MAKING SENSE OF THE DISTRICT’S TAX ABATEMENT DOLLARS:
NINE QUESTIONS TO CONSIDER

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The process for awarding property tax abatements in the District has, for a long time, lacked a coherent and systematic approach. This has resulted in a process which appears to amount to “first-come, first-serve” approval that fails to adequately consider the costs and benefits of proposed tax abatements or how such abatements fit within the context of the District’s overall budget outlook and economic development goals.

This paper outlines nine critical questions that the DC Council and the public ought to consider when weighing the merits of a given tax abatement proposal:

1. How much subsidy is required, at this point in time, to enable a project to move forward?
2. Have the developers sought private financing before seeking a public subsidy?
3. How much will the abatement cost in terms of lost revenue?
4. What are the community benefits of the abatement?
5. Does this project address an economic development priority for the city?
6. Are any costs of the abatement hidden?
7. Does this abatement have a clawback provision?
8. Is the cost of the abatement capped?
9. Does an abatement have a sunset and subsequent review process?

Some of these questions were incorporated in the recently approved “Exemptions and Abatements Information Act.” The remaining questions represent an effort to advance the goal of increased transparency and accountability regarding property tax abatements even further.

Why are these questions important?
TAX ABATEMENTS DON'T RECEIVE AS MUCH SCRUTINY AS ON-BUDGET PROGRAMS

Tax abatements are a form of government spending through the tax code. The District, like any jurisdiction, has a legitimate interest in promoting economic and community development. One way the District furthers this interest is by awarding subsidies or other tax incentives targeted on new commercial developments or on employers. However, unlike a direct form of subsidization, such as grants for a particular project or business, property tax abatements represent indirect spending. Tax abatements reduce or eliminate a property owner’s obligation to pay property taxes, which is a financial cost to the city for a certain period of time and a financial gain to the recipient. While the impact of a tax subsidy and a direct expenditure for the same purpose may be the same, they often are not seen as such.

The indirect spending that occurs through tax abatements does not receive a great deal of scrutiny because it often is not considered within the budget process. When direct spending on programs is considered and debated within the yearly budget process, the Mayor and Council weigh the costs and benefits of a program in relation to other programs and the District’s overall fiscal health. In this way, policymakers determine which programs are essential to maintaining a healthy, educated, and productive populace, and prioritize these programs accordingly.

Unlike direct spending, spending on property tax abatements occurs “off the books” because it is not reflected in the budget of any DC government agency. If the Deputy Mayor for Planning and Economic Development awarded $10 million in grants for economic development, for example, that would be reflected in budget documents, but $10 million in tax abatements for the same purpose would not. This means that property tax abatements don’t receive the same level of scrutiny as police department staffing levels or teachers’ salaries, for example. In an era of tight budgets, when numerous services for city residents are being curtailed, it becomes all the more important for lawmakers to keep an eye on how taxpayers’ money is being spent.

TAX ABATEMENTS CAN BE QUITE COSTLY

For some commercial properties, a ten-year property tax abatement can be worth millions of dollars. The Unified Economic Development Budget (UEDB) Report released last year by the Office of the Chief Financial Officer was the first systematic attempt at tracking the various economic development subsidies handed out by the District. According to the UEDB, in 2010, the DC Council authorized 17 tax abatements with an estimated future cost of $166 million over a number of years. Moreover, the cost of tax abatements is estimated when they are adopted, but no follow up is conducted to assess the actual costs as the abatement is implemented. The costs of a property tax break would rise, for example, if a property’s value grows faster than projected when the abatement was adopted.
AN AD HOC PROCESS PREVENTS TAX ABATEMENTS FROM BEING CONSIDERED RELATIVE TO OTHER ABATEMENTS, SUBSIDIES, OR PROGRAMMATIC SPENDING

The Mayor and Council have few tools to weigh the merits of a tax abatement proposal against those that have come before, are currently up for consideration, or may be proposed in the future. This is true in part because tax abatements are considered in an ad hoc fashion and are not part of a comprehensive budget. In the city’s budget process, the Mayor and Council divide up a fixed amount of revenue among an array of competing priorities. This forces policymakers to determine if they think spending on one program is more important than spending on another program.

