measure%20GG%20-%20City%20of%20Berkeley%20-%20Fossil%20Fuel%20Tax.pdf).

<sup>27</sup> *Id.* sec. 7.77.080(C)(1).

<sup>28</sup> *Id.* sec. 7.77.080(C)(2).

<sup>29</sup> OR. CONST. art. IX, sec. 3b; art. VIII, sec. 2(1)(g).

<sup>30</sup> 2024 Biennial Report, OR. DEPT. OF ENERGY 20 (Nov. 2024), available at <https://www.oregon.gov/energy/Data-and-Reports/Documents/2024-Biennial-Energy-Report.pdf>.



Adopted as Ballot Measure 3 in 1980, the two provisions were passed as constitutional amendments in the wake of the discovery of natural gas reserves around Mist, Oregon. Oregon courts interpret legislatively referred ballot initiatives like Measure 3 by looking not just at the text of the measure, but also the context of its passage, its legislative history, and contemporaneous sources like the voter’s pamphlet and newspaper editorials, to determine the voters’ intent in passing the measure.<sup>31</sup> The legislative history, contemporary news reports, and the voter’s pamphlet explanation of the measure indicate that the restrictions on the level and appropriation of a tax on natural gas was meant to apply only to Oregon-produced gas.

The measure’s legislative history frequently describes the tax as a “severance,” a type of tax that can only be applied to in-state production.<sup>32</sup> Proposed amendments to the measure would have reserved one-third of any revenue raised by a tax on natural gas for the county from which the gas was produced, a clause that makes sense only if the law applied exclusively to Oregon produced gas.<sup>33</sup> A typical editorial in the period leading up to the November, 1980 election described Measure 3 as locking “into the Oregon Constitution a 6 percent ceiling on severance taxes on oil and *natural gas extracted in Oregon* and dedicate any future revenue to the common school fund.”<sup>34</sup> Finally, the context noted above cannot be ignored: the amendments were passed in the immediate aftermath of the discovery of the first natural gas reserves in Oregon.

Surviving a constitutional challenge would be a necessary step in instituting an effective policy targeting natural gas usage directly for two reasons. First, an effective tax would need to be set at a rate higher than six percent. For example, the Berkeley tax starts at a level that is about 50 to 100 percent of the value of the gas itself. Second, the policy can only be effective if the revenue can go towards equitable decarbonization policies, which will be impossible if the funds must go to the Common School Fund.

Berkeley’s Measure GG failed, garnering only about 30 percent of the vote. Local governments in Oregon could learn several lessons from the Measure’s failure. Opponents feared the measure would have unintended consequences that could harm city residents, rich and poor. They argued that, despite the measure’s text prohibiting building owners from passing the cost of the tax onto renters, owners would simply raise rents to recover at least some of the tax.<sup>35</sup> Other city residents not subject to the tax might also have felt its effects—the city’s analysis of the measure found that non-profits and some businesses like restaurants may have needed to make “short term

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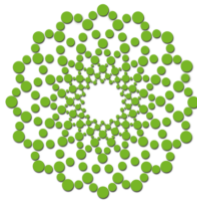
<sup>31</sup> *State v. Sagdal*, 356 Or. 639, 642, 652 (2015) (“We interpret referred constitutional amendments within the same basic framework as we interpret statutes: by looking to the text, context, and legislative history of the amendments to determine the intent of the voters.”)

<sup>32</sup> Testimony of Representative Wolfer before the House Revenue Committee, March 27, 1979, tape 22, side 2 at 0287, testimony before Senate Agriculture and Natural Resources Committee, June 6, 1979, tape 26, side 1 at 0193.

<sup>33</sup> *Proposed Amendment to the Oregon Constitution to Use of Mineral Sales or Transaction Taxes as a Source for Common School Fund: Hearing on HJR 6 Before the S. Comm. on Trade and Econ. Dev. 1979 Leg. 60th Sess.* (Or. 1979) (Ex. A of June 30, 1979).

<sup>34</sup> “No on Measure 3,” *Oregon Journal* 16 (Oct. 2, 1980) (emphasis added).

