TAX POLICY AND ECONOMIC DEVELOPMENT IN DC

Presentation to DC Tax Revision Commission

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

Presentation Goals

- Outline broad changes in economic development policy climate in DC since late 1990s (previous TRC Report)
- Discuss tax code related economic development programs
  - Briefly explain how programs work (the backgrounder circulated before the meeting provides more detail)
  - Identify issues that have impacted their use
  - Identify trends in how DC has used them
- This information will be expanded into a paper for submission to the TRC in March

Focus of Our Analysis

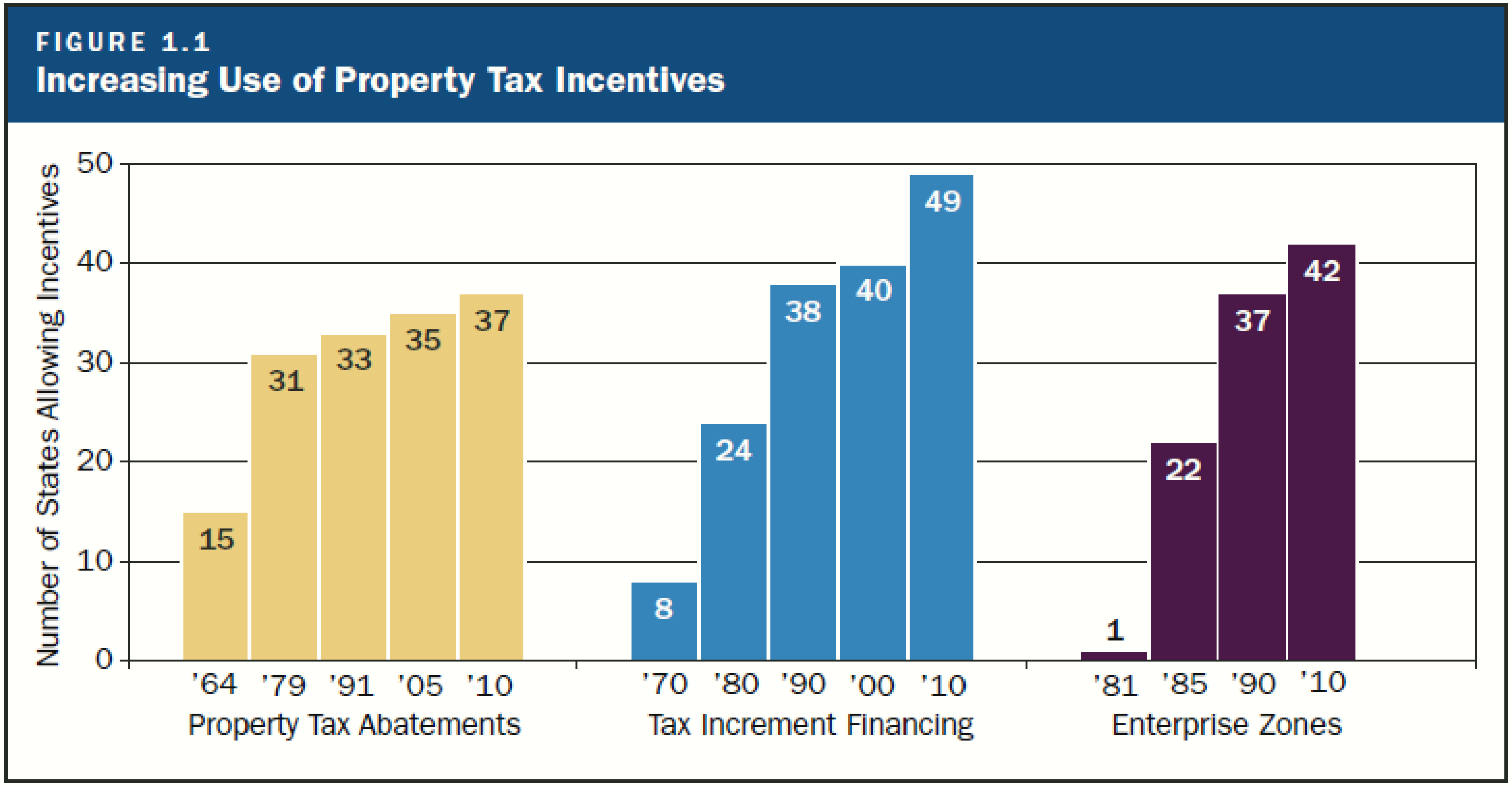
- Focusing our attention on programs that use tax policy to spur economic development
- Defining “economic development” as policies aimed at growing and diversifying DC’s tax base
- Typical program activities:
  - Financing construction of housing or commercial real estate
  - Financing large-scale attractions, such as convention center and ballpark
  - Business attraction and retention
  - Neighborhood revitalization
  - Encouraging specific uses to locate in underserved areas

How Much of DC Economic Development Spending Are We Talking About?

- Since 1990s, tax code related program costs have grown from almost nothing to more than ¼ of the District's economic development budget

Economic Development Spending and Tax Expenditure	FY12 Approved Budget (millions)	Percent of Total
Expenditures on Contracts	$316.30	51.1%
Grants	$125.40	20.2%
Tax Code Related Costs (bond debt service, tax expenditures)	**$177.70**	**28.7%**
Total	$619.40	100.0%

DC Reflects National Trends in Growing Use of Tax Code for Economic Dev.



Note: Property tax abatements are stand-alone programs that are not part of broader economic development programs.

Source: Lincoln Institute of Land Policy Report "Rethinking Property Tax incentives for Business," 2012.

