EVALUATING THE DISTRICT OF COLUMBIA TAX INCREMENT FINANCING (TIF) PROGRAM

FTA REVENUE ESTIMATION CONFERENCE
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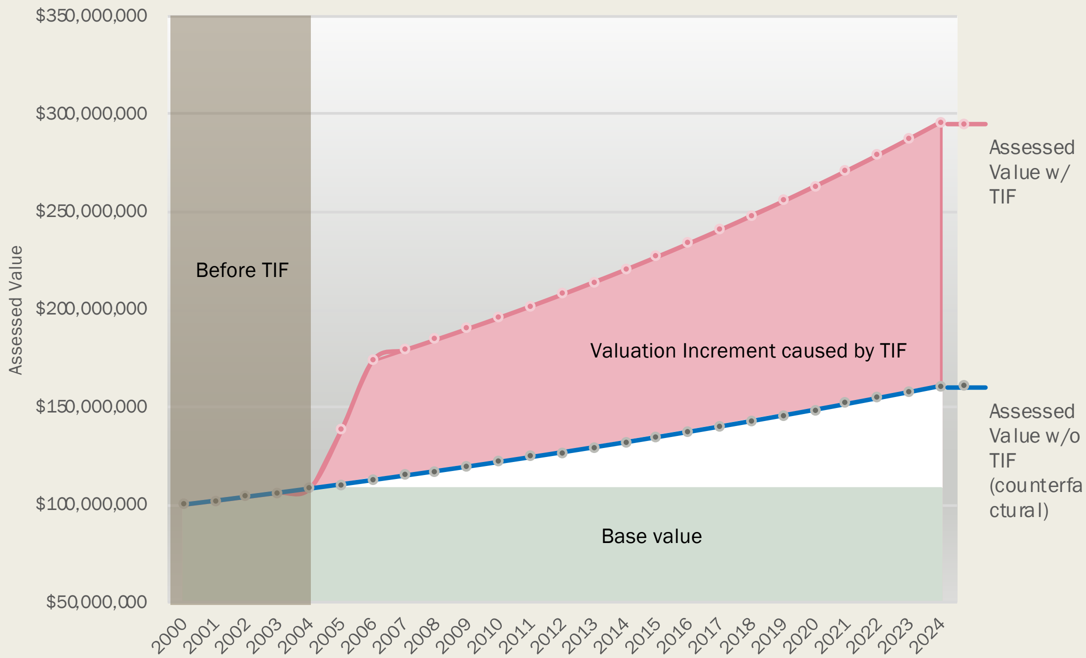
What is TIF?

- Background
  - One of the most important roles of state and local governments is to promote economic development
  - Successful development often requires coordination between local governments and the private sectors
  - Private-sector investments can face significant impediments such as infrastructure bottleneck
  - These impediments can often be remediated by government and private-sector actors working together
  - Tax increment financing (TIF) can provide a framework for such cooperation

- Definition
  - TIF involves earmarking the new real property and sales taxes generated by TIF project to pay for the public and private investments that make that redevelopment possible. Core elements of TIF include:
    - a designated TIF district with defined geographic boundaries;
    - a defined and limited operation period;
    - Expenditures supported by debt such as bonds or loans used for economic development; and
    - Increment in real estate tax and sales tax used to finance development expenditures
  - Increment in tax base will result if the TIF investment stimulates real estate appreciation and sales tax generation.
  - "But-for" test
    - Increment tax revenues would not exist "but for" the TIF that enabled the development
    - There is no loss to the local governments

An Example of How TIF Works



- Without TIF (the Counterfactual)
  The value of the parcels would have grown from about $100 to $160 million between 2000 and 2024
- With TIF
  The value of the parcels would have grown from about $100 to Almost $300 million in the same period
- Base value of the TIF district
  - The value of the real estate in the district when TIF was established
  - Around $108 million
- Incremental Tax base
  - The assessed Value with TIF subtracted by the base value, or alternatively,
  - The assessed Value with TIF subtracted by the counterfactual assessed value
  - Incremental tax base represents valuation lost to local governments
  - Incremental taxes generated from incremental tax base are directed to a designated TIF revenue fund separate from the District's General Fund.

Principal Objective of this Study

To use a standard model to evaluate the economic returns on city government investment in Six different currently-financed TIF projects in terms of actualized real property values and sales tax collections.

