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:	**April 3, 2009**
SUBJECT:	**Fiscal Impact Statement: "CEMI-Ridgecrest-Walter Washington Community Center Real Property Tax Exemption and Equitable Real Property Tax Exemption and Equitable Real Property Tax Relief Act of 2009"**
REFERENCE:	**Bill 18-199, As Introduced**

Conclusion

Funds are not sufficient in the FY 2009 budget and the FY 2010 through FY 2013 proposed financial plan to implement the proposed legislation.

The proposed legislation would reduce property tax collections by $132,864 in FY 2009 and by $251,591 in the FY 2009 through FY 2012 financial plan period.

Background

The proposed legislation provides tax relief to Walter Washington Community Center—a privately-owned, taxable property that is operating as a community center. The property is currently in a tax sale, and the provisions of this legislation would take it out of tax sale.

The proposed legislation exempts the real property located at Lot 128, Square 6159, owned by CEMI-Ridgecrest, Incorporated, from real property tax so long as it is used as a community center. The legislation also requires that taxes and charges currently owed by CEMI-Ridgecrest, Incorporated for the real property be paid for through a mortgage agreement entered into between the District and the owner, on terms that are same as the terms as the current mortgage agreement between the two parties.

Lastly, the proposed legislation requires all other amounts necessary to redeem the real property under a tax sale be deposited with the Chief Financial Officer on behalf of the owner. And it further specifies that if the property is used for any purpose other than as a community center, the sum of all forgiven unpaid real property tax and penalties shall be paid to the District with 5 percent interest, and further provides that in that case a lien will be placed against the real property to secure the repayment.

Financial Plan Impact

Funds are not sufficient in the FY 2009 budget and the FY 2010 through FY 2013 proposed financial plan to implement the provisions of this legislation. This legislation would reduce property tax collections by $132,864 in FY 2009 and by $251,591 through the financial plan period.

Bill 18-199 – CEMI-Ridgecrest-Walter Washington Community Center Real Property Tax Exemption and Equitable Real Property Tax Exemption and Equitable Real Property Tax Relief Act of 2009
Estimated Reductions in Property Tax Collections, FY 2009 through FY 2012

	FY 2009	**FY 2010**	**FY 2011**	**FY 2012**	**Four Year Total**
Current Property Tax Owed (including penalties and interest)	$94,484				$94,484
Total Property Tax Exempted	$38,380	$38,413	$39,361	$40,953	$157,107
Total Reduction in Revenues	**$132,864**	**$38,413**	**$39,361**	**$40,953**	**$251,591**

The legislation allows the District to collect unpaid taxes, interest, and fees ($94,484) through the payments for a mortgage it would hold for this property. The legislation also notes that such a mortgage would have the same terms as the existing mortgage on the property. Initial research with the Recorder of Deeds of the District of Columbia[1] did not reveal any recorded mortgages for this property. Without a payment plan in effect, it is not possible to account for the fiscal impact of such future payments.

Additionally, given that the proposed property tax abatement would not expire as long as the property remains a community center, the proposed legislation would continue to have a negative fiscal impact beyond the four-year financial planning period. For example, in the ten years following FY 2012, the proposed legislation is expected to reduce the property tax collections by an additional $544,772, bringing the total cumulative negative fiscal impact to $796,213.

[1] Query conducted on the DC Recorder of Deeds Database (http://www.wam1.landata.com/) April 2, 2009.

Fiscal Impact of Bill 18-199 Estimated Annual Reductions in Property Tax Collections for FY 2013 through FY 2022		
	Value of the Tax Abatement	**Cumulative Negative Fiscal Impact**
FY 2013	$43,309	$294,900
FY 2014	$44,936	$339,836
FY 2015	$46,617	$386,453
FY 2016	$50,052	$436,506
FY 2017	$52,294	$488,800
FY 2018	$54,626	$543,426
FY 2019	$57,051	$600,477
FY 2020	$61,688	$662,165
FY 2021	$64,396	$726,561
FY 2022	$69,652	**$796,213**
Total	$544,623	

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 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 Walter Washington Community Center neighborhood has increased by an average of 12.30 percent between FY 2006 and FY 2009, and the gross capitalization rate has gone down from 10.42 percent to 8.30 percent.

According to the assessment reports for this neighborhood, over the next decade, the net operating income is expected to grow at more subdued rates of 2 to 4 percent. The capitalization rates in this neighborhood are already high compared to the rest of the city, and they are expected to stay around 8.3 percent. Thus, the property values are expected to grow at 2 to 4 percent.

Expected Property Values and Growth Rates
In the Walter Washington Community Center Neighborhood, in $ Millions
FY 2009 through FY 2012

	FY 2009	FY 2010	FY 2011	FY 2012
Net Operating Income	$6.1	$6.5	$6.6	$6.8
Annual Percentage Change From Previous year	0.70%	2.90%	2.70%	3.00%
Capitalization Rate	8.12%	8.30%	8.34%	8.30%
Value of real property in the neighborhood	$75	$78	$80	$82
Annual Percentage Change From Previous Year	2.90%	4.11%	2.14%	3.51%

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.