GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO:	**The Honorable Linda W. Cropp** **Chairman, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	**June 23, 2003**
SUBJECT:	**Fiscal Impact Statement: "The District of Columbia Neighborhood Economic Development and Investment Amendment Act of 2003"**
REFERENCE:	**Bill Number 15-104 as Introduced**

Conclusion

Funds are not sufficient in the FY 2004 through FY 2007 proposed budget and financial plan to implement the District of Columbia Neighborhood Economic Development and Investment Amendment Act of 2003. **Implementing the proposed legislation could result in unbudgeted costs of $73.75 million in FY 2004 and $270 million in FY 2004 through FY 2007.**

Our analysis only addresses the fiscal impact on the District over the next five years--which is our Congressional mandate for fiscal impact statements in the District of Columbia. That said, our analysis assumed no net increase in tax revenue associated with funded projects since the legislation permits the approval of projects that may result in a net decrease in tax revenue during that five-year period. To the extent that funded projects result in a net increase in taxes, the cost of the legislation would be reduced in the out-years; however, it is not possible to forecast these offsets, if any, in the absence of the consideration of specific projects. It is important to underscore that it may very well be that over the long term—10 to 20 years, for example—the proposals contained in this legislation could actually result in a significant increase to tax revenues.

Background

The legislation has four major parts:

1. A replacement Tax Increment Finance (TIF) program that allows TIF projects and districts.
2. A Payment in Lieu of Taxes (PILOT) program that would exempt parcels of land from real property taxes. Owners of these parcels would pay a PILOT amount is negotiated with the District.
3. Special assessment district (SAD) program to secure bonds that would finance public infrastructure improvements.
4. Tax abatements and credits including a five-year real property tax abatement, recordation tax abatement, and employee tax credits, and sales tax abatement for certain District businesses.

For financial assistance under the TIF, PILOT, and SAD programs the Mayor must determine that the project to be funded will generate a net increase in taxes or that the project would be in the general interest of the District.[1]

I. Tax Increment Financing Program

The bill repeals the current TIF legislation and replaces it with new language that facilitates the establishment of TIF areas. The creation of TIF areas and the approval of projects for funding are separate actions under the legislation, although it is likely that approval will occur simultaneously in many cases. The creation of a TIF area is recommended by the Mayor and approved by the Council. Approval of a TIF area triggers the base period for sales and real property taxes for the area from which the CFO would calculate incremental changes in taxes. Once a project is approved, incremental tax revenue is deposited into an account for use in funding economic development projects in the area. The money could then be used for TIF bonds, or directly for project-related purposes. At the end of each tax year, in the absence of TIF bonds being issued, any remaining funds in the TIF account revert to the General Fund.

The bill caps the total amount of outstanding TIF bonds or direct support at $300 M. The bonds issued under the current TIF statute would count against the cap, meaning that

[1] For purposes of this fiscal impact statement no net increase in tax revenue associated with funded projects was assumed since the legislation permits the approval of projects that may result in a net decrease in tax revenue. To the extent that funded projects result in a net increase in taxes, the cost of the legislation will be reduced. It is not possible to forecast these offsets, if any, in the absence of the consideration of specific projects.

about $173 million in additional bonds or direct grants could be issued.[2] The cap may be exceeded upon the recommendation of the Mayor and approval of the Council.

II. Payment in Lieu of Taxes Program

The legislation creates a new program that permits the exemption of otherwise taxable parcels and authorizes payments in lieu of taxes to be dedicated to economic development purposes. The program directs that the portion of the PILOT payment attributable to the value of the parcel at the time that the property is designated as a "PILOT parcel" be transferred to the General Fund annually. The remainder of the PILOT payment may be used to secure bonds or directly to fund economic development projects. The Mayor negotiates the terms and conditions of funding any project based on what the Mayor deems to be in the best interest of the District and any agreement is subject to approval by the Council.

The legislation authorizes issuance the up to $250 million in bonds outstanding or direct assistance at any one time through the PILOT program. While this cap limits the amount of bonds that could be outstanding and the amount of direct cash assistance that could be provided, it does not include any implicit tax abatement that could be negotiated by the Mayor as part of an economic development agreement. Implicit tax abatement will result whenever the Mayor negotiates a PILOT payment that is less that the property tax would otherwise be on the property, if the parcel remained on the property tax rolls.

The PILOT program circumvents General Obligation bond escrow requirements by redirecting incremental growth in real property tax revenue from the General Fund, where it must be used for GO bond obligations, to a PILOT fund to support economic development. The program may decrease the amount of tax revenue available for repayment of GO bonds, hurt the District's future borrowing ability, and negatively impact the District's bond ratings.