Specific Objectives

Use a standardized model to

1. Estimate the project's annual ***economic*** return on investment assuming standard 25-year debt service
    a) Estimate each project's first year of positive cash flow;
    b) Estimate each project's break-even timeline;

2. Determine whether each project adds economic/financial value to the city's fiscal portfolio (i.e. is self–supporting)

3. Determine whether the entire TIF Program (per the six projects) adds economic/financial value to the city's fiscal portfolio (i.e. is self–supporting)

Key Features of the TIF Evaluation Model

1. The Annual Costs
   a) A debt template that assumes a 25-year loan at a 6 percent interest rate will be applied to each TIF project.
   b) The loan amount will be the actual TIF loan amount for each project.

2. The Counterfactual
   a) The actual economic performance of the TIF will be compared to a counterfactual.
   b) The counterfactual assumes a nearly comparable project was privately-financed and whose property 2019 assessment value is equal to 75% of the actual TIF project's actual 2019 property assessment value.

3. The Annual Benefits – The three sources of debt repayment
   a) The net or increment in RPT collections increment for TIF Property equals the actual total RPT collections for the project minus the estimated RPT collections for the counterfactual (assuming 75% of actual 2019 value).
   b) The net or increment in RPT collections for the Contiguous Squares (CSs) equals the actual total RPT collections for the CSs minus the estimated RPT collections for the CSs assuming they were 75% of actual 2019 value.
   c) The sales tax collections from the TIF Project proper.

The Contiguous Squares

Contiguous Squares are the actual city blocks that are immediately adjacent to the TIF Square

An analysis is conducted on the taxable assessment values of all properties contained in the Contiguous Squares beginning when the TIF was issued.

It is assumed that 25% of the net AV of CSs are primary due to the TIF project. Therefore 25% of the increment in AV of CSs will be considered a tax revenue source for debt repayment.

Capital Hill Towers/ Courtyard Marriott

Square 0741

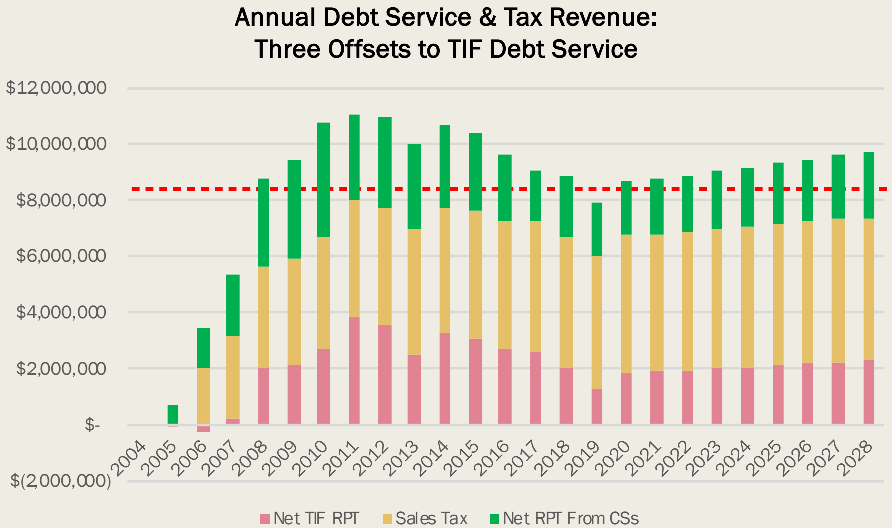
Contiguous Squares: 0738, 0739, 0767, 0768, 0769
0742, 0743, 0740, 0738

WCSA Convention Center Hotel/ Marriott Marquis

Square 0370

Contiguous Squares: 0369, 0401, 0402,
0371, 0342, 0341

A Hypothetical Project



<u>A Large Retail Project</u>

TIF Issued: 2004

Original TIF Amount: $100 million

Interest Rate: 6%

Total Debt: $193.3 million

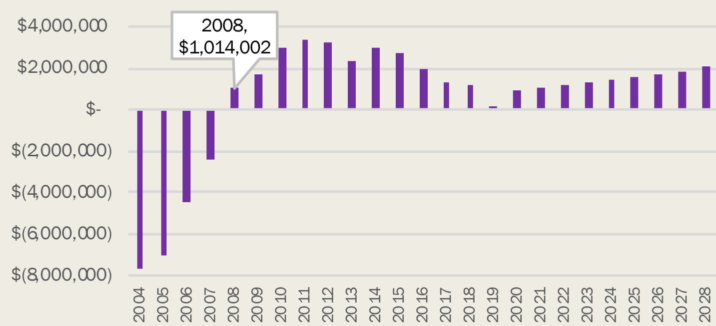
Annual Cash flow: annual tax revenue minus annual debt service

Annual Debt Service: $7.7 million

A Hypothetical Project (Cont.)

