PUBLIC ROUNDTABLE ON

BILL 15-306, "DISTRICT OF COLUMBIA RETAIL INCENTIVE ACT OF 2003"

Before the

Committee on Finance and Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

July 7, 2003, 12:00 p.m.
Room 412
John A. Wilson Building

Testimony of
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Good afternoon, Chairman Evans, and members of the Committee on Finance and Revenue. I am John Ross, chief of operations for the Office of Research and Analysis in the Office of the Chief Financial Officer (OCFO). I am pleased to be here today to testify on Bill 15-306, the "District of Columbia Retail Incentive Act of 2003."

The "District of Columbia Retail Incentive Act of 2003" would change the rules of the current tax increment financing (TIF) program for certain retail projects. Under this legislation, the Mayor would designate neighborhoods having difficulty attracting retail stores as Retail Priority Areas and would issue bonds to finance new Retail Development Projects. Within each Retail Priority Area there would be a number of individual TIF Areas. Each TIF Area is essentially a footprint of a Retail Development Project – home furnishing, apparel or other business – that has been approved by the Mayor and a committee that includes the Deputy Mayor for Planning and Economic Development and retail brokers and property owners appointed by the Mayor.

The proposed legislation would establish the Downtown Retail Priority Area as the first Retail Priority Area and would allow up to $30 million in bonds to be issued for the downtown area. The $30 million would be included as a part of the $300 million TIF bond cap and would bring the total TIF debt outstanding and pending to about $179 million.

The committee would create a rating system to evaluate potential projects using factors such as the uniqueness of the retailer. A numeric formula would also be

developed to determine the amount of the subsidy for a given TIF project. The Mayor would certify the amount of bond proceeds allocated to a particular project, the designation of each TIF Area and each project's eligibility to become a TIF Area.

Bonds cannot be issued, nor their proceeds disbursed to the developer, until the TIF project is open for business. Once the business is open, the sales tax increment revenues generated by the project would be deposited into tax increment allocation accounts within the General Fund and dedicated to the repayment of the TIF bonds. Although not explicitly stated in the legislation, we believe that the current plan is to pool the dedicated sales tax revenues and use the pool to repay all TIF bonds issued as a part of this program. The majority of the sales tax increment would be used to pay for retail development costs; however, $1 million may be used for administration of the program, and $5 million may be used for streetscape and facade improvements.

Fiscal Impact

The fiscal impact analysis is based on several key assumptions. First, it was assumed that half of the retail businesses would fail. A number of federal and private sector studies have indicated that a large percentage of small businesses fail within the first year. Given the proposed pooling mechanism, sales tax revenues from successful TIF projects would be used to pay the debt service on the failed projects. That sales tax revenue from the successful projects would otherwise come to the District's General Fund. Second, we assume that $10 million in TIF bonds would be sold per year in FY 2004 through FY 2006. It is our understanding that the interest rate on these bonds would be variable starting at the London Interbank Offered Rate (LIBOR) plus 325 basis points. At the end of June

2003, LIBOR plus 325 basis points was approximately 4.75 percent; however, if we base the interest rate on the average for LIBOR plus 325 basis points, the rate would be 8.25 percent. We therefore assume a starting interest rate of 4.75 and increase the interest rate by a percentage each year in the fiscal impact analysis.

Funds are not sufficient in the proposed FY 2004 through FY 2007 budget and financial plan to enact the "District of Columbia Retail Incentive Act of 2003." This act could cost up to $860,000 in FY 2005 and up to $5.39 million from FY 2005 through FY 2007.

Those projects most likely to succeed without the TIF subsidy should not be financed by the bill – the market would support them, and tax revenue could flow to the District from them, rather than the other way around. Because projects assisted by economic development subsidies are always risky – otherwise the market itself would cover the project – the Council and Mayor need to be prepared for some to fail to cover their costs.

Concerns

The OCFO's concerns with this bill are very similar to our concerns with the "District of Columbia Neighborhood Economic Development and Investment Amendment Act of 2003." First, the bill contains no criteria or priorities for the selection of the Retail Priority Areas, the Retail Development Projects, or the amount of the subsidies. For example, there is neither a "but-for" test nor required certification that the project will generate sufficient sales tax revenue to pay debt service. The "but-for" test would ask whether or not the development would have taken place <u>but for</u>, or without, the District's assistance. Without the rigorous

application of this test to every individual project, there is no way of knowing if the retail project actually requires public assistance to succeed.

Revenue certification is also very important for the financial health of the city. Currently, TIF bonds require a certification that expected incremental revenue from the project would be sufficient to cover debt service on the costs on the TIF bonds or notes. Without this certification, there is no assurance that incremental tax revenues from these retail projects would be sufficient to pay debt service.

The plan to pool sales tax revenues from all of the retail projects to support the bonds is also a concern. As a consequence of this pooling, excess incremental tax revenues from successful projects that would have otherwise come back to the District are used to pay debt service on the bonds of failed projects, ensuring that the bondholders are made whole. The District would bear the risk of default and would lose sales tax revenue if a project fails. When this pooling arrangement is coupled with the current proposal to finance with adjustable rate bonds, the potential revenue loss to the District is even more threatening. Funds that could be used to provide other public services such as police and education would be diverted to pay debt service, making budgeting and financial planning all the more difficult.

Finally, we are concerned with retail brokers and building owners establishing the system for rating proposed retail development projects and recommending potential TIF awards. Best financial practices dictate that those who receive the subsidies should not be the ones determining the qualifications for assistance.

These are some of our concerns. We understand the importance of economic development to the future of the District, and we support a carefully constructed toolbox of development incentives. We look forward to working with you, Mr. Chairman, and with Deputy Mayor Price over the course of the summer to resolve these issues.

I will be pleased to answer any questions.

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