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

CHAIRMANGRAY

2008 DEC 16 AM 9: 16

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:	DEC 15 2008
SUBJECT:	**Fiscal Impact Statement – "Eckington One Residential Economic Development Act of 2008"**
REFERENCE:	**Bill Number 17-855 – Committee Print**

Conclusion

Funds are not sufficient in the FY 2009 through FY 2012 budget and financial plan to implement the proposed resolution. The estimated impact of the proposed legislation over the FY 2009 through FY 2012 budget and financial plan period is $75,072.

Background

The proposed legislation would amend Chapter 46 of Title 47 of the District of Columbia Official Code to authorize a 10 year real property tax abatement for the Eckington One Residential development project ("Project") located in Square 3576, Lots 816, 817, 818, 819, and 820 in Ward 5. The Project involves 600 residential units (approximately 560,000 square feet), including approximately 48 units of affordable housing; approximately 1,000 square feet of ground floor retail space; below-grade parking garages; and other ancillary improvements.

The tax abatement would be capped at $5 million plus 6 percent annual interest on the unused amount of the real property tax abatement from the commencement of development. The abatement will be in effect for the 10 consecutive fiscal years beginning the tax year in which the developer starts development (but not earlier than FY 2010). The developer expects to break ground in the second quarter of FY 2009 and the project would be completed in FY 2012.

The proposed legislation would only partially abate the property tax obligation. Specifically, in FY 2010, the abatement would be for taxes in excess of 107 percent of the taxes paid for tax year 2009; in FY 2011, for taxes in excess of 113.96 percent of the taxes paid for tax year 2009; and in FY 2012 and each year thereafter, for taxes in excess of 121.25 percent of the taxes paid for tax year 2009.

Financial Plan Impact

Funds are not sufficient in the FY 2009 through FY 2012 budget and financial plan to implement the proposed resolution. The abatement proposed by this legislation would not have any impact on the FY 2009 budget but would cost $75,072 in the FY 2009 through FY 2012 financial plan period.

Table 1
Estimated Impact to the Budget and Financial Plan of B17-855, FY 2009 – FY 2012
Eckington One Residential Economic Development Act of 2008

	FY2009	FY 2010	FY 2011	FY 2012	FY 2009 – FY 2012
Land value[a]	$26,873,000	$27,488,886	$28,566,173	$29,269,378	
Improvements [b]	NA	NA	NA	$49,623,824	
Total value	$26,873,000	$27,488,886	$28,566,173	$78,893,202	
Tax Bill [c]	$491,151	$502,544	$522,474	$670,592	
Tax obligation not covered by abatement	NA	$525,531	$559,715	$595,520	
Value of Abatement (for a negative impact on the financial plan)	**NA**	**$0**	**$0**	**$75,072**	**$75,072**

Source: Office of Revenue Analysis Calculations

[a] The FY 2009 Land Value is the publicly available assessed value for this property. The land value is expected to grow by 0.90%, 2.29%, and 3.92% in the subsequent three fiscal years.

[b] According to the developer, the property is going be completed in FY 2012. The value of the improvement is calculating by using the observation that the land value of the developed properties in this neighborhood is 37.1 percent of the total value.

[c] This property is currently classified as Class 2 and taxed at $1.65/$100 for the first $3 million of value and at $1.85/$100 for any value above. The analysis assumes that it will be rezoned as Class 1 once the construction is completed in FY 2012, and therefore the value, which also now includes improvements, would be taxed at $0.85/$100.

Note that the abatement has zero value in FY 2010 and FY 2011 because the allowable growth in property taxes specified in the legislation is higher than the expected growth rate during this period. The methodological appendix explains how these growth rates have been calculated.

Additionally, the abatement would continue to have a fiscal impact beyond FY 2012. Between FY 2013 and FY 2019 (the year the abatement expires), it would reduce the total real property tax collections by the District of Columbia by an additional $897,274. Under these conditions, the total fiscal impact over the years the abatement is effective would be less than the $5 million cap specified in the legislation.