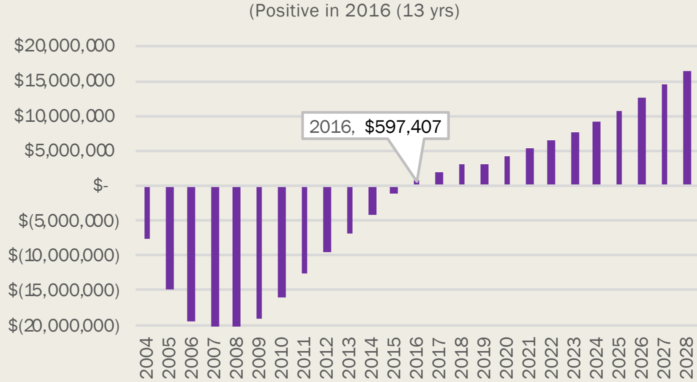
Annual Cash Flow

(Positive in 2008 (5 yrs)



Breakeven (cumulative of annual cash flow)

(Positive in 2016 (13 yrs)



A Few Key Metrics

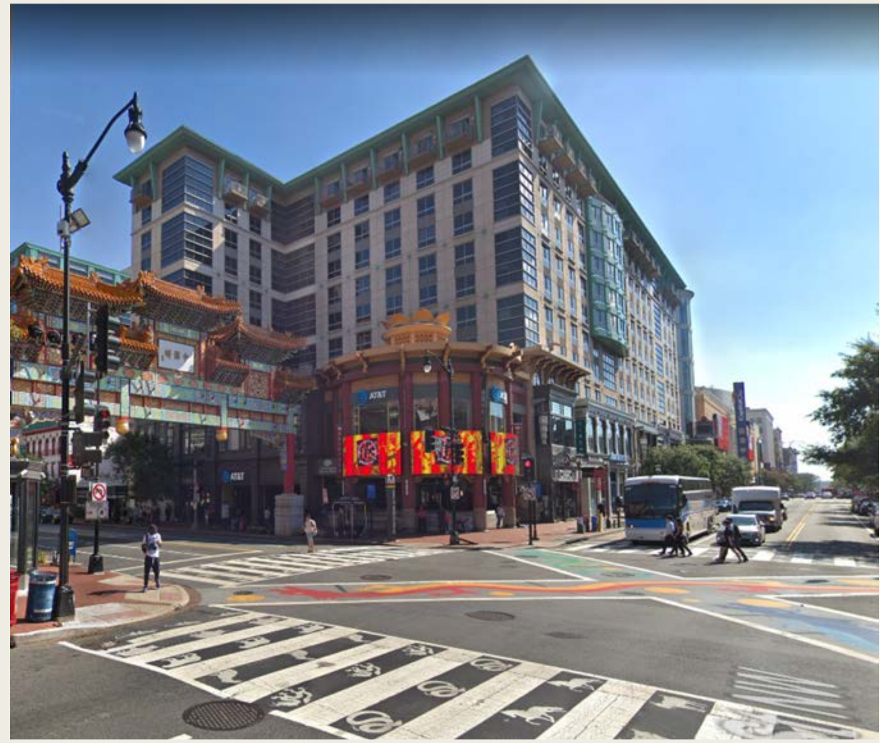
- Positive Cash Flow in 5 Years
  (annual tax revenue minus annual debt service)
- Breakeven Point in 13 Years,
  (cumulative cash flows)
- Modestly Positive ROI (~12%) over 25 years
- Total Debt/TIF Property AV
  - 5 years after delivery: 81.3%
  - 25th year of debt service: 38.6%
- Total Net Revenue Sources/Annual Debt Payment
  - 5 years after delivery: 143%
  - 25th year of debt service: 126%

  (These measures INCLUDE Sales Tax)
- Total Net *Property* Revenue/Annual Debt Payment
  - 5 years after delivery: 88.4%
  - Last year of debt service: 60.3%

  (These measures EXCLUDE Sales Tax)