General Trends in DC Economic Dev. Programming in Past 15 Years

- Budget growth
  - Expenditures and tax expenditures for economic development have grown in general
  - Recession had a major impact on revenues and on the debt cap
- Expansion of targeted geographies
  - Early focus on investments downtown
    - Downtown Action Agenda (2000)
  - Over time, increased focus on revitalizing neighborhoods, building up new areas beyond downtown (NoMA, SW Waterfront)
    - City Center Action Agenda (2008)
- Evolution of government management
  - Centralization of strategy and implementation under Mayor and DMPED
  - Increased financial oversight from OCFO

Debt Financing

TIFs, PILOTs, and Special Debt Financing

Tax Increment Financing (TIF) Program

- DC issues bonds backed by the *incremental* property and sales tax revenues generated by the benefitting project
- Differs from traditional TIF programs
  - DC's is a project-specific financing program
  - Other jurisdictions use TIF to capture incremental taxes from larger area to fund communal infrastructure
- First authorized in DC in 1998; first bonds issued in 2001
- Geographically limited to "Priority Development Areas" and "Retail Priority Areas"
- Use as of August 2012:
  - TIF Bonds issued: $505 million
  - TIF Authorized but not yet issued: $277 million

Payment In Lieu Of Taxes (PILOT)

- Previously tax-exempt property to be privately developed remains technically tax-exempt, but pays the equivalent of its property tax bill in PILOT; DC issues bonds backed by the PILOT revenue stream
- Differs from traditional PILOT programs
  - DC's is a project-specific financing program for taxable property
  - In other jurisdictions, PILOT programs allow government to negotiate payment from institutions that are otherwise tax-exempt
- First authorized in DC in 2004
- Use as of August 2012:
  - PILOT Bonds issued: $153 million
  - PILOT Authorized but not yet issued: $110 million