<sup>35</sup> LaTanya Bellow, “Section 9212 Report: Large Buildings Fossil Fuel Emissions Tax” CITY OF BERKELEY 4 (July 30, 2024).



adjustments to the impact of the unexpected tax by reducing their staffing (and/or the benefits offered to employees), reducing the quality of the service offerings to customers and reducing or eliminating the services and benefits that they offer to the community.”<sup>36</sup>

Thus, the construction of Measure GG is likely to blame for its failure to even come close to passage. The proposal came from outside city government as a citizen-initiated ballot measure, meaning the city did not “know whether, how, and to what extent the community, including community organizations and impacted communities, was engaged during the drafting process.”<sup>37</sup> A more open process that took into account community concerns might have helped temper local opposition and, perhaps more importantly, led to a better version of a similar tax. The rules around exemptions elucidate this point. Measure GG provided exemptions for non-profits with less than \$1 million in revenue, single-family residences, and multifamily residences where at least 50 percent of the units are affordable.<sup>38</sup> Berkeley has no non-profits, though, owning buildings larger than 15,000 square feet with yearly revenues under \$1 million.<sup>39</sup> In addition, the measure prevents Berkeley’s city council from adopting exceptions beyond those embedded in the measure, which would have limited the ability of the city to work out the kinks in this first-of-its-kind tax. Opponents also pointed out that Measure GG would go into full effect in January 2025, giving those entities subject to the tax no time to prepare for what all parties agreed was a policy imposing a drastic uptick in the price associated with using natural gas.

Local governments may be able to craft a less controversial natural gas tax if they engage the public from the outset and get support not just from climate activists, but also from residents, non-profits, and businesses. They also may want to focus on residential, rather than commercial, buildings. Although targeting commercial buildings can achieve greater emissions reductions while affecting fewer individuals, doing so presents challenges both for local governments and for those subjected to the tax. For example, some restaurants strongly opposed Berkeley’s proposal, arguing that they would be stuck between a rock and hard place because the cost of either the natural gas tax or electrifying their cooking appliances would be catastrophically high.<sup>40</sup> Possible alterations from Berkeley’s proposal could include focusing the tax on large residential properties (including large single-family houses); providing broader exceptions for non-profits, hospitals, and other low-profit entities; and allowing for a more phased-in tax to allow individuals subject to the tax time to budget for electrification. Additionally, the Oregon Department of Energy is in the process of adopting (and then implementing) building performance standards on commercial buildings over 200,000 square feet that will require

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<sup>36</sup> *Id.* at 18.

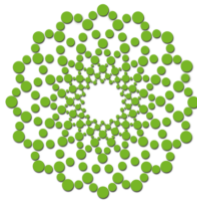
<sup>37</sup> LaTanya Bellow, “Section 9212 Report: Large Buildings Fossil Fuel Emissions Tax” CITY OF BERKELEY 8 (July 30, 2024).

<sup>38</sup> LaTanya Bellow, “Section 9212 Report: Large Buildings Fossil Fuel Emissions Tax” CITY OF BERKELEY 3 (July 30, 2024).

<sup>39</sup> *Id.* Indeed, the fact that a non-profit with low levels of revenue would not be able to afford to own (let alone rent) a large building in one of the most expensive areas of the country is fairly intuitive.

<sup>40</sup> Akielly Hu, “Berkeley’s gas ban was blocked in court. Now a new plan has emerged,” CANARY MEDIA (Sept. 4, 2024), available at <https://www.canarymedia.com/articles/carbon-free-buildings/berkeley-pioneering-gas-ban-was-blocked-in-court-its-got-a-new-plan>.





energy benchmarking, reporting, and efficiency upgrades over time.<sup>41</sup> Thoughtful local policy should consider whether covered commercial buildings are already complying with separate state requirements to reduce energy use and related greenhouse gas emissions.

With the right implementation, the benefits of the tax are many-fold. Short of banning the use of natural gas, few policies would create a stronger incentive to owners of natural-gas-intensive properties to electrify. Additionally, at least based on the City of Berkeley’s assessment, a similarly structured tax could bring in large amounts of revenue for decarbonization programs that could transition those properties not subject to the tax away from natural gas, especially those in disadvantaged communities.