Because tax abatements are considered in isolation of one another, this process does not occur. A given tax abatement proposal may appear to have substantial benefits relative to its costs, but there may be other projects which could provide even greater benefits at an equal or decreased cost to the District. The process for evaluating tax abatements should give lawmakers the ability to prioritize tax abatements. As such, not only are the principles laid out in this paper meant to provide the public with greater accountability in the issuance of property tax abatements, but they are also meant to provide lawmakers with the tools necessary to utilize taxpayer dollars as efficiently as possible.

THE EXEMPTIONS AND ABATEMENTS INFORMATION REQUIREMENTS ACT IS AN IMPORTANT FIRST STEP

The District needs tools and a framework to assess the costs and benefits of proposed abatements so they can be considered in the context of other possible uses for the resources spent on them. An important step towards such a framework was achieved in the FY2012 budget, which included the Exemptions and Abatements Information Requirements Act. The most important aspect of the legislation is that it requires a financial analysis of any project seeking a tax abatement to assess whether or not the project would be able to go forward in the absence of a subsidy and how much subsidy is needed for those projects that otherwise would not move forward. The act also requires a listing of community benefits the developer has agreed to as well as a description of the number and quality of jobs that will be filled by District residents.

While the Exemptions and Abatements Information Requirements Act is an important step, much work remains to be done. This paper addresses the relevant questions that policymakers and taxpayers ought to take into account when considering a
property tax abatement. It begins with those questions that the Exemptions and Abatements Information Requirements Act sought to address, followed by a series of questions for which the answers are not routinely gathered by any District government agency. Nevertheless, it is possible to find information needed to answer these questions.

1. **How Much Subsidy Is Required, At This Point In Time, To Enable A Project To Move Forward?**

   The decision to award a tax abatement to an economic development project should be based on evidence that it is unlikely to proceed without financial help from the city. Until recently, the District has had no process to address the very basic question of whether a proposed tax subsidy for a commercial development was critical to that project moving forward. This contributed to situations where tax abatements have been provided without clear justification. As one indication, a variety of development projects have been offered the same type of tax abatement in recent years – such as a 100 percent property tax break for 10 years – even though it is likely that the financing gaps differed significantly from project to project.

   In other cases, tax abatements were offered to projects that did not appear to need any financial help. For example, the District approved a $5.7 million tax abatement in 2009 for the View 14 residential development in Ward 1, at 2303 14th Street, NW. In early 2011, the Council considered (but did not approve) an additional tax break for the project. Yet this project was sold by the developer in June 2011 at a price that “shatter[ed] the record for the highest price per square foot in the metro area for a Class A rental product” according to the *Washington Business Journal.*

   Every commercial development project seeking financial help from the District through a tax abatement should be required to provide evidence of the need for a subsidy, which should then be scrutinized by the District to make an independent assessment. Such analyses currently occur through DC’s Tax Increment Financing (TIF) program – another form of tax support for economic development – but these kinds of analyses have not been required for tax abatements until recently.

   The Exemptions and Abatements Information Requirements Act, approved in 2011, recognizes the importance of a financial analysis of proposed tax abatements, similar to those required for TIF projects. Starting in fiscal year 2012, the act requires the DC Chief Financial Officer to conduct a financial analysis of projects seeking a tax abatement, to determine whether the project needs financing help to move forward, and the level of tax subsidy that would be needed in these cases.

   One example of such an analysis was conducted for a proposed 5-star hotel in Adams Morgan, which was seeking a 15-year property tax abatement. This analysis took place because the developers of the project originally sought tax increment financing (TIF) as their source of subsidization. If the developers had not initially sought a TIF, such a study would not have been conducted. The study commissioned by the CFO found that the hotel project faced a financing gap which prevented it from moving forward. Ultimately, this study helped to bolster the developer’s case for the tax abatement, which was approved by the DC Council.