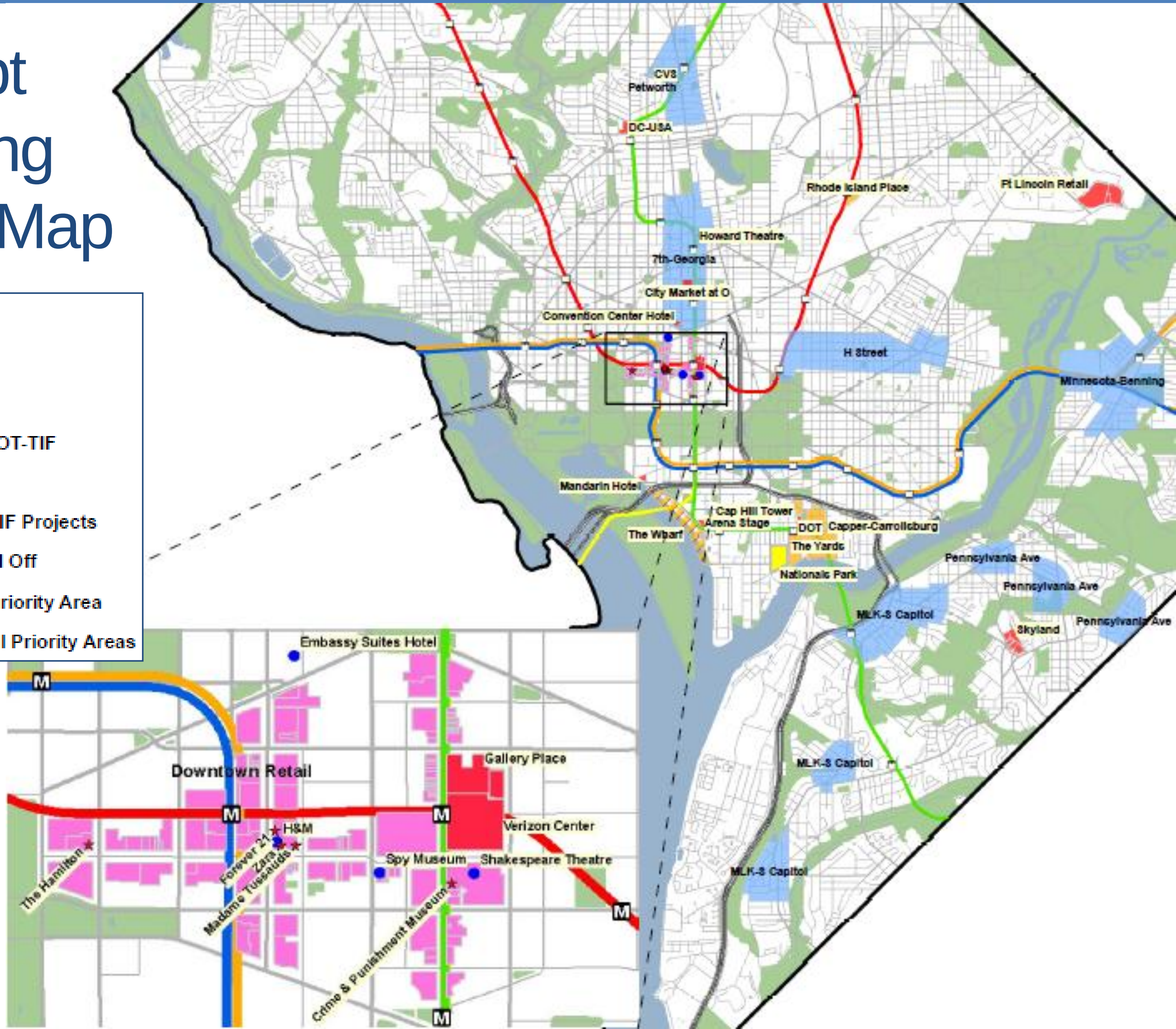
Additional Debt-Financed Projects

- Washington Convention Center
  - Debt: $524.5 million in bonds issued in 1998
  - Revenue: 4.45% add-on to the District hotel tax and a 1% addition to the gross receipts tax on restaurant meals and alcohol
- Washington Nationals Ballpark
  - Debt: $534.8 million in bonds issued in 2006
  - Revenue:
    - 4.25% sales tax on ticket sales, parking, and concessions
    - Fee on corps and partnerships with >$5M in gross receipts
    - Tax on sales of utilities to non-residential users
    - Rent income from the ballpark lease
- Verizon Center renovation
  - Debt: $50 million in bonds issued in 2008
  - Revenue: 4.25% sales tax on ticket sales and concessions

DC Debt Financing Project Map

Legend

- Baseball
- PILOT Projects
- SW Waterfront PILOT-TIF
- TIF Projects
- ★ Downtown Retail TIF Projects
- ● Project Bonds Paid Off
- Downtown Retail Priority Area
- Great Streets Retail Priority Areas



Debt Ceiling – Limit on Debt Financing

- Home Rule Act prohibits issuing GO Bonds resulting in debt service over 17% of General Fund expenditures
- In 2009, District passed a stricter limitation on borrowing ("Debt Ceiling")
  - District Bond debt service cannot exceed 12% of the District's annual General Fund expenditures and transfers in the year of issuance or any of the next 6 years
  - District Bond debt includes TIFs, PILOTs, and other economic development debt as well as GO Bonds
- Little room for new economic development borrowing in coming years
  - Lingering effects of recession – decreased expenditures and refinancing of debt to push costs into out years
  - Growing costs of TIFs and PILOTs already authorized