In summary, local governments likely have the legal authority to adopt a tax on natural gas usage to fund decarbonization programs. The devil, however, is in the details. In its report on the Berkeley proposal, the Interim City Manager noted the potential pitfalls of Berkeley’s “one size fits all” approach: “The inability to provide additional exemptions to larger non-profits, healthcare facilities, essential services such as grocery stores, or other properties that serve the public interest may result in a reduction of community services to Berkeley residents.”<sup>42</sup> A drafting process that gets community engagement and support on the front end, and allows for the flexibility to address the unique circumstances of entities operating in the public interest on the backend, could ensure that the benefits (and burdens) of decarbonization are doled out in an equitable manner without sacrificing other city services.

### 3. Taxes on Pollution from Natural Gas

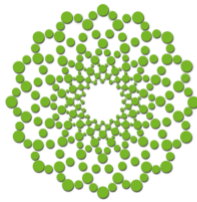
When natural gas is used to operate appliances in buildings, the combustion process emits greenhouse gases and other air pollutants into the indoor and ambient air. Because these emissions are the primary drivers of the climate and health hazards building decarbonization efforts aim to address, policies centered on reducing emissions may achieve similar outcomes to those centered on deterring gas consumption. As an extension of their home rule authority to raise revenue, protect public health and safety, and reduce local climate impacts, local governments in Oregon generally have the

#### Natural Gas Pollutants

- **Greenhouse gases**
  - Carbon Dioxide
    - Released by combustion of natural gas
  - Methane
    - Released as leakage from pipes
- **Gas that harms human health**
  - Nitrous Oxides
    - 12.7 percent of childhood asthma linked to in-home gas stove
  - Benzene
    - Running gas oven at 350 degrees for 45 minutes makes air equivalent to secondhand smoke

<sup>41</sup> ORS § 469.275–469.291; “Building Performance Standards Rulemaking,” OR. DEPT. OF ENERGY, (last visited Nov. 25, 2024) available at <https://www.oregon.gov/energy/Get-Involved/Pages/BPS-Rulemaking.aspx>.

<sup>42</sup> LaTanya Bellow, “Section 9212 Report: Large Buildings Fossil Fuel Emissions Tax” CITY OF BERKELEY 12 (July 30, 2024).



power to impose taxes and fees on air pollutant emissions from buildings in their jurisdiction.

Emissions fees can apply to a variety of pollutants produced from natural gas combustion, including greenhouse gases like carbon dioxide and methane, as well as pollutants that cause indoor air pollution that threaten public health, such as nitrogen oxides and carbon monoxide. These policy options could incentivize building occupants to reduce gas consumption, encourage building owners to replace gas appliances with electric options, and deter developers from connecting newly constructed buildings to the local gas distribution system, all while funding decarbonization solutions for frontline communities.

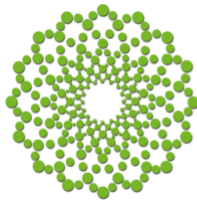
There are several options for structuring taxes or fees on building emissions. One option is to impose a flat-rate surcharge or fee on every ton of emissions produced by the building in an established period. This option would apply the “polluter pays” principle to building emissions and enable building owners to reduce their financial obligation by reducing their emissions. This option would most directly impose a fee on pollution, but also would present administrative challenges for local governments that lack capacity or resources to track and verify emissions.

Another option is to impose tiered surcharge rates for all buildings within specific size and use classes, where the surcharge for each building class reflects the average emissions produced by buildings in the class. For example, a municipality could impose a flat surcharge on all single-family homes connected to the gas distribution system, with the surcharge rate reflecting the average monthly or annual emissions produced by a single-family home in the area. This option would likely be easier to administer at the local level but would not provide a strong incentive for building owners or occupants to reduce emissions because doing so would not remove them from the class to which they belong, unless they fully electrify. Local governments that go this route should be careful to design the surcharge so that low-income residents are not unduly burdened by a policy that does not deliver particularly meaningful decarbonization.

A third option would be to impose an emissions surcharge on each appliance installed in a building, with the surcharge rate reflecting the average emissions associated with each appliance class. Because electric appliances do not produce on-site emissions, these appliances would be exempt from the surcharge, which would create an incentive for building owners or occupants to replace emitting appliances with non-emitting appliances. Option three would be more challenging to administer than option two because a municipality would need to have some system in place for verifying which appliances are in use in each building.

A fourth option would be to impose a one-time fee on new construction that reflects a building’s total projected emissions over a longer period. This type of upfront emissions fee could help deter developers from installing gas appliances in new buildings and incentivize construction of efficient, all-electric buildings.