   With the Exemptions and Abatements Information Act, it is likely that a financial analysis will be conducted for most tax abatement proposals. However, if an abatement is considered without this
type of analysis – such as through emergency legislation – the lack of such analysis would be an important reason to reject the tax abatement.

2. Have The Developers Sought Private Financing Before Seeking A Public Subsidy?

A critical element of understanding whether a project needs a public subsidy comes from an assessment of the developer’s efforts and success at obtaining private financing. Indeed, the clearest sign that a project may need a subsidy is if it cannot obtain enough private financing.

While seeking private financing would seem to be a logical prerequisite to seeking public financing, this has not always been the case. In 2008, the District approved a $35 million tax increment financing subsidy for a mixed-use project to replace the O Street Market in Shaw.³ The Chief Financial Officer indicated at the time that it could not assess the merits of the subsidy request because the developer had not completed lining up private financing, including even the amount of equity the developer would contribute directly to the project.³ Similarly, the CFO was unable to assess a proposed subsidy for the SW Waterfront development because the subsidy request came before other financing had been identified.

The Exemptions and Abatements Act addresses this issue by requiring the CFO to assess a developer’s documentation of: a) efforts to seek alternate financing; and b) the factors that limit the developer’s ability to obtain adequate financing. This is important for two reasons.

First, this can help highlight whether a developer has done everything possible to raise funds privately before asking for a public subsidy. If a developer has not attempted to line up private financing, it is impossible to accurately assess the true financing gap that may exist and require subsidization.

Second, this requirement will help illustrate why a project is unable to secure the necessary financing on its own. If a project faces trouble accessing adequate financing, it may be an indication that the proposed development is not viable or sustainable. Could it be that the project is overly ambitious? Does the project have excessively high construction costs? Have potential financiers indicated that the market for the project would be more desirable at a later date?

On the other hand, this analysis also could highlight projects that appear viable but are having trouble attracting investment because private investors are nervous of perceived risks. A development in a low-income neighborhood or in an emerging market may have trouble attracting financing for this reason. In these situations, public support may be warranted.

3. How Much Will The Abatement Cost In Terms Of Lost Revenue?

The cost of a tax abatement – the amount of revenue that the District would forgo – is one of the most important issues to address when considering an abatement. As noted, tax abatements are a use of public resources to meet a specified goal, similar to funds expended on health care or libraries or transportation. Thus, tax abatements should be assessed based on their benefits relative to their costs.
The process for measuring the fiscal impact of a tax abatement should be straightforward, by measuring the revenues that would not be collected as a result. Yet proponents of tax abatements at times argue that the tax break has little or no cost to the city.

- **The method currently used by DC’s CFO to measure the fiscal effect of tax abatements is the preferred method.** The Office of the CFO measures the cost of an abatement by taking into account projections of property values and the taxes that would be raised by a given project under current property tax rates. The CFO compares this with the taxes that would be paid under the proposed abatement. The difference between the two is the fiscal impact.

- **Some tax abatement proponents falsely claim that the abatement will have no effect on tax collections.** In some cases, proponents of tax abatements suggest that they will not have a cost, particularly when the abatement promotes development on property that is currently vacant and therefore contributing little tax revenue. Yet, just because a property is currently vacant does not mean it will never develop if a subsidy is not granted. The District has one of the most vibrant and desirable commercial real estate markets in the country, which suggests that it often is not reasonable to assume that vacant land will not otherwise be developed. Moreover, allowing tax abatements for vacant land to be determined as having no cost would result in a tremendous weakening of the city’s future tax base, since it could create incentives to adopt such tax abatements.