Debt Ceiling – Impact in Future Years

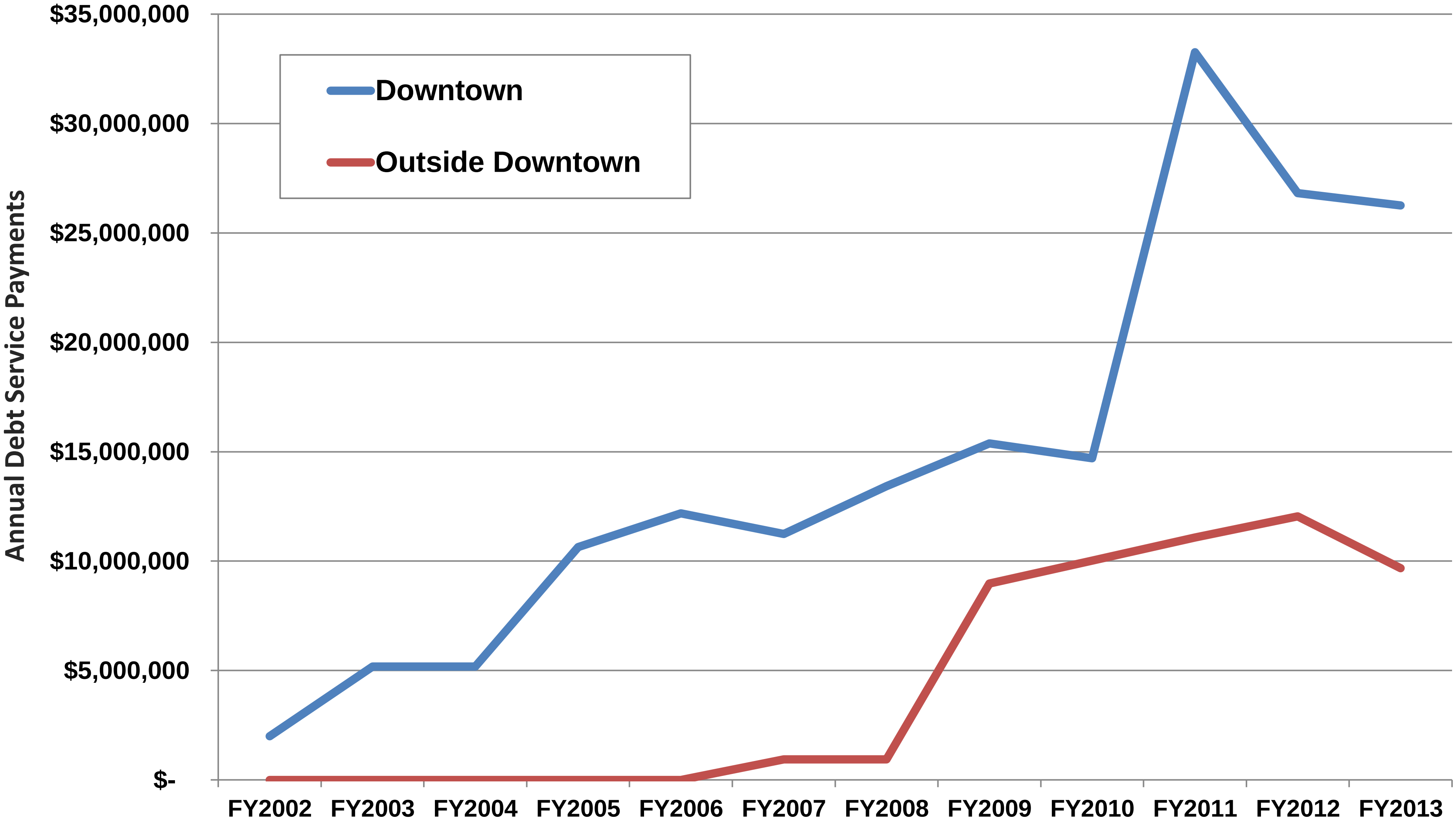
	FY 2013 Estimate	FY 2014 Estimate	FY 2015 Estimate	FY 2016 Estimate	FY 2017 Estimate	FY 2018 Estimate	FY 2019 Estimate	FY 2020 Estimate
Total G.O./I.T. Bonds Debt Service	$469,752,780	$522,308,784	$563,614,656	$599,832,253	$626,015,323	$682,848,486	$701,263,970	$747,017,277
School Modernization Fund	$8,625,713	$11,862,513	$11,411,713	$14,275,513	$13,522,513	$8,749,175	$8,750,925	$8,749,675
Prospective Paygo Capital Account	$0	$0	$0	$0	$1,970,000	$6,656,250	$14,095,750	$24,339,625
Certificates of Participation	$32,541,713	$24,619,294	$24,620,075	$24,622,431	$24,620,269	$24,620,738	$24,622,938	$24,621,863
Master Lease Equipment Purchases	$50,035,750	$40,285,177	$34,092,025	$29,959,702	$23,414,960	$20,086,265	$19,624,856	$19,967,235
Capital Leases[2]	$2,792,500	$2,792,500	$2,792,500	$2,792,500	$1,396,250	$0	$0	$0
Housing Production Trust Fund	$8,220,857	$10,868,058	$13,515,963	$15,979,947	$15,980,350	$15,976,463	$15,980,988	$15,977,913
TIF/PILOT Bonds Issued & Authorized[3]	$36,723,943	$57,279,020	$49,509,527	$60,100,000	$60,189,678	$60,047,180	$59,773,382	$59,517,413
Special Projects (projects below)	$81,063,532	$82,021,126	$82,322,659	$75,934,483	$74,887,235	$73,973,430	$72,875,014	$72,650,243
Ballpark Bonds[4]	*$32,579,589*	*$33,509,654*	*$32,798,587*	*$24,556,220*	*$23,519,562*	*$22,621,357*	*$21,543,497*	*$20,548,758*
Verizon Center Revenue Bonds	*$3,411,038*	*$3,447,417*	*$3,481,162*	*$3,517,274*	*$3,550,423*	*$3,585,609*	*$3,622,503*	*$3,660,775*
Convention Center Hotel Financing	*$11,984,580*	*$11,984,580*	*$13,055,435*	*$14,903,314*	*$14,909,276*	*$14,909,239*	*$14,898,539*	*$15,680,234*
Convention Center Bonds	*$33,088,325*	*$33,079,475*	*$32,987,475*	*$32,957,675*	*$32,907,975*	*$32,857,225*	*$32,810,475*	*$32,760,475*
Total Debt Service on Tax-Supported Debt	$689,756,788	$752,036,472	$781,879,117	$823,496,828	$841,996,578	$892,957,986	$916,987,823	$972,841,243
Total Expenditures as of June 22, 2012[5] (Incl. UDC Total Exp)	$6,639,367,950	$6,787,821,599	$6,931,075,814	$7,112,873,107	$7,290,694,935	$7,472,962,308	$7,659,786,366	$7,851,281,025
Ratio of Total Debt Service to Total Expenditures (Debt Ceiling is 12%)	10.39%	11.08%	11.28%	11.58%	11.55%	11.95%	11.97%	12.39%
Total Economic Development Debt (HPTF, TIF, PILOT, Special Projects)	$126,008,332	$150,168,204	$145,348,149	$152,014,430	$151,057,263	$149,997,072	$148,629,383	$148,145,568
Percent Economic Development Debt	18.3%	20.0%	18.6%	18.5%	17.9%	16.8%	16.2%	15.2%

1. Includes annual judiciary property tax payment to the District.
2. Does not include Judiciary Square COP which is also classified as a capital lease.
3. Actual Debt Service and new issuance projections based on 7.25.12 economic development analysis.
4. Assumes annual cash defeasances beginning in FY15 in accordance with the Ballpark Debt Repayment.
5. Assumes 2.5% GF Expenditure Growth beginning after 2016 based upon growth during final year of financial plan and consistent with Federal CBO annual projected GDP growth rates.