These options are not mutually exclusive, and indeed might work best in conjunction with each other. For example, Ashland is currently considering a carbon charge for new residences that



uses a methodology not so different from the one used in Berkeley’s Measure GG. Taking the product of the average residential therms of natural gas usage (564), the emissions factor in terms of MT CO<sub>2</sub>e/term (.005291), a social cost of greenhouse gases (\$208/mt CO<sub>2</sub>e), and an average appliance lifespan of 16 years, Ashland is proposing a base surcharge of \$9,931.16. One noteworthy distinction between Ashland’s proposal and Berkeley’s is the cost per therm: Ashland’s is about \$1.10/therm, whereas Berkeley’s was set almost three times higher, at \$2.96/therm. Ashland’s policy melds the second and fourth options proposed here, assessing a one-time fee on new construction based on projected emissions that is also tied to building size.

In 2021, Burlington, Vermont passed a charter amendment allowing the city to assess a “carbon impact fee.” The exact design and rate of the fee was left to the voters, who, in 2023, approved a fee that applied to new buildings, existing commercial and industrial buildings over 50,000 square feet, and existing city-owned buildings.<sup>43</sup> For each “ton of greenhouse gas emissions attributable to a building’s fossil fuel thermal energy systems over their lifetime” the city assesses a fee that started at \$150 and is adjusted for inflation each subsequent year. The revenue is directed to a renewable energy fund.<sup>44</sup> Half of the proceeds paid by existing large buildings is available, upon request, to the payor for “projects to reduce greenhouse gas emissions at any site owned by the payor in the city.”<sup>45</sup> The remaining proceeds—the other half from existing buildings and all proceeds from new buildings—provide financial assistance for low-income residents and owners of multifamily housing with at least 25 percent low-income units to reduce emissions.<sup>46</sup> The City Council failed to pass a proposal in early 2024 that would have begun a process to put on the ballot an expansion of the fee, which would have raised the fee itself and applied to the fee to a wider array of building types.<sup>47</sup>

## **CHOICE-MODIFIERS**

### *1. Construction Excise Taxes*

Under Oregon law, municipalities can impose a construction excise tax (CET) on improvements to residential, commercial, and industrial real property if the improvement either creates a new structure or adds square footage to an existing structure.<sup>48</sup> Taxes on residential structures are

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<sup>43</sup> Patrick Crowley, “In Burlington’s ballot question, loudest debate centers on police control board,” VT DIGGER, (March 3, 2023), available at <https://vtdigger.org/2023/03/03/in-burlingtons-ballot-questions-loudest-debate-centers-on-police-control-board/>.

<sup>44</sup> BURLINGTON, VT. CODE OF ORDINANCES ch 8-79(b).

<sup>45</sup> *Id.* ch. 8-79(d)(1).

<sup>46</sup> *Id.* ch. 8-70(d)(2).

<sup>47</sup> Pat Bradley, “Burlington councilors consider updated carbon impact fee and revised development agreements during latest meeting,” WAMC NORTHEAST PUBLIC RADIO (Feb. 16, 2024) available at <https://www.wamc.org/news/2024-02-16/burlington-councilors-consider-updated-carbon-impact-fee-and-revised-development-agreements-during-latest-meeting>.

<sup>48</sup> ORS § 320.192.



capped at one percent of the permit valuation for residential construction permits, but CETs on commercial and industrial property are theoretically unlimited.<sup>49</sup>

Local governments can use the structure of a CET itself to prioritize electrified buildings and upgrades. Nothing prevents a CET from treating subcategories of residential, commercial, and industrial structures differently. For example, Portland does not impose its CET when the value of the improvement is less than or equal to \$100,000 dollars.<sup>50</sup> Corvallis offers a range of exemptions, including for additions of non-covered decks in Adair Village and Benton County and for equine facilities in Linn County.<sup>51</sup> Cities could create additional exemptions for improvements that also transition a structure from gas to fully electric, or could create a differential tax rate for projects that have an electrification component. The exemption structure could be more effective for commercial and industrial CETs because cities can leverage the “stick” of a relatively high CET with the “carrot” of an exemption for electrifying.