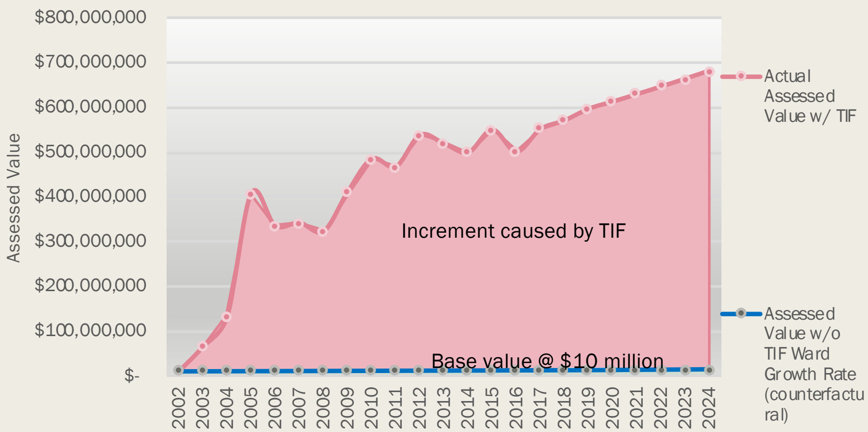
An Early Success Story: Gallery Place, Washington, DC

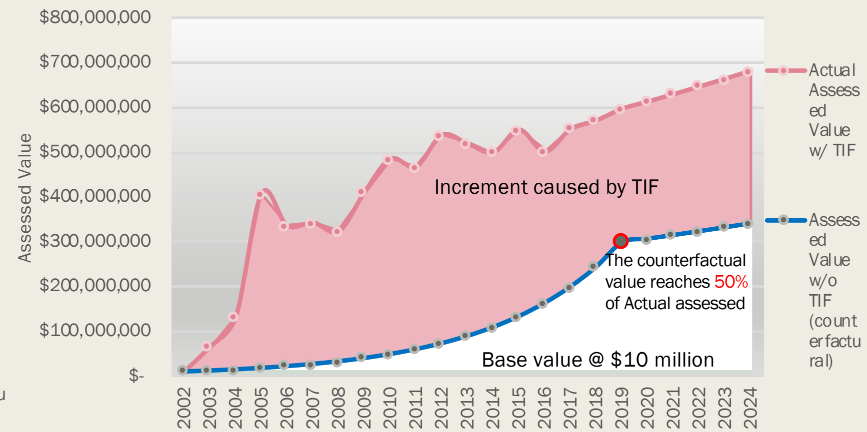
- Gallery Place is a $240 million, downtown mixed-use project in Washington DC.
- DC issued a $74 million bond for the TIF project in 2002.
- The project includes 193 residential units, 200,000 s.f. of retail, 200,000 s.f. of office space, and 2400 cinema seats.
- Gallery Place has been a leading catalyst for the revitalization of the eastern downtown by attracting 6 million annual visitors to the Chinatown area,
- The project created about $10 million in new sales and property tax revenues per year once stabilized.
- Debt repaid ahead of schedule, returned $15 million to city above debt