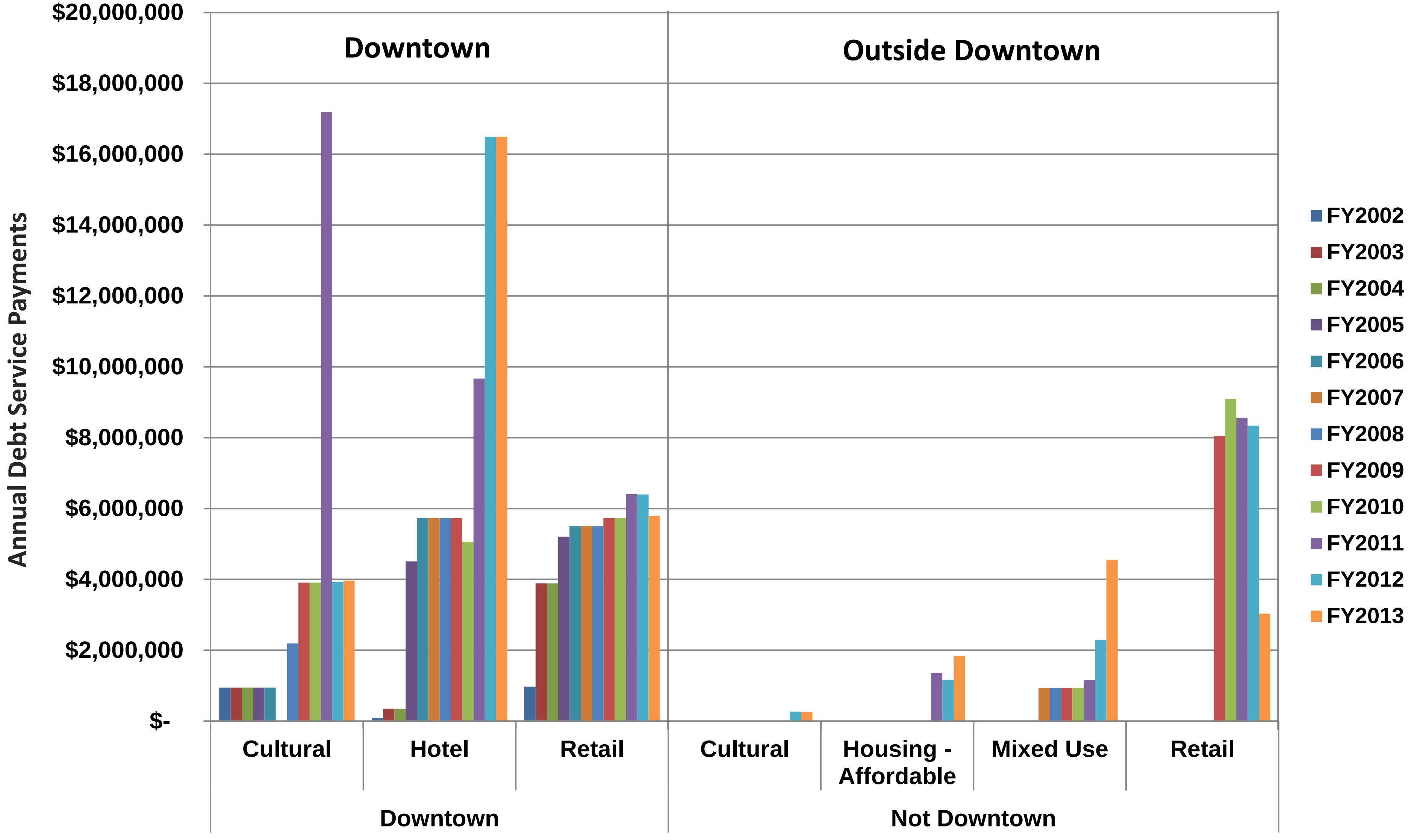
TIF/PILOT Trends – Fiscal Impact

- TIFs more effective for commercial than residential development
  - Commercial tax rate is higher
  - Commercial projects generate more sales tax increment
  - Hotels make particularly effective TIFs because the hotel tax is part of the increment
- OCFO analytical role impacts decisions on program use
  - Fiscal Impact Statements look at costs over the 4-year financial plan period, so some TIFS and PILOTs are delayed until out-years to minimize impact
  - OCFO conducts “but-for” test as well to judge whether project needs the subsidy

TIF/PILOT Trends – Project Location



TIF/PILOT Trends – Land Use



Tax Code Incentives

Tax Abatements and Tax Credits

Tax Incentives

- Typical uses of tax incentives
  - Targeting development and revitalization to certain neighborhoods – property tax abatements
  - Attracting and retaining businesses – income tax credits and tax abatements
- Tax incentives for economic development are provided in two ways:
  - By-right incentives to construction projects or firms that meet certain eligibility criteria
  - Discretionary or firm-specific tax relief that is granted on a case-by-case basis