Table 2 Estimated Impact to the Budget and Financial Plan of B17-855, FY 2013 – FY 2019 Eckington One Residential Economic Development Act of 2008							
	FY 2013	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	**Total**
Land	$29,985,822	$30,954,253	$31,955,714	$32,991,360	$34,062,383	$35,170,023	
New Improvements	$50,838,497	$52,480,392	$54,178,287	$55,934,138	$57,749,971	$59,627,883	
Total[a]	$80,824,319	$83,434,645	$86,134,001	$88,925,497	$91,812,354	$94,797,907	
Tax Bill	$687,007	$709,194	$732,139	$755,867	$780,405	$805,782	**$4,470,394**
Tax obligation not covered by abatement	$595,520	$595,520	$595,520	$595,520	$595,520	$595,520	**$3,573,120**
Value of Abatement[b]	$91,487	$113,675	$136,619	$160,347	$184,885	$210,262	**$897,274**

Source: Office of Revenue Analysis Calculations

[a]The property value is expected to grow by 2.46% in FY 2013. The annual growth rate in the property values is expected to gradually increase during this period to reach 3.25% by FY 2019.

[b] This property is currently classified as Class 2 and taxed at $1.65/$100 for the first $3 million of value and at $1.85/$100 for any value above. The analysis assumes that it will be rezoned as Class 1 once the construction is completed in FY 2012, and therefore the value, which also now includes improvements, would be taxed at $0.85/$100.

Methodological appendix

Markets value an income generating equity by taking into consideration the future income from that equity and the rate by which we discount future earnings. This discount rate takes into consideration the opportunity cost of investment, the inflation rate, and the risks associated with that equity.

Real property markets work in similar ways. The value of a property depends on its *net operating income* and the *capitalization rate*.[1] The net operating income is the future income from a property—in the case of a rental building, it is the rental income the owner expects to collect from this building over the lifetime of the building. The owner then discounts the future net operating income by the capitalization rate. The capitalization rate tends to increase when the real interest rate, which is the opportunity cost of investing, increases. The capitalization rate also increases when the inflation rate increases. This is because inflation reduces the purchasing power of future income. Finally, the capitalization rate increases when the property markets become riskier. This is because by holding the property, the owner exposes himself to risk specific to property markets.

The Office of Tax and Revenue ("OTR") collects data both on net operating income and on capitalization rates. According to OTR, the net operating income in the Eckington One neighborhood has increased by an average of 12.6 percent between FY 2006 and FY 2009, and the gross capitalization rate has gone down from 7.20 percent to 6.32 percent.

According to the assessment reports for this neighborhood, over the next decade, the net operating income is expected to grow at rates more in line with the rest of the city at 3 to 4 percent. As the risk in property market increases, the capitalization rate is expected to gradually increase to 6.50 percent. The growth in the capitalization rate will be muted over this period—that is, the capitalization rate will not quickly increase to its FY 2006 levels, because interest rates and inflation is expected to stay low given the current massive inflow of funds engineered by the federal government to help financial markets, the and recessionary outlook.

Table3
Expected property values and growth rates in the Eckington One neighborhood, in $ millions
FY 2009 - FY 2012

	FY 2009	FY 2010	FY 2011	FY 2012
Net Operating Income	$76.30	$78.60	$80.90	$84.20
Annual Percentage Change	12.10%	3.00%	3.00%	4.00%
Capitalization Rate	6.32%	6.45%	6.49%	6.50%
Value of real property in the neighborhood	$1,207.30	$1,219.00	$1,246.53	$1,295.38
Annual Percentage Change	21.50%	0.90%	2.29%	3.92%

Source: Office of Tax and Revenue and Office of Revenue Analysis

Table 3 shows the estimated growth rate of the value of real property in the neighborhood where the Eckington One Residential property is located. The value of all real property in this neighborhood is estimated by dividing net operating income by the capitalization rate. The annual growth rates calculated

---

[1] Specifically, the value of a property is calculated as $V = \frac{NOI}{c}$ where ***NOI*** is the net operating income and ***c*** is the capitalization rate. This calculation is an approximation, since it assumes that the property has an infinite life. Given the relatively long life of commercial and multi-unit residential buildings, this approximation is reasonable.

from these values, as depicted in the last line of Table 3, are used to estimate the estimate the Fiscal Impact presented in Table 1.