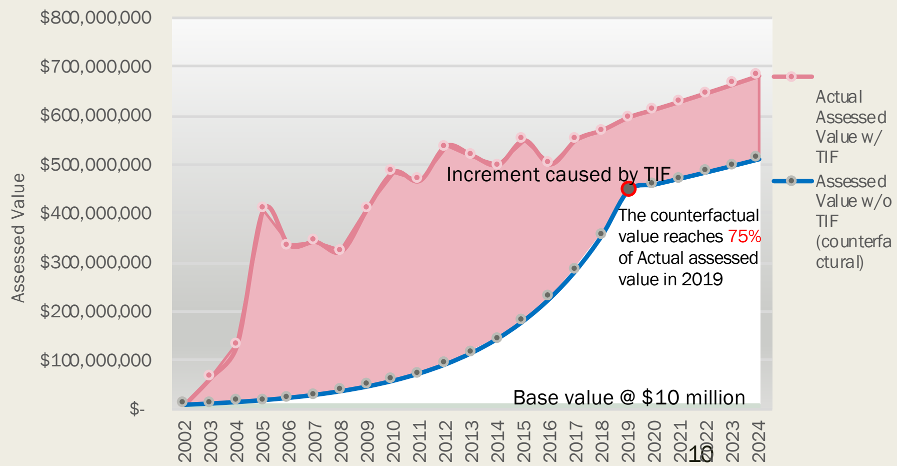
Source: Google map street view

Gallery Place – Actual and Counterfactual Assessed Values



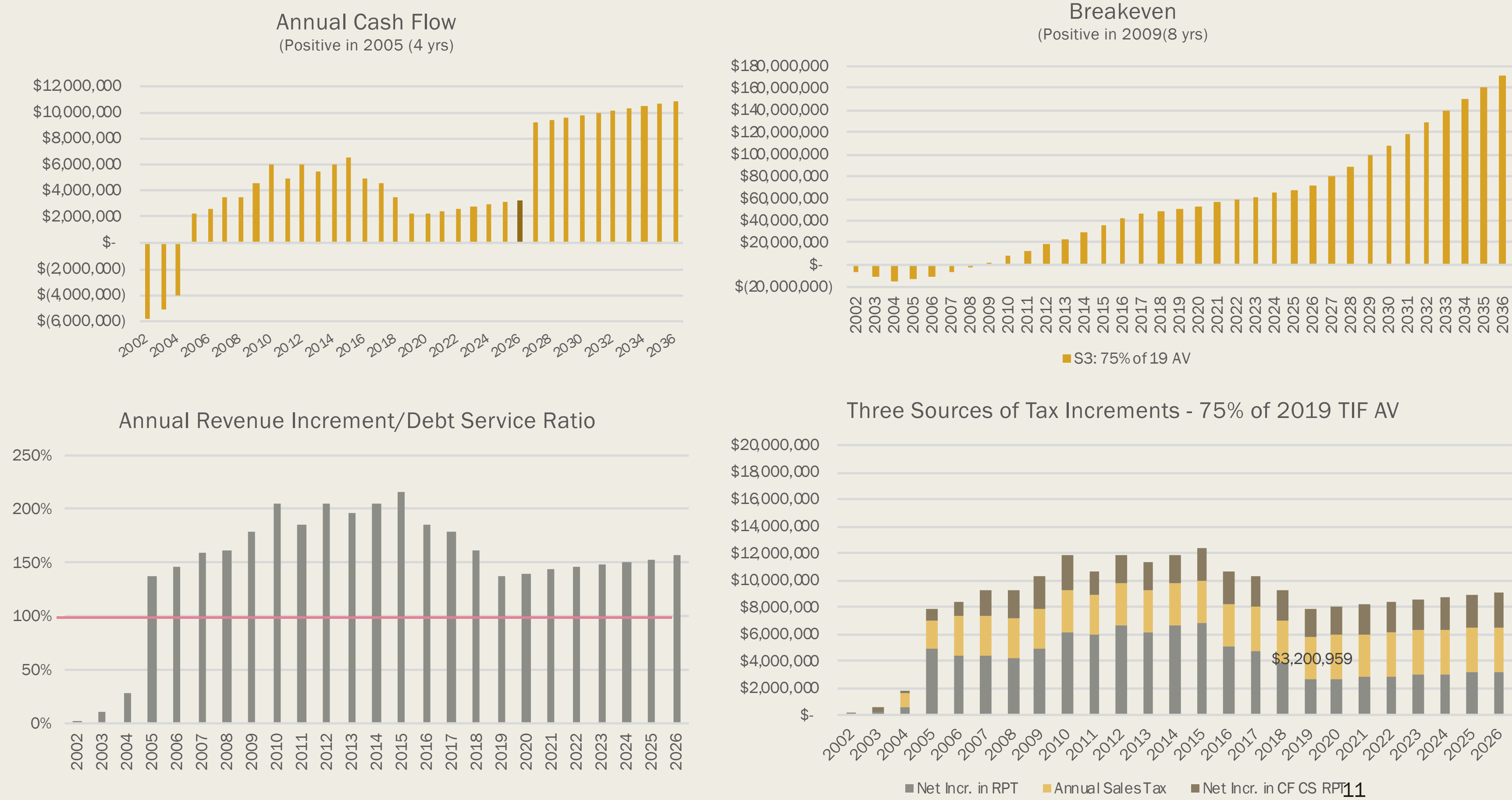


- Chart 1 (upper left) Assumes that without TIF, assessed value in the area would grow at the same speed of real property growth in the ward (1.5%) inflation adjusted rate;
- Chart 2 (upper right) Assumes that the counterfactual assessed value would reach 50% of the actual value by 2019 (an average annual growth rate of 22%);
- Chart 3 (lower right) Assumes that the counterfactual assessed value would reach 75% of the actual value by 2019 (an average annual growth rate of 25%);
- These charts do not include assessed value of the continuous square, and they do not include sales tax, which is also earmarked for repayment of the bond



Gallery Place – Actual and Counterfactual Assessed Values

(75% of 2019 TIF AV)