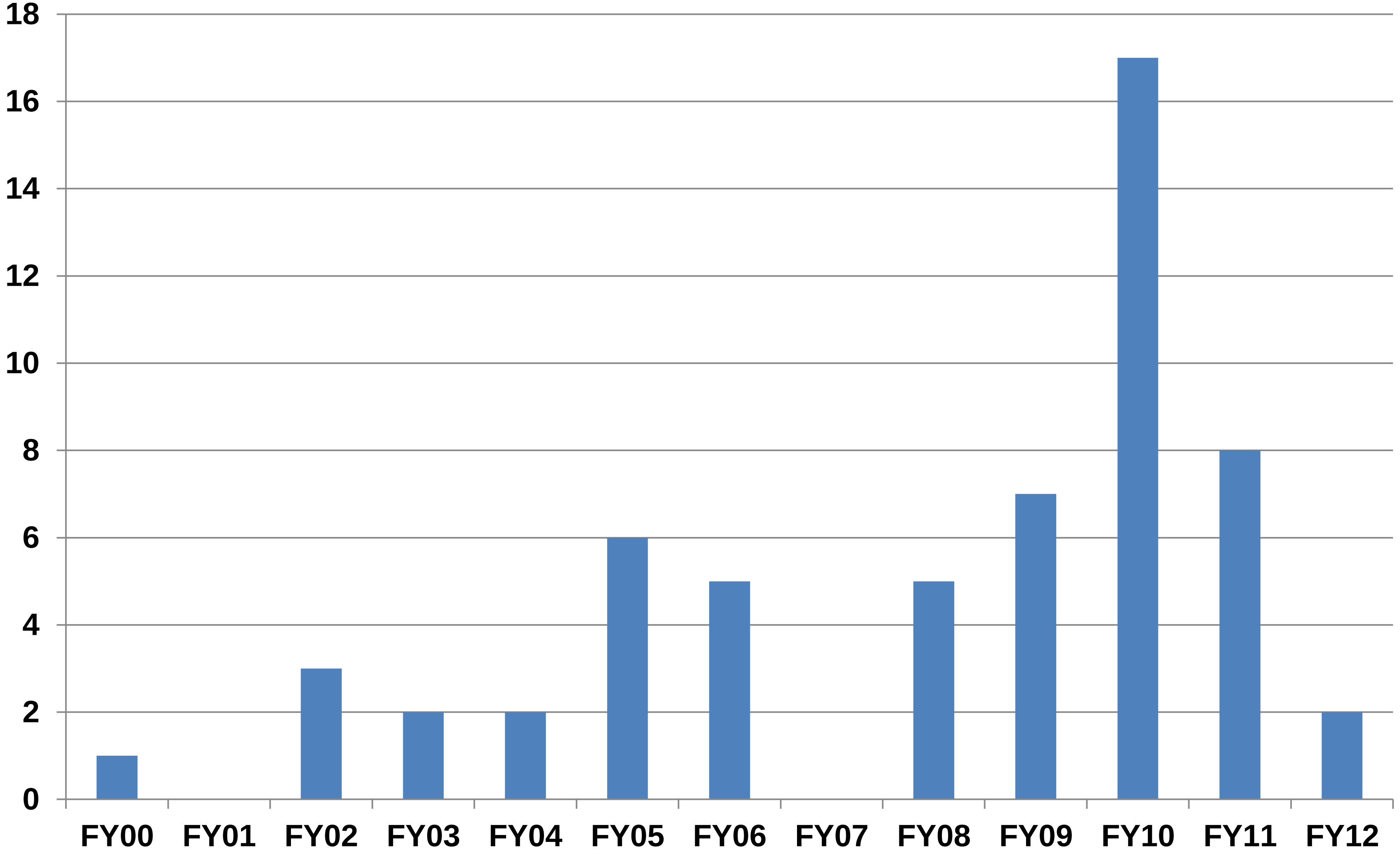
Tax Incentives – By-Right Programs

- Tax incentives aimed at neighborhood revitalization:
  - Property and sales tax exemptions for supermarkets
  - Real property tax abatements for new residential development in NoMA , downtown, and other designated areas
  - Real property tax abatements for non-profits locating in emerging commercial neighborhoods
- Tax incentives aimed at business attraction and retention:
  - QHTC – tax credits to qualified high technology companies
  - CAPCO – tax credits to insurance companies for investing equity in small business venture capital funds
  - Supermarket and non-profit tax incentives mentioned above