III. Special Assessment District Program

The legislation authorizes the Mayor, with the approval of the Council, to create special assessment districts. Money raised from a special assessment tax can be used to support the issuance of bonds for purposes of funding public infrastructure improvements. Public infrastructure improvements are limited to improvements owned by the District, dedicated to the District or any other government entity.

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[2] The CFO has certified the Capitol Hill Towers TIF project for $11.5 million and the Mayor recently transmitted a resolution to the Council for consideration. In addition, the CFO recently determined that a proposed Embassy Suites Hotel project would be certified for an $11 million TIF note. If the Council approves both projects, the available cap would be reduced from $173 million to about $150.5 million.

Although the legislation is somewhat unclear on this point, we have concluded that the drafters of the legislation intended to deposit special assessment revenue in a special fund outside of the General Fund.[3] As a result, special assessments will neither increase General Fund revenue nor increase debt supported by General Fund revenue.

The amount of debt outstanding or direct spending backed by special assessment levies is not subject to a cap.

IV. Tax Abatements and Credits

Allocation of Fees Related to Issuance of Revenue Bonds

The legislation would require fees earned in connection with revenue bonds issued by the District to be deposited into a non-lapsing account outside the General Fund controlled by the Office of the Deputy Mayor for Planning and Economic Development. These funds could be used to pay for administrative costs as well as economic development grants, loans, credit enhancement and other purposes.

Real Property Tax Abatement for Certain Businesses

Subject to approval by the Council, the Mayor is authorized to abate the real property tax liability of any Qualified Business for a period up to five years.

A Qualified Business includes businesses whose retention or expansion within the District or whose relocation to the District will help to retain or increase employment and expand the tax base in the District, according to the Mayor's determination. LSDBE-certified businesses, businesses located in enterprise zones, and certain other businesses automatically qualify for the designation.

The real property tax abatement is subject to a cap of $25 million within every two-year period, commencing with the passage of the legislation. The abatement would decrease the amount of tax revenue available for repayment of GO bonds. Abatement of recordation tax counts against this cap (discussed below).

Employment Tax Credit

In addition to being eligible for real property tax abatement, Qualified Businesses are entitled to an employment tax credit against corporate franchise tax liability of up to $3,000 per qualified employee, so long as the business hires 10 or more District residents as part of a business expansion in the city. Unlike the real property tax abatement, this credit is available to the taxpayer without approval by the Council.

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[3] See Section 17(e) of the legislation.

The employment tax credits are allocated over a 36-month period and may be carried forward for up to five years.

Forgiveness of Recordation Tax Liability

The Mayor is granted the authority to waive recordation tax payable by a Qualified Business upon passage of an approval resolution of the Council. As noted previously, the recordation and real property tax abatements for Qualified Businesses is subject to a cap of $25 million within every two-year period. Abatement of real property tax also counts against this cap (discussed above). The abatement would decrease the amount of tax revenue available to the General Fund and the Housing Production Trust Fund.[4]

Sales Tax Exemption on Construction Materials

With the approval of the Council by resolution, the Mayor may grant an exemption from the sales tax for purchases of construction materials and related tangible personal property used to construct, equip, or furnish a facility owned, used, or occupied by a qualified business.

The sales tax abatement is not subject to a cap. Last year, the District collected about $10 - $20 million in sales and use tax on construction materials. If the sales tax abatement were granted to all builders, the potential reduction in sales taxes collections would be significantly higher than we estimated. The $5 M annual cost estimate equates to the exclusion of about $87 million from the sales tax base each year.

Administrative Costs

The various programs authorized by this legislation will require significant technical improvements within the Office of Tax and Revenue. This includes changes in forms, taxpayer educational programs, and other investments. Additional staff within OTR will be required to implement these programs.

[4] Fifteen percent of recordation tax collections will be allocated to the Housing Production Trust Fund, beginning in FY 2004.

Summary

The following table presents a summary of the net annual impact to the financial plan as a result of implementing the proposed legislation.

Net Impact to the Financial Plan ($ in millions)					
Item	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**	**4-Year Total**
TIF Program Total	($30)	($30)	($30)	($5)	($95)
Grants	($25)	($25)	($25)	0	($75)
Debt service payments	($5)	($5)	($5)	($5)	($20)
PILOT Program Total	($25)	($25)	($25)	($25)	($100)
Grants	0	0	0	0	0
Debt service payments	($25)	($25)	($25)	($25)	($100)
Special Assessment District Program	$0	$0	$0	$0	$0
Employment Tax Credit	($1)	($1)	($1)	($1)	($4)
Real Property and Recordation Tax Abatements	($12.5)	($12.5)	($12.5)	($12.5)	($50)
Sales Tax Exemption	($5)	($5)	($5)	($5)	($20)
Administrative Costs	($0.25)	($0.25)	($0.25)	($0.25)	($1)
Net Impact	**($73.75)**	**($73.75)**	**($73.75)**	**($48.75)**	**($270)**