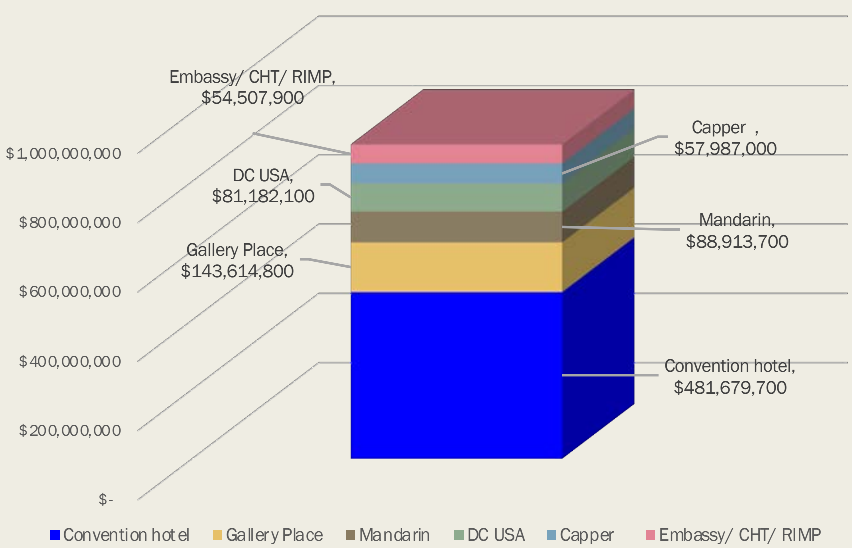
Evaluation of Eight TIF Projects – Some Key Metrics

	TIF Bond at Origination	Bond to Project Value Ratio	Positive Cash Flow in (75% growth)	Breakeven in (75% growth)	ROI in 25 Years @ ward growth in counterfactual	Excess Revenue @ ward growth in counterfactual*	ROI in 25 Years @ 75% growth in counterfactual	Excess Revenue @ 75% growth in counterfactual*
Gallery Place (Res, retail & office)	$74,300,000	21%	Year 4	Year 8	192.92%	$ 204,479,950	66.94%	$ 70,950,781
Mandarin Hotel (Hotel)	$46,000,000	8%	Year 2	Year 2	382.78%	$ 251,185,410	289.42%	$ 189,920,429
Capitol Hill Towers (Res,Hotel,Retail)	$10,000,000	8%	Year 3	Year 4	684.94%	$ 91,811,709	435.83%	$ 58,419,242
Embassy Suites (Hotel)	$11,000,000	4%	Year 3	Year 3	2290.98%	$ 337,797,134	1278.25%	$ 188,474,325
DC USA (Res, Retail)	$42,000,000	17%	Year 3	Year 6	238.85%	$ 126,209,195	160.77%	$ 84,951,204
Capper Carrols (Public housing)	$30,000,000	47%	-	-	-153.54%	$ -52,816,424	-150.27%	$ -51,690,812
Convention Center Hotel (Hotel)	$249,200,000	59%	Year 24	Year 31	-3.52%	$ -10,049,683	-35.66%	$ -101,887,969
Rhode Island MP (Mixed use)	$7,200,000	8.01%	Year 21	Year 30	90.07%	$ 7,435,982.75	-39.21%	$ -3,236,796

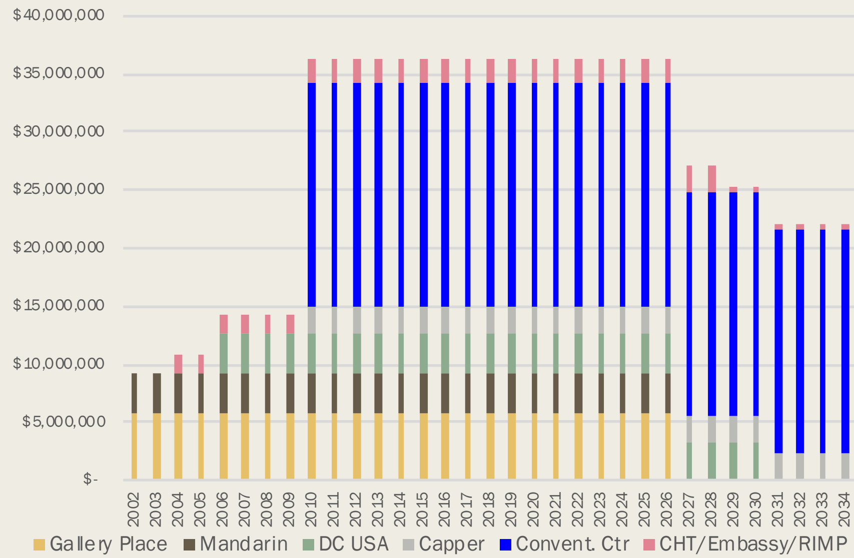
- *Excess revenue is defined as total tax revenue increments subtracted by total debt payments at the end of 25th year when the TIF bonds are paid off.
- Assuming no prepayment of debt.