CETs may also generate moderate funds. The available uses of CET funds depend on the type of property being taxed. For all types of CETs, up to four percent of the revenue raised can be used for administrative expenses. CETs on residential improvements are distributed as follows: 50 percent to fund certain developer incentives, 15 percent to down payment assistance programs of the Housing and Community Services Department, and 35 percent for programs and incentives related to affordable housing “as defined by the city or county.”<sup>52</sup> Funds from CETs on commercial and industrial improvements are less restricted: 50 percent must be used for “programs of the city or county related to housing” and the remaining 50 percent is fully discretionary.<sup>53</sup>

Although residential CET funds are fully earmarked, cities and counties would still be able to use the funds to support decarbonization efforts, particularly in affordable housing. Although the 15 percent that is directed to the Housing and Community Services Department would be out of a city’s control, the remaining 85 percent could support decarbonization programs for low-income housing. Most clearly, the 35 percent reserved for “programs or incentives of the city or county *related to* affordable housing” gives cities and counties a great amount of leeway in terms of the nature of those programs. For example, cities could create programs that provide funding for new affordable housing units that use only electric appliances, retrofit existing affordable units with electric appliances, or weatherize affordable units to lower their energy usage.

The remaining 50 percent of residential CET revenues must be used to fund three types of “developer incentives”:<sup>54</sup> 1) incentives for developers that opt to pay an “in-lieu” fee in exchange

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<sup>49</sup> *Id.*

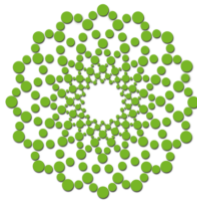
<sup>50</sup> PORTLAND, OR. CITY CODE ch. 6.08.

<sup>51</sup> Construction Excise Tax Information Sheet, CORVALLIS SCHOOL DIST. 2 (last visited Oct. 22, 2024), available at <https://archives.corvallisoregon.gov/public/ElectronicFile.aspx?dbid=0&docid=3857796>.

<sup>52</sup> ORS § 320.195(3).

<sup>53</sup> ORS § 320.195(4).

<sup>54</sup> ORS § 320.195(3)(a).



for providing the requisite number of housing units within a multifamily structure at below-market rates;<sup>55</sup> 2) for multifamily structure developers who do not opt to pay the in-lieu fee, incentives granting fee waivers as well as finance-based incentives;<sup>56</sup> and 3) other voluntary incentives to increase the number of affordable housing units in a development, decrease the sale or rental price of affordable housing units, or build affordable housing units for households with an income below 80 percent the county’s median family income.<sup>57</sup> Cities may be able to achieve both affordable housing and decarbonization goals with the third type of incentive. Nothing prevents a local government from imposing additional conditions to qualify for the voluntary incentives, e.g., to also require that the housing development be fully electrified.

Cities have greater flexibility in their use of revenues from commercial and industrial CETs. 50 percent of the funds are fully discretionary—local governments could combine this money with other CET revenues or use it to fund more ambitious programs.<sup>58</sup> The remaining 50 percent also gives cities quite a bit of flexibility, because it must fund “programs . . . related to housing.” Unlike residential CETs commercial, and industrial CETs do not necessarily need to be used to support *affordable* housing, just housing. Also unlike residential CETs, commercial and industrial CET revenues must go to a *program* as opposed to either a program or an incentive.

While local governments certainly could create different programs and incentives specifically designed for each source of revenue, administrative efficiencies could be achieved by creating a single program that funds decarbonization efforts in affordable housing units. 100 percent of commercial and industrial CETs, and at least 35 percent of residential CETs, could go into a single program aimed at decarbonizing affordable housing. Alternatively, a local government could funnel all the available funds from a residential CET into affordable housing incentives and put 100 percent of commercial and industrial CETs into a program that decarbonizes housing. In any event, local governments that already have CETs supporting affordable housing should be sure that new CETs are additive rather than divertive, i.e., that changes raise additional revenue for decarbonization efforts without sapping funds already supporting housing affordability.

## 2. Appliance Surcharges

Local governments can also try to influence consumer choices when they buy heating or cooking appliances. Surcharges on natural gas appliances—furnaces, water heaters, stoves, ovens—can shift the economic incentives away from gas and towards electric appliances. Unlike some of the other options discussed above, appliance surcharges have few legal or logistical hurdles to overcome. That said, this policy option would likely be the least efficacious of those proposed to this point because it sends a relatively weak signal to consumers and is unlikely to generate large revenues.

