Government of the District of Columbia
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO:	**The Honorable Vincent C. Gray** **Chairman, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	MAY 16 2008
SUBJECT:	**Fiscal Impact Statement: "Southwest Waterfront Bond Financing Act of 2008"**
REFERENCE:	**B17-0591**

Conclusion

Based on the information received, funds are sufficient in the FY 2008 and FY 2009 budgets, but funds are not sufficient in the District's FY 2009 – FY 2012 budget and financial plan to implement the proposed legislation. At this time it is not possible to estimate the full extent of the proposed legislation's fiscal impact or the specific periods impacted, because the final development plan and financing package have not been completed. Our best estimate is that there will be a $4 million per-year budget impact due to a net loss of tax revenues, which may begin as early as FY 2010, for a total of up to $12 million in the financial planning period. In addition, because the debt will be backed by the Downtown TIF Area, there will be an additional budget impact of up to $20 million. That amount will have to be set aside in the budget as the TIF/PILOT bonds are issued. However, this additional budget impact would be outside the financial planning period.

Background

The proposed legislation would approve the issuance of up to $198 million in TIF/PILOT bonds to pay for infrastructure and other costs related to the development of the Project. It would create a Tax Increment Finance (TIF) area, a Payment In Lieu of Taxes (PILOT) area, and a Special Assessment District to support debt service for these bonds. The Project, a 23 acre site in the Southwest quadrant of the District, is proposed to include more than 2.1 million square feet of office, hotel, residential, and commercial development and 200 – 400 marina slips. Through separate legislation, the Council will be asked to approve a disposition of the land, which is currently assessed at $95 million. This, in addition to the $198 million TIF/PILOT bonds, would bring the total subsidy to this project to approximately $293 million.

In addition to the TIF, PILOT and Special Assessment District, the legislation authorizes the use of the Downtown TIF Area to support the debt service on the TIF/PILOT bonds to be issued by the District. This means that a reserve of up to $20 million must be included in the budget once all the bonds are issued. This reserve would be non-lapsing, would be used if revenues from the Downtown TIF Area become necessary, and would be replenished if used. Any replenishment would also have to be budgeted.

<u>Risks/Costs to the District</u>

- The Deputy Mayor for Planning and Economic Development has completed a preliminary feasibility analysis based on certain size and use assumptions. However, because the Project still requires master planning, rezoning, and permitting, there are no final plans and/or cost estimates. This means that the proposed $198 million in TIF/ PILOT bonds may be more or less than the Project needs. This also means we cannot complete an analysis of whether the projected TIF and PILOT payments can cover the debt service. If the Project's TIF and PILOT payments, with the proposed special assessment do not cover the debt service, debt service would need to be paid from the budget.

- At this point, the District is the only participant in the transaction that is actually committing funds to the Project. In a normal TIF transaction, the developer comes to the District with an equity commitment and some idea of the availability of private debt for the project. TIF subsidy is intended to fill the gap between the project cost and what can be contributed by the developer. In this Project, the District is committing to a certain level of TIF funds, and the developer is subsequently going to seek equity and debt partners to fill the gap. Thus, although the terms of the transaction require the developer to have private financing in place before the land is transferred to the developer, the TIF commitment will be in place one to two years prior to that time.

- The Term Sheet acknowledges that there has yet to be a successful resolution with respect to the interests of existing leaseholders in the development. Based on information received from the Mayor, the condemnation value of the current leaseholds pursuant to the original leases is approximately $24 million. Conversely, the estimated cost to negotiate buy-outs of the current leaseholders on the site is more than $70 million. Therefore, the cost of requiring the Developer to negotiate buy-outs with current leaseholders rather than having the District condemn the leases is approximately $46 million. While there would likely be additional costs to the District related to condemnation protests, a decision not to condemn indirectly costs the project up to $46 million in additional subsidy.

- Approximately $4.4 million in annual sales taxes and $545,000 in annual property taxes are currently generated from the long-term leaseholders. Through this legislation, all sales taxes, and all PILOT payments above $945,000 per year will be pledged to the TIF/PILOT fund to support the debt. Each year, the $945,000 base amount will be paid into the General Fund. According to the proposed legislation, the TIF/PILOT period begins at land transfer; this transfer could occur as early as FY 2010. Sales taxes from current businesses will continue going to the General Fund until those businesses are closed. Once all of the current businesses are closed, the net reduction of taxes to the General Fund will be approximately $4 million per year.

- As currently proposed, the bonds could be taxable, significantly increasing the long-term interest cost to the District. Depending on the market at the time of issuance, a taxable issuance could increase the interest rate on the bonds one to two percentage points and could result in annual debt service of $15 - $20 million compared to an issuance of $12 to $15 million. Under current market conditions a taxable issuance would cost an additional $60 million over the term of the bonds.

- Because the proposed debt issuance will be backed by the Downtown TIF Area, at least one year of debt service will have to be accounted for in the budget. The Developer estimates an initial bond issuance in 2014, so this debt service set-aside would have no impact on the FY 2008 budget and FY 2009 – 2012 budget and financial plan.

- Issuing this amount of debt could limit future debt issuances by:

  - Using up debt capacity. As indicated in the OCFO's letter to the Council on June 20, 2007, the District's borrowing capacity is limited. The letter recommended a maximum of $1.5 billion in economic development debt. So far, issued, authorized, and proposed economic development debt issuances (including this Project) have reached $1.4 billion, very close to the limit. Thus, issuing $198 million for this Project reduces the amount available for TIF, PILOT, and revenue bond debt for other projects.
  - Using up the capacity of the Downtown TIF. All debt backed by the Downtown TIF Area and issued at parity with currently issued debt must meet a three-times coverage test. This means that the Downtown TIF Available Revenues must be three times greater than the total debt service backed by it. We have just completed a study that indicates that, based on this new requirement, there is now approximately $32.4 million currently available for annual debt service to back debt for eligible projects, if issued at parity. By backing this Project with the Downtown TIF Area, the District will be limiting the future capacity of the Downtown TIF to back other economic development projects around the City.

Financial Plan Impact

Funds are sufficient in the FY 2008 and FY 2009 budget, but are not sufficient in the District's FY 2009 – FY 2012 budget and financial plan to implement the proposed legislation. At this time it is not possible to estimate the full extent of the proposed legislation's fiscal impact or the specific periods impacted. However, the annual financial impact beginning as early as 2010 would be at least $4 million. In addition, beyond the financial plan period, the budget will need to include an additional amount up to $20 million, which would be included in the budget when the TIF/PILOT bonds are issued.