Overview of Total Debt and Annual Debt Payments

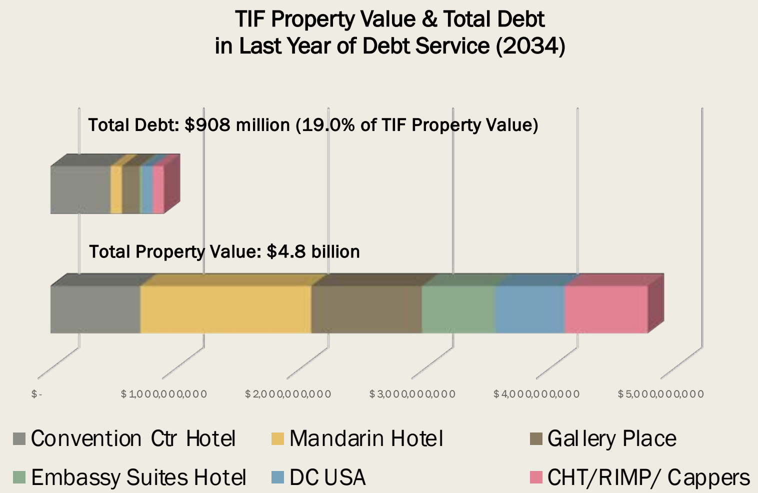
DC's TIF Program
(Total Costs of Major Projects, - $908 million)