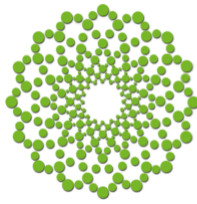
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<sup>55</sup> ORS § 197A.465(5)(c).

<sup>56</sup> ORS § 197A.465(5)(d).

<sup>57</sup> ORS § 197A.465(7).

<sup>58</sup> ORS § 320.195(4).



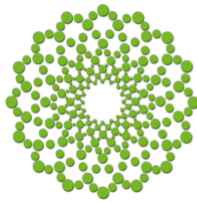
First, local governments would have to decide whether to design the surcharge as a tax or a fee, which largely would be a question of how revenue from the surcharge is spent. Funding a rebate program for electric appliances, for example, could qualify as a fee because of the close connection between the purpose of the surcharge and the use of the funds it derived. If funds were used for broader decarbonization efforts, however, the surcharge would likely be classified as a tax. Second, local governments would need to decide at what point to assess the surcharge: the point of sale or the point of installation. Assessing at the point of sale would operate like a sales tax: consumers would pay the surcharge when purchasing the equipment, and retailers would be tasked with directing the money received to the city. Alternatively, a municipality could instead assess the surcharge at the point of installation with the intention of incentivizing installers to market electric appliances.

Taxing at the point of sale has several potential drawbacks that a local government should consider. For example, if the surcharge does not appear in the listed sale price, the policy will be less successful. Consumers shopping to replace a furnace, water heater, or oven will likely not face the same disincentive if they only become aware of the surcharge at the actual time of purchase, as opposed to at the time of shopping. Because of the complicated cost-balancing that goes into buying an appliance—involving not just the upfront cost, but potential long-term savings based on fuel type, efficiency, lifespan, etc.—many consumers rely on third parties to provide analyses of which appliance to buy. Those third-party analyses are unlikely to integrate the minutia of local ordinances. So, while any consumer-facing ordinance would likely want provisions requiring price-transparency, even that may not be enough to alter a substantial number of consumer decisions.

Cities that are not in isolated rural areas will have to grapple with consumer movement. Basically, if a city is the only one in its area with a consumer-facing surcharge, consumers may opt to simply purchase appliances in adjacent municipalities. On the other hand, a municipality with a high concentration of appliance retail stores may be able to affect the decisions of citizens not just in their own city-limits, but those in surrounding areas with a consumer-facing surcharge.

An installer-based surcharge has the obvious benefit of being functionally unavoidable for city residents by filling in the “consumer travel” problem of a consumer-facing surcharge. That said, the efficacy of an installation surcharge is uncertain because it has a less direct influence on consumer decisions. This policy option assumes that installers will direct consumers away from gas-based appliances out of their own self-interest (in avoiding the surcharge itself or having to pass the costs onto the consumer) and consumer choice will follow suit. This bank-shot style of regulation may not be enough to overcome a consumer’s preference for gas appliances.

Finally, local governments would need to determine the optimal level at which to set a surcharge to balance achieving policy outcomes with the equity concerns involved in raising the price of necessary consumer goods. For example, a surcharge set at a relatively low level may not change



the economics for individual consumers but could change the habits for developers of multifamily housing. A city may find it preferable to have more people pay the surcharge, creating more funds for programs that could decarbonize low-income housing. On the other hand, a higher surcharge would be more effective at preventing purchases of new gas appliances in the first place, but also may not generate funds for broader decarbonization programs.

One solution to this last problem could be to pair an appliance surcharge with other revenue-generating policies like a CET. The revenues from just one policy may not be enough to justify the administrative costs of a decarbonization program. But pairing the revenue streams of multiple policies could allow those policies to be more effective at changing individual behavior while also raising enough aggregate revenue to run an effective, equitable decarbonization program.

### 3. Utility Fees

Local governments can impose fees on utilities either in a franchise agreement with the utility or, if no franchise agreement exists, by ordinance via licensing or right-of-way usage fees. These utility fees are imposed for the use of the locality's streets and public property.<sup>59</sup> When utility fees are used for reasons unrelated to the public right-of-way, they are categorized as a "privilege tax."<sup>60</sup> Like taxes on natural gas sales, utility fees are passed through to the consumers of the utility. Indeed, any utility fee charged beyond three percent of the utility's gross revenue can be itemized on a customer's bill.<sup>61</sup> Thus, an increase in a utility fee that is not paired with a bill assistance program will exacerbate the energy burden of a locality's citizens, harming those with the lowest incomes most severely.

