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** **Chair, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	DEC 11 2007
SUBJECT:	**Fiscal Impact Statement: "Multi-unit Real Estate Tax Rate Clarification Act of 2007"**
REFERENCE:	**Bill Number 17-072, Committee Print**

Conclusion

Funds are not sufficient in the Mayor's proposed FY 2008 through FY 2011 budget and financial plan to implement the proposed legislation. The proposed legislation is likely to result in an unquantifiable revenue loss to the local General Fund and will have implementation costs of $100,000 in FY 2008 and $400,000 in the FY 2008 through FY 2011 budget and financial period.

Background

The proposed legislation would amend District of Columbia Official Code § 47-820 to require the District's Office of Tax and Revenue (OTR) to determine the fair market value of residential multi-unit property on the exclusive basis of actual use on the date on which the valuation is made. In addition, the proposed legislation would require OTR to consider three specific factors in its proposed assessed value of multi-unit residential property – government-imposed restrictions on rental income, reported historic operating expenses, and the cost to cure any adverse conditions present at the property. This proposed change in assessment practice would begin with assessment for Tax Year 2008.

Current District law (Title § 47-820(3)) specifies that in the process of estimating assessed value OTR "shall take into account any factor that may have a bearing on the market value of real property."[1] Specifically, the current D.C. Official Code specifies that OTR shall consider factors including, but not limited to:

- Sales information on similar types of real property;
- Mortgage or other financial considerations;
- Reproduction cost less accrued depreciation because of age, condition, and other factors;
- Income-earning potential (if any);
- Zoning; and
- Government-imposed restrictions.

The proposed legislation would alter current assessment practices in at least two broad ways.

First, the "actual use" requirement in the proposed legislation would remove one of the factors – "highest and best use" – used by OTR to estimate assessed value of multi-unit residential buildings. By disallowing consideration of the highest and best use of a multi-unit property, such as potential conversion to condominium or cooperative, the proposed legislation would provide mitigation of any premium for condominium property in the D.C. residential real estate market. Consideration of conversion in establishing fair market value is likely to raise the value of the multi-unit rental property relative to similar rental properties that do not have conversion potential. Given recent developments in the D.C. residential real estate market, however, it is not clear if a condominium conversion premium still exists.[2] In the long-run, however, excluding "highest and best use" as a factor for assessing the value of multi-unit rental property is likely to lower assessment values, and thus real property tax revenue, in the District.

Second, the proposed legislation would more tightly constrain the discretion and flexibility of assessment administration. The proposed legislation would seem to privilege the three enumerated factors over other considerations that OTR might include in determining the estimated assessed value of multi-unit residential properties. Each factor is discussed below.

- *Any government-imposed restrictions on rental income.* Current District law explicitly states that OTR shall consider, among other factors, "government-imposed restrictions" and "income-earning potential" in assessing the value of real property. Thus, the proposed legislation would specify a specific consideration of restrictions on "rental income." However, under current OTR guidelines for assessment, restrictions on rental

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[1] In addition, D.C. Official Code also permits OTR to determine assessed value by manual or automated means, such as the Computer-Assisted Mass Appraisal System.

[2] One indication of a premium for condominium conversion would be the existence of an increase in the number of condominiums under construction, relative to apartment units. For example, in December 2005, the number of condominiums under construction in the District had increased by 2,829 from December 2004. By comparison, the number of rental apartments had *decreased* by 1,627 compared to a year earlier. By the third quarter of 2007, however, the number of condominiums under construction in the District had *decreased* by 1,069 compared with the third quarter of 2006, while the number of apartment units under construction had risen by 524 over the same period of time. The provides some evidence to suggest that the demand for condominiums relative to apartments, and thus the premium for condominium conversion, has cooled considerably in the past year. Source: ORA, *Economic Indicators*, September 2007.

income should be captured through the income approach to valuation, which converts net operating income into a value through a process called capitalization.[3] It is not clear that particular provision of the proposed legislation would change current assessment practices.

- *Reported historic operating expenses.* The proposed legislation does not define "reported historic operating expenses." Under current OTR guidelines for assessment, however, operating expenses are accounted for in the valuation process through the "income approach."[4] If property owners do not submit expense reports, OTR must use other techniques to estimate operating expenses in order to value the property.

- *Cost to cure any adverse conditions present at the property.* The proposed legislation does not define "adverse conditions" nor does it specify how the "cost to cure" is to be determined. The ambiguity of this provision may provide an incentive to property owners to avoid curing, or delay the cure of, adverse conditions, as this would lower the assessment of the property. While it is unlikely that the intent of the legislation is to incentivize such behavior on the part of multi-unit residential property owners, the practical effect may be to encourage such an outcome.

Financial Plan Impact

Funds are not sufficient in the Mayor's proposed FY 2008 through FY 2011 budget and financial plan to implement the proposed legislation.

It is estimated that the proposed change in property tax assessment procedures could reduce real property tax collections, but it is not possible to quantify the amount. However, the Office of Tax and Revenue (OTR) will require additional resources in order to implement the provisions of the proposed legislation. An additional $100,000 will be required for a staff addition in FY 2008 and ongoing costs associated with the staff in outyears.

Summary Table Estimated Impacts to the Financial Plan ($ in millions)					
Item	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**4 - Year Total**
Reduced Revenue Collections	Indeterminate	Indeterminate	Indeterminate	Indeterminate	Indeterminate
Unbudgeted Operational Burden	$.1	$.1	$.1	$.1	$.4
Net Annual Impact	$.1	$.1	$.1	$.1	$.4

[3] See *2008 General Reassessment Program – Assessor's Reference Materials*, OCFO, OTR, Real Property Tax Administration Division for a discussion of the income approach to valuation.

[4] Ibid.