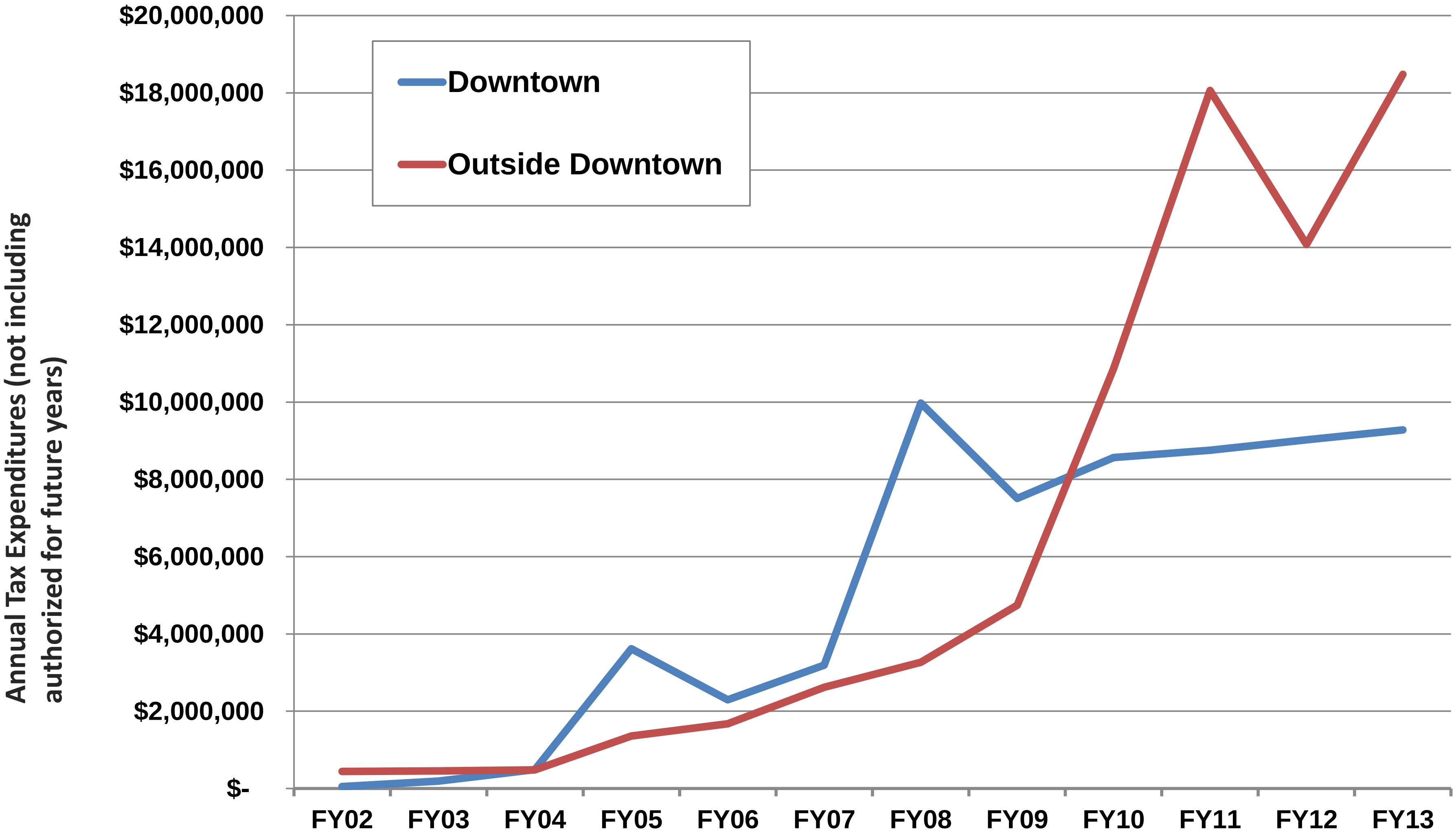
Tax Incentives – Discretionary

- Discretionary or firm-specific incentives require legislative action by the Council and the Mayor
- Most often, discretionary incentives are abatements of property taxes, but packages can also include abatements of sales tax on construction materials, deed and recordation tax, etc.
- Since 2011, OCFO has been required to prepare a “but-for” analysis before an incentive can be enacted. Previously, no such analysis was conducted.