- **Recognize that the CFO’s analysis may actually understate the ultimate cost of the abatement.** As noted, the CFO compares their projections of future property values and the taxes that would be raised by a given project to the taxes that would be paid under a proposed abatement. However, the CFO must oftentimes be conservative in their projection of future tax revenue. If, however, property values and their respective property taxes rise faster than the CFO’s projections, the cost or foregone revenue as a result of the abatement increases. As part of a 2010 deal to lure the CoStar Group to relocate from Bethesda to downtown, the Council granted the developers a 10-year property tax abatement worth $6.1 million. However, after purchasing the property for $41 million, the CoStar Group sold it a little over a year and a half later for $101 million, in what the *Washington Post* described as “the most profitable flip of Washington commercial real estate from the recession to date.” This deal illustrates that had the District not awarded the CoStar Group tax abatement, the city could reasonably have expected to obtain much more than the $6.1 million in property tax revenue over ten years that the CFO projected.
4. What Are The Community Benefits Of The Abatement?

The Exemptions and Abatements Information Requirements Act requires information to be provided on the community benefits that will come from a development seeking a tax abatement. This information must be provided prior to a hearing on the abatement legislation. This step is critical because the benefits of a project should be weighed against its costs. A tax subsidy with low costs that yields substantial benefit to the city is clearly superior to a costly subsidy that provides limited benefits.

The Exemptions and Abatements Act lays out the types of benefits that ought to be articulated.

- **Affordable Housing**: For residential properties information must be provided on the number of affordable housing units that will be included in the project, and the income levels for which the units will be affordable.

- **Jobs**: For all developments seeking abatements, information must be provided on both the number and quality of jobs that will be available to District residents. Project supporters must identify the number of temporary construction jobs that will be created and the wages and benefits of those jobs, as well as the number of permanent jobs associated with the completed project and the wages and benefits of those jobs. Information on whether jobs will be full-time or part-time is also required.

MOVING BEYOND THE EXEMPTIONS AND ABATEMENTS INFORMATION REQUIREMENTS ACT

While the adoption of the Exemptions and Abatements Act marks an important step in establishing the level of transparency and accountability necessary for lawmakers to make reasoned and strategic decisions regarding the sorts of property tax abatements they award, the process can be improved even further.

5. Does This Project Address An Economic Development Priority For The City?

When the District makes a decision to invest in a commercial development with a tax abatement, the decision should be in recognition of how the interests of the private developer align with those of the city. Tax abatements in the District typically are considered on an ad hoc, first-come, first-serve basis, but it would be better to consider each abatement proposal within the context of the city’s economic development goals. An abatement proposal ought to address a stated development priority of the city – such as retail development in a particular area, support for a specific sector of the city’s economy, or supporting jobs that match the skills of DC residents – that has been incorporated into a comprehensive development strategy produced by the Mayor’s office. In the absence of a formal city-wide economic development plan, an abatement should advance one or more understandable economic development goals, including the following:

- **Promoting development in an economically depressed area of the city as a way to jumpstart development there**. There are a number of areas in the District which have yet to
attract the sort of retail, commercial, and housing development that has occurred in other parts of the city. Oftentimes, developers are deterred from investing in these areas due to perceived investment risks. Without assistance from the District to push development in these areas over a tipping point, it could take much longer to bring amenities to the residents of these areas.

- **Promoting projects that help advance an industry identified as having growth potential for the District.** This could include sectors such as information services, health care, and hospitality, which have considerable growth potential for the District’s economy.

- **Promoting certain kinds of development.** Some areas of the city have limited retail options, which creates a rationale for subsidies geared toward retail development.

- **Promoting projects that bring much needed jobs to the District.** To the extent that the District chooses to subsidize private development, city officials ought to certainly give greater weight to those projects that can help bring temporary and permanent employment to District residents.

While these types of targeted investments may make sense, it also is important to assess when further public investment in a given neighborhood or economic sector is not needed. Should DC, for example, continue to subsidize development around Nationals Stadium or in NoMa – areas that have received substantial public investments and are likely to grow in the future – or should it target subsidies to jumpstart development in areas whose economic future is less clear?