#### Energy Burden

- The percentage of your household income that you spend on energy costs
- Recommended energy burden: 6 percent
- Extremely energy burdened: more than 10 percent
- The median energy burden of Black (43% higher), Hispanic (20% higher), and Native American (45% higher) households are higher than the median energy burden for white householders.

A city can impose a privilege tax on a utility without a franchise agreement through two sources of authority. First, if a city and utility have not had a franchise agreement for 30 days, ORS § 221.450 allows the city to impose a privilege tax "not exceeding five percent of the gross revenues" of the utility earned within the locality's boundaries.<sup>62</sup> Cities wishing to impose a privilege tax beyond that five percent threshold can still do so under their home-rule powers if they are taxing an investor-owned utility.<sup>63</sup> If a utility fee is a privilege tax it may also need to comply with ORS § 317A.158, which preempts local taxes on "commercial activity," essentially

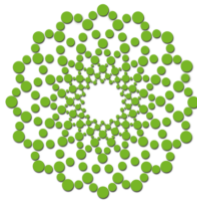
<sup>59</sup> ORS § 221.420(2)(a).

<sup>60</sup> NW Nat. Gas Co. v. City of Gresham, 359 Or. 309, 324 (2016) (hereinafter "City of Gresham").

<sup>61</sup> OAR 860-022-0040(1).

<sup>62</sup> ORS § 221.450.

<sup>63</sup> City of Gresham, 359 Or. at 350.



gross revenues.<sup>64</sup> Two exceptions in the statute, though, could negate its applicability to utility fees. First, cities that have existing utility fee ordinances taxing utility revenue should be able to amend those ordinances upward so long as the fee was originally passed before April 1, 2019.<sup>65</sup> Second, cities that do not have an existing utility fee may still be able to create one because the statute has an exception for “privilege taxes not measured by commercial activity, *franchise fees* or right-of-way fees.”<sup>66</sup> This second exception is less certain than the first because the statute is vague as to whether the exception applies to all franchise fees and right-of-way fees (utility fees) or only those that are not also privilege taxes. A utility fee is a privilege tax if it directs the revenue towards expenses not related to the local government’s right of way.

Many local governments already impose utility fees, and therefore could amend those fees under the first exception. Gresham, for example, has imposed a ten percent utility license fee via city ordinance, deemed a privilege tax by the Oregon Supreme Court, which it uses to fund essential city services like the fire department.<sup>67</sup> Heightened utility fees may prove an unattractive option for several reasons. First, local governments would be unable to ensure that a utility fee was assessed in an equitable manner. Several considerations come into play here, such as the rate of low-income residents connected to natural gas and how the fee is assessed, issues that could determine whether a higher utility fee is a viable option or not, but which are largely out of a city’s control. Residents will likely pay the fee with no consideration for their income level, regardless of whether it is assessed as a flat fee or on a usage basis. Thus, a local government that increases the utility fee should consider using at least some of the revenue on a bill assistance program, or else the increase will act as a regressive tax on some lower-income residents.

Second, an increased utility fee may not actually achieve decarbonization goals, because a modest increase in one’s natural gas bill may not influence decision-making much in an era of rising utility rates, especially in areas served by an investor-owned electric utility. Finally, as noted above, utilities may itemize utility fees greater than three percent on customer bills and name that itemization as they see fit. For example, Northwest Natural customers in Portland have a line-item on their bills called “2% Portland Franchise Fee” and customers in Washington have a “WA Climate Act Fee” line-item. Therefore, a utility fee could be politically unseemly without delivering major decarbonization benefits.

An increased utility fee would not be all bad, though. An increase in the cost of natural gas could tip the balance in favor of electrification when customers replace gas appliances. Pairing an

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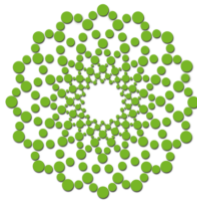
<sup>64</sup> ORS § 317A.158(1).

<sup>65</sup> ORS § 317A.158(2)(a).