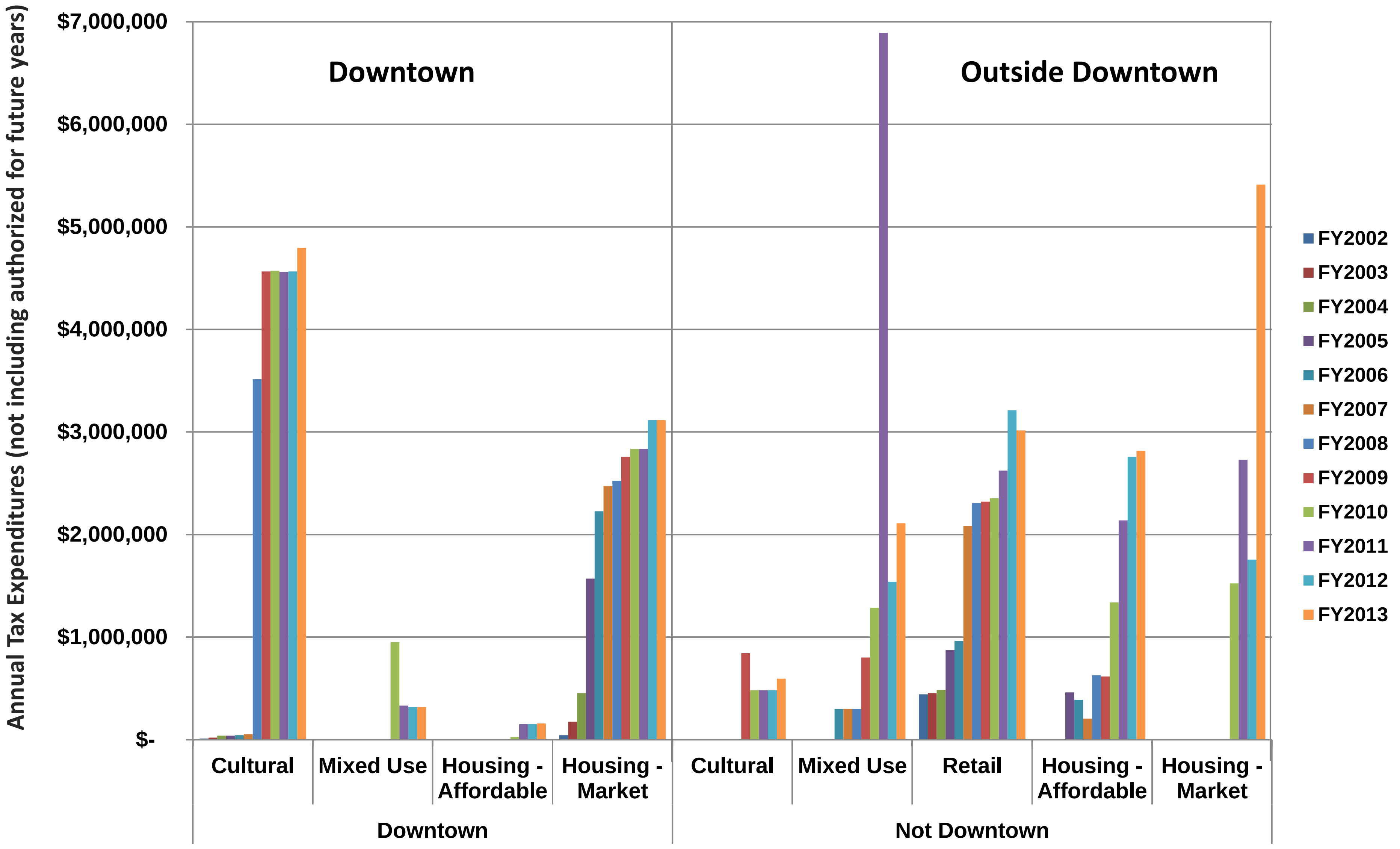
Tax Abatements Passed Each Year



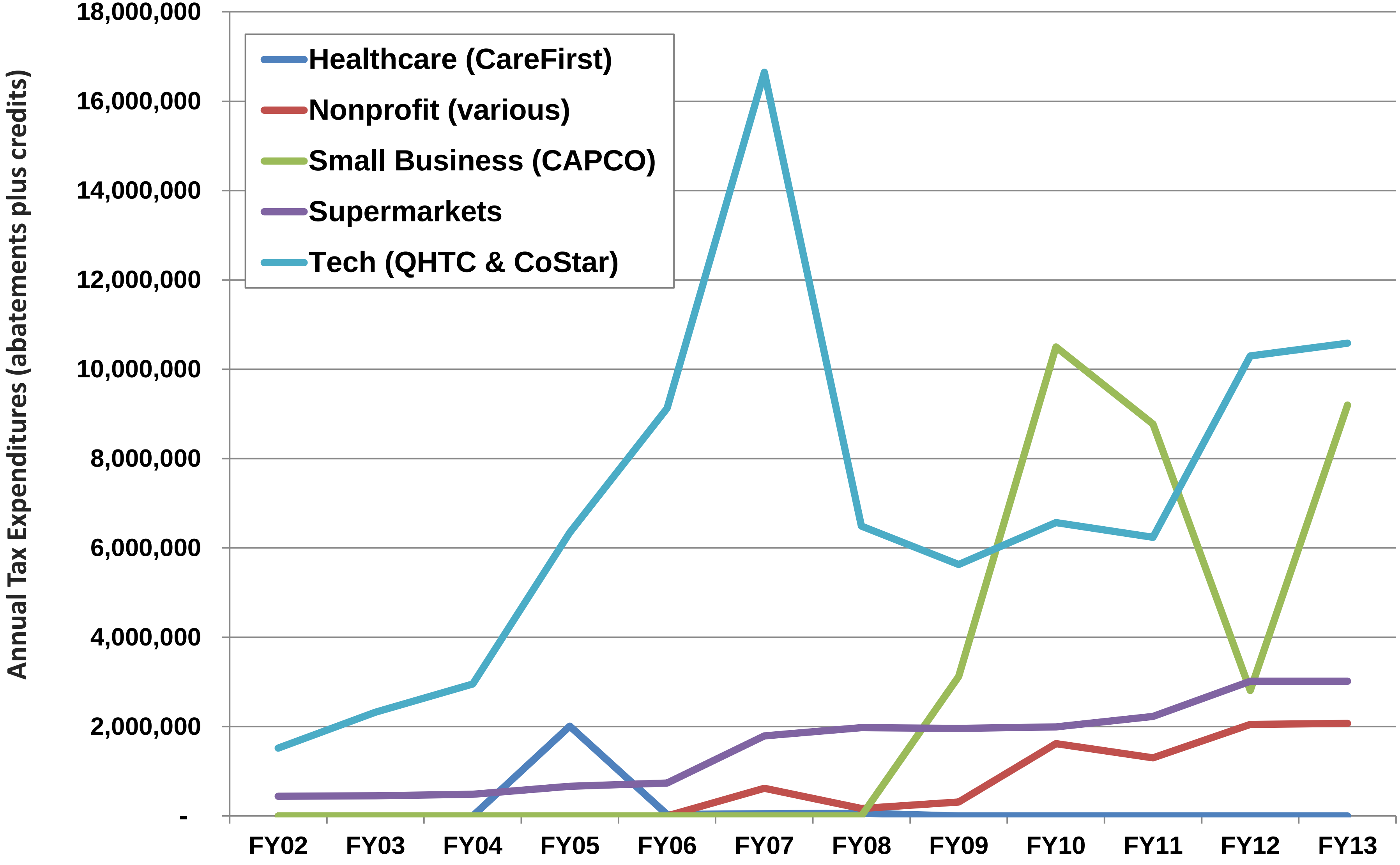
Tax Abatement Trends – Project Location



Tax Abatement Trends – Land Use



Tax Incentives for Business Attraction



Private Activity Bonds

Tax-exempt municipal bond debt issued on behalf of private projects

Private Activity Bonds in DC

- States can issue tax-exempt municipal bonds on behalf of private projects to lower their cost of capital
- Federal government allocates private-activity bond authority annually
  - DC will receive $291.87M for 2013
- DMPED divides DC's authority between 3 programs:
  - Industrial Revenue Bonds
    - Non-profits and manufacturing businesses qualify
  - Enterprise Zone Bonds
    - Up to $15M in loans for businesses located in low-income areas of DC
    - Businesses also receive various local hiring incentives
  - DC Housing Finance Agency Bonds
    - Finance mixed-income and affordable housing projects

Private Activity Bond Usage by Year

NOTE: Awaiting data for this chart, will add
Before presentation to TRC

Concluding Thoughts

Programs Imply Tax Code Tradeoffs

- Location-specific programs trade short-term real property tax revenue from a site for revenue from: (tax in parens)
  - Job creation (Income, Business)
  - Economic activity on the site (Sales, Business)
  - Possible property value increases around the site (Property)
  - Long-term, return of site to the tax rolls (Property)
- Business-specific attraction and retention programs trade short-term business tax revenue for revenue from:
  - Job creation (Income, Business)
  - Private business investment (Business, Income)
  - Diversification of employment base and greater resiliency of the local economy (All)

Programs Require Long-Term Planning

- Bond programs
  - Up-front analysis may be only real opportunity for government input in project
  - Bond investors will not accept risk of government options to change terms after bond issuance
  - Bond terms of 20+ years lock in government spending decisions
- Tax code incentives
  - Often significant time lag between passage and project completion
  - Options for government leverage over time are limited, but can be significant
    - Linking incentives to public benefits, like local hiring or affordable housing
    - Clawback provisions
    - Program sunset provisions