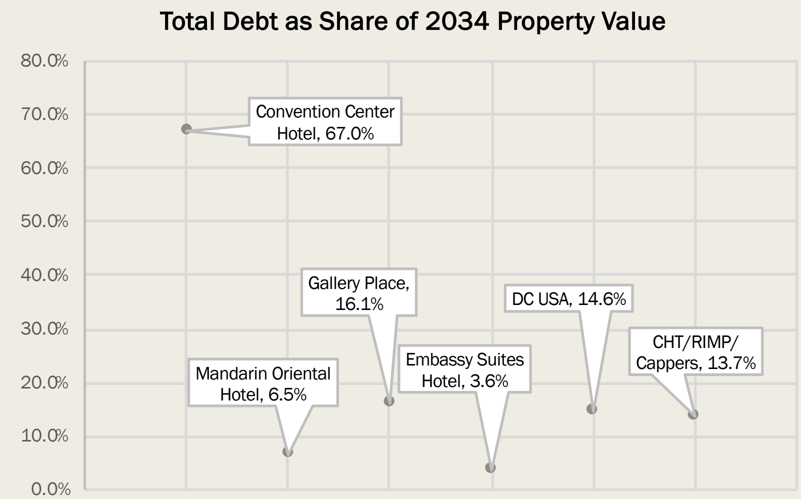


Total Annual TIF Debt Payments

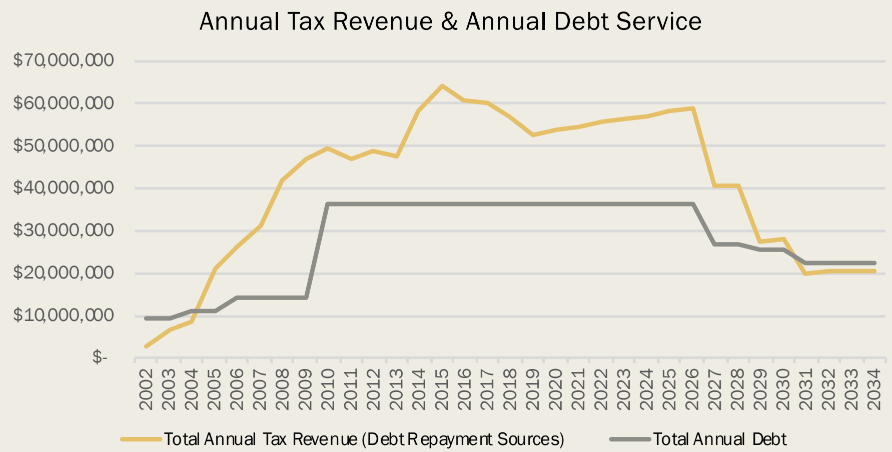


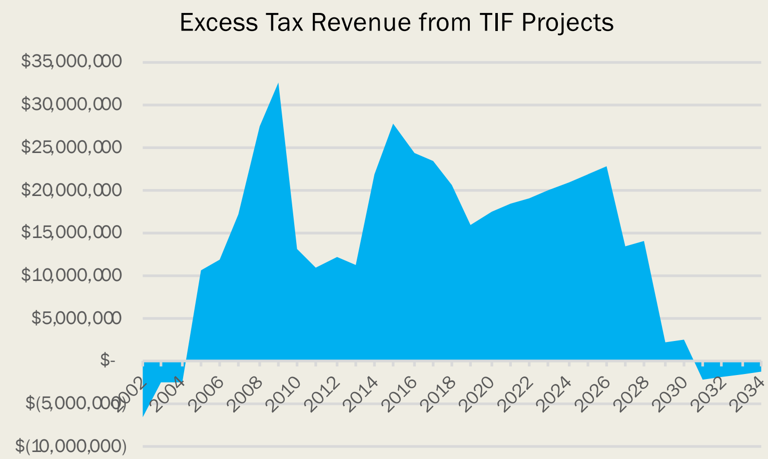
TIF Debt Relative to TIF Property Value

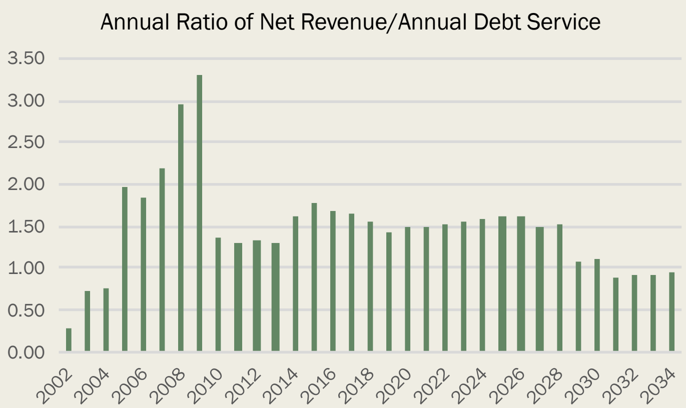




The Program's Capacity to Incur New TIF Debt







- Declining capacity stems from exclusion of the earlier TIFs being 'paid off' and no longer earmarked for debt service

Summary

- This was a standardized Ex Post analysis predicated on the actual economic/fiscal performance of TIF projects. The methodology relies on cash flow analysis and ROI evaluations.

- The model's depends on the estimation of counterfactual property value. A conservative counterfactual estimate significantly lowers the estimated net benefit of TIF projects

- Per the 8 projects analyzed, the TIF Program, as a whole, appears to be solvent until 2031
  - However, all individual TIF projects authorized after the recession have been insolvent
  - But between years 2019 and 2030, the city could support an additional $17 million in debt annually on average

- Of the 8 projects analyzed, the first 5 TIF issued were self supporting (Breakeven within 8 years)
  - Projects had relatively low debt ratios and existed in high property growth areas (CBD & gentrifying neighborhoods)

- Goals Matter: Remaining 3 projects appear to have goals that superseded financial viability
  - Appears Capper Carrollsburg is tax exempt with no expected significant spillover effects for neighborhood
  - The Convention Center Hotel appears to have been significantly over-leveraged
  - Rhode Island Metro Plaza has not facilitated large property appreciation in neighborhood

- Per the model, the city would be paying $36 million a year in TIF debt service for years 2010 to 2026 of which $19 million belongs to the convention center hotel

Lessons Learned & Things to Consider Going Forward

Counterfactual Matter

- Academic research suggests that may TIFs failed to meet the "but-for" test and local governments often enact TIF in part to capture growth that would happen w/o TIF. Our estimated counterfactual valuation would address this concern by estimating to how fast the area would grow w/o the support of TIF.

Sales Tax Matters:

- Sales collections help as a source of debt repayment especially when destination is a high volume business (DC USA), or a hotel (high tax rate)/

Debt Amount Matters:

- Keep debt to value ratio low and ensure new economic activity (new property and sale taxes) from new TIF projects can finance the new debt.

Location Matters:

- Cappers Carrollsburg & Rhode Island Metro Plaza suggest future TIF Projects in the eastern/non-gentrifying areas of the city may not produce significant amounts of new tax revenue.

Goals Matter:

- Social benefit, for example, may offset negative financial performance
- It may be important to the viability of the overall TIF program that any new insolvent projects do not dominate the city's TIF portfolio.