<sup>66</sup> ORS § 317A.158(2)(b).

<sup>67</sup> City of Gresham, *Utility License Fees*, <https://greshamoregon.gov/Utility-License-Fees/>; City of Gresham., 359 Or. at 326–27. The Oregon Supreme Court also found that the privilege tax did not violate ORS § 221.450, which states that a privilege tax “shall be . . . in an amount not exceeding five percent.” The Supreme Court nevertheless upheld Gresham’s then seven-percent utility fee because, stating that the statute in question acted as a grant, rather than a limitation, of authority, and therefore did not preempt local governments from imposing a higher tax, at least on private utilities. City of Gresham, 359 Or. at 342–45.





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increase in the gas utility fee with a decrease in a city's electric utility fee could mitigate some of the harm to low-income customers while further incentivizing electrification for the broader public. In addition, an increase in a gas utility fee could bring in somewhat substantial revenue. The City of Eugene, for example, found that a one percent increase in NW Natural's utility fee could generate \$300,000–\$400,000 annually.<sup>68</sup>

As noted above, local governments should also be aware that a privilege tax may only exceed 5 percent when applied to an investor-owned utility.

## **CONCLUSION**

Like any problem facing local government, decarbonizing buildings within a city will require money and resources. While the list of proposals here is anything but exhaustive, they do offer local governments the means to collect and expend the necessary resources, financial and otherwise, to make substantive steps towards the intensive undertaking of eliminating emissions from buildings. But through consistent, steady action, local governments can provide meaningful decarbonization while also delivering economic and health-based benefits to their residents.

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<sup>68</sup> Work Session Agenda, EUGENE, OR. 200 (Oct. 11, 2023), available at [https://omponetwork.s3-us-west-2.amazonaws.com/sites/134/documents/cc\\_agenda\\_packet\\_231011\\_ws\\_public.pdf?3atMV5vfMrkWN\\_NgzIXSNzml1E.eZObe](https://omponetwork.s3-us-west-2.amazonaws.com/sites/134/documents/cc_agenda_packet_231011_ws_public.pdf?3atMV5vfMrkWN_NgzIXSNzml1E.eZObe).

# Construction Excise Taxes

1



## Residential

- Improvements resulting in
  - New buildings
  - Increase in sq. footage of existing buildings, or
  - Increase in living space
- CET cannot exceed 1% of the permit valuation

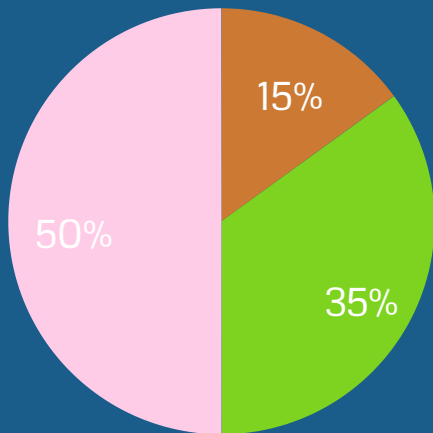
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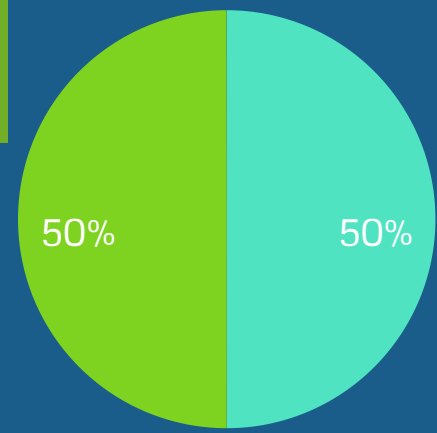
## Commercial & Industrial

- Same prerequisites as for residential CETs
- Mixed use buildings apply C&I rules for C&I portion
- No limit on value of CET
  - Ordinance must state the rate and base

## Distribution of CET Revenue



- Housing Community Services Dept
- Programs/Incentives Related to Affordable Housing
- Developer Incentives



- Discretionary
- Programs Related to Housing

## CET policies to promote decarbonization and equity

- Exemptions from tax for:
  - Improvements that transition from fossil fuel to electric
  - Improvements to multifamily housing structures with minimum percentage of affordable units
- Differential tax rates for structures with high emissions (higher) and affordable housing (lower)