### 6. Are Any Costs Of The Abatement Hidden?

The Office of the CFO produces fiscal impact statements based on a four-year fiscal window. In some cases, the full costs of a tax abatement are obscured because some or all of the costs occur outside this window. This can occur because a development project may take several years to be completed. However, some tax abatement proponents also choose to defer the costs beyond the four-year fiscal window specifically so that the abatement will be certified as having no official impact on DC’s finances. For example, the District approved a $10 million loan to Arena Stage but deferred providing the loan for four years, resulting in a conclusion that the bill had no fiscal impact. There appeared to be no reason to delay the loan other than eliminating the official fiscal impact.

Fiscal impact statements from the CFO typically highlight costs that will occur beyond the four-year fiscal window, but these costs do not have to be offset when the legislation is considered.

Any tax abatement legislation that has delayed or hidden costs should be scrutinized carefully. If it appears that costs have been deferred intentionally, this is reason to oppose the legislation or to modify it so that its full costs are reflected. In other cases where the full costs are delayed, the costs that will later be incurred should be assessed to determine if the abatement could prove to be overly costly in the future.

In the long-term, a better way of bringing transparency to the costs would be to average out the cost over the full period of the abatement, so that costs would begin to be recognized in year one. For example, if an abatement were designed to award a $10 million subsidy over 10 years, but the
entire $10 million was deferred until the final 6 years in order to obscure the cost, policymakers should recognize that the per-year cost is $1 million and take that amount into consideration along with other budget expenditures.

7. Does This Abatement Have A Clawback Provision?

Some communities include “clawback” provisions in commercial property tax abatements and exemptions, which obligate developers to repay some or all of the tax subsidy received if agreed-upon community benefits are not met. Because subsidies are intended to create results, the District is perfectly within its right to ask that its initial investment be repaid if the expected results are not realized. Clawback agreements are one way of bringing increased accountability to economic development programs.

The District does not require clawbacks in all tax abatements, although some recent abatements have included them. For example, a tax abatement approved in 2010 for a hotel to be built in Adams Morgan included binding commitments to provide training for area residents and to hire residents for a share of jobs during construction and in the completed hotel. The legislation denies the tax break in any year that the benefits are not met.

According to Good Jobs First, at least 20 states have put into place some sort of clawback agreement in various economic development subsidy programs. For example, Virginia’s “Major Business Facility Job Tax Credit” program mandates that “if the number of qualified full-time employees drops below the average number employed during the first year of the credit, the state recalculates the original credit with the lower number of employees, and increases the company’s taxes by the difference between that amount and the credit claimed.” If the company’s employment falls below a pre-determined minimum level the entire subsidy must be repaid to the state. Maryland has clawbacks for both the “Job Creation Tax Credit” and “Property Tax Credit”. For the Job Creation Tax Credit, “if the number of qualified positions at a company decreases during the three years after the credit begins, a percentage of the subsidy is recaptured. If qualified positions fall below the threshold number, the entire subsidy is recaptured.” For the Property Tax Credit, “all credits claimed for a taxable year will be recaptured if, during the three years after the credit is claimed, a company fails to meet the thresholds for employment or physical size.”

8. Is The Cost Of The Abatement Capped?

Many tax abatements are awarded as a full or partial exemption from property taxes for a specified period of time. The estimated cost to the city in foregone revenue is based on projected property values. But the cost to the city in lost revenue could rise beyond expectations if property values rise faster than projected.

However, the District could elect to cap the amount of property taxes that will be abated, so that if the property value appreciates faster than projected, the cost to the city in lost revenue would not increase beyond the original estimate. In this way, the developer still obtains the amount of subsidy that they expected to receive and the District is not on the hook for foregoing more than officials expected to forego in tax revenue.
The District has capped the cost of some tax abatements, but typically it does not. For example, the District adopted a 20-year 100 percent tax abatement for the View 14 residential development. But the total value of the tax abatement was capped at $5.7 million. This meant that when the value of the tax abatement reached this level, the abatement ended and the developer was required to start paying property taxes.

