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:	**December 15, 2008**
SUBJECT:	**Fiscal Impact Statement – "Walker Jones/Northwest One Unity Health Care Tax Abatement Act of 2008"**
REFERENCE:	**Bill Number 17-917 – Committee Print**

Conclusion

Funds are not sufficient in the FY 2009 through FY 2012 budget and financial plan to implement the abatement authorized by the proposed legislation. The proposed abatement will not have an impact on the FY 2009 budget, but will reduce the real property collections by $755,125 in the FY 2009 to FY 2012 budget and financial plan period.

Background

The proposed legislation would amend D.C. Official Code §47-4600 *et seq.* to add a new subsection 16 for codifying an abatement of real property taxes for the temporary Walker Jones/Northwest One Unity Health Center, which is located at 40 Patterson Street, N.E., in Lot 253, Square 672 for the period of October 1, 2009 to September 30, 2013.

Financial Plan Impact

Funds are not sufficient in the FY 2009 through FY 2012 budget and financial plan to implement the abatement proposed by the legislation. The proposed abatement would not have any impact on the FY 2009 budget but would cost $755,125 in the FY 2009 through FY 2012 financial plan period. The proposed legislation recognizes the revenue impact of the abatement, and makes its implementation subject to inclusion in an approved budget and financial plan.

Table 1 Estimated Impact to the Budget and Financial Plan of B17-917, FY 2009 - FY 2012 Walker Jones/Northwest One Unity Healthcare Tax Abatement Act of 2008					
	FY 2009	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2009 - FY 2012**
Land and Improvements [a]	$12,454,380	$12,837,936	$13,817,793	$15,134,799	
Taxes that would be abated [b]	NA	$231,502	$249,629	$273,994	$755,125

Source: Office of Revenue Analysis Calculations
[a] The FY 2009 value is the publicly available assessed value for this property. The property value (mostly land, improvements are slightly under $2,000) is expected to grow by 3.1%, 7.6%, and 9.5% in the subsequent three fiscal years. The methodological appendix explains how these growth rates have been calculated.
[b] This property is currently classified as Class 2 and taxed at $1.65/$100 for the first $3 million and at $1.85/$100 for any value above $3 million.

Additionally, the abatement would reduce real property tax collections by $309,833 in FY 2013[1].

[1] The property is expected to grow by 12.8 percent from FY 2012 to FY 2013. That year the property value is projected to be $17,072,053

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*.[2] 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 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 "Unity Health Center" neighborhood (Official assessment neighborhood code name is "R.L.A. NE" and NBHD code: 044) has increased by an average of 22.1 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, the area has 8.5 million square feet of office space with an 11.3 percent vacancy rate. The area also has 2.3 million square feet of office space under construction, with a large portion due to deliver beginning in 2011. Much of this space has been leased or sold to U.S. Department of Justice (a new 500,000 square foot office building), Hilton Garden Inn, Harris Teeter, and National Public Radio. The new 300,000 square foot ATF headquarters opened in 2008. As a result, the net operating incomes of properties located in the same neighborhood are expected to grow at 8 to 12 percent over the next three years. The capitalization rate is expected to gradually increase to 6.50 percent through FY 2012. The capitalization rate will not quickly increase to its FY 2006 levels despite increase in perceived risk because interest rates and inflation are expected to stay low given the recessionary outlook, and the current massive inflow of funds engineered by the federal government to help financial markets.

Table 2
Expected Property Values and Growth Rates in the Northwest One Unity Neighborhood, in $ millions
FY 2009 – FY 2012

	FY 2009	FY 2010	FY 2011	FY 2012
Net Operating Income	$167.5	$176.2	$190.8	$209.3
Annual Percentage Change	12.80%	5.20%	8.30%	9.70%
Capitalization Rate	6.32%	6.45%	6.49%	6.50%
Value of Real Property in the Neighborhood	$2,650	$2,732	$2,940	$3,221
Annual Percentage Change	27.80%	3.08%	7.63%	9.53%

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

---

[2] 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.

Table 2 shows the growth rate of the value or real property in the neighborhood where the Northwest Unity One 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 from these values, as depicted in the last line of Table 2, are used to estimate the estimate the Fiscal Impact presented in Table 1.