In the same vein, the District has a variety of economic development tax incentive programs which offer property tax abatements to all future developments that meet certain criteria. Examples of tax incentive programs include the Net 2000 tax credit program, which offers property tax abatements and other tax subsidies for high-tech companies that locate in DC, and the NoMa Residential Development program, which provides tax incentives for residential developments in the NoMa area. In some cases, the costs of these programs are capped – which means that the District will award tax benefits until the capped level has been reached – such as the NoMa housing tax subsidies, and in other cases the program’s cost are not capped, such as the Net 2000 subsidies. Tax subsidy programs that are not capped run the risk of higher-than-expected costs, especially if more businesses qualify than expected.

A different approach would entail establishing a ceiling for the amount that an abatement program could subsidize. The abatements could be offered on a first-come first-served basis or they could be awarded on a competitive basis, which would allow the District to target subsidies in ways that are most beneficial to the city. For example, the NoMA Residential Development program caps the annual amount of tax abatements that can be awarded at $5,000,000 and the cumulative amount over the life of the program at $50,000,000. Making tax abatement programs competitive increases the likelihood that businesses awarded subsidies will be those with the best ideas, and whose projects would produce the most cost-effective results for the District’s overall economic development.

Whether competitive or not, a cap on the cost of tax abatement programs would limit the District’s exposure to financial risk.

9. Does An Abatement Have A Sunset And Subsequent Review Process?

Property tax abatements can create long-term obligations of District resources. And because tax subsidies are intended to support certain policy objectives – such as helping grocery stores open in underserved areas or helping a particular commercial project move forward – it would make sense to review the effectiveness and ongoing need for each tax subsidy. One way to further this goal is by creating a “sunset” or expiration date for all tax subsidy programs. A sunset typically leads to an evaluation to gauge the success of the tax expenditures, and can lead to revisions or elimination if the program is not achieving its stated goals or if it is no longer needed.

The District has property tax break programs in place both for projects within a particular area, such as the NoMa Residential Development Program, and for projects within a particular industry, such as the Net 2000 high-tech tax incentive program. These programs have been in place for several years but lack mechanisms to determine whether or not the subsidies are in fact helping to further their stated goals. Instead of allowing a program to exist indefinitely, a sunset could be
critical to assessing whether there may be other development tools that would be more effective at promoting employment growth.

A sunset set at a reasonable interval, such as four or five years, would give policymakers and the public the chance to review a tax abatement and assess its effectiveness. This is one way to ensure that indirect spending through the tax code is treated with scrutiny in the way that the annual appropriations process results in regular review of on-budget programs and services. Direct spending programs are essentially sunset every year, as funding must be reauthorized each fiscal year.

Some states have moved to establish sunsets for tax subsidies. Oregon, for example, recently enacted legislation requiring most of its tax credits to sunset every six years.iii

CONCLUSION

Tax abatements are a legitimate economic development tool for the City Council to utilize. The question is not whether they should be used at all. The question is whether they are effective at furthering the District’s economic development aims when they are considered in the context of other governmental responsibilities and priorities. For far too long, the District has had no framework available to evaluate proposed tax abatements in this manner. In order to begin addressing this question, policymakers and the public need more information on proposed tax abatements and a structured process for evaluating them.

The Exemptions and Abatements Act along with the Unified Economic Development Budget Report provide some of the initial steps critical to attaining the accountability and transparency that the Council needs, but this paper has laid out a number of areas in which the process for assessing property tax abatements could be further improved. These areas include a more conscientious alignment of property tax abatements with the District’s economic development goals, fully spelling out any potentially hidden costs, and exploring options such as capping the amount of an abatement, including clawback agreements, and sunset clauses. Improvements in these areas could go a long way towards building upon the framework established by the Exemptions and Abatements Information Act and the Unified Economic Development Budget Report.