D.C. POLICY CENTER

Fiscal Year 2020 Budget Proposal Highlights

MARCH 21, 2019

Dear supporters of the D.C. Policy Center:

Yesterday, Mayor Bowser submitted her Fiscal Year 2020 – Fiscal Year 2023 budget and financial plan proposal to the Council. This budget proposes increasing the District's expenditures considerably, with a 9 percent increase in local revenues—largely coming from one-time uses of past savings and increases to commercial real estate taxes.

This is notable because D.C. already has some of the highest commercial real estate taxes and transaction costs in the region.

More fundamentally, these proposed taxes are haphazardly applied, and continue to move the District away from sound tax principles.

D.C.'s budget is growing much faster than the economy; the commercial sector and the one-time use of savings pay for this growth.

The local portion of the proposed FY 2020 budget shows a 9 percent growth from last year—a rate much higher than the growth in personal incomes (3.5 percent) or wage and salary earnings in the city (2.2 percent). Baseline revenue increases related to economic growth only accounts for 37 percent of the increase in the budget. New taxes pay for another 18 percent, and one-time use of past savings pay for another 42 percent.

Importantly, the bulk of the new revenue is coming from the commercial real estate sector. The proposed budget increases deed transfer and recordation taxes on commercial property (including the commercial portions of multifamily or mixed use properties) from 2.9 percent to 5 percent if the transaction value is greater than $2 million. This generates more than $90 million in revenue in FY 2020, and over $444 million between 2019 and 2023.

Current deed transfer and recordation taxes are already among the highest in the region. The District taxes deed transfers and recordations at 1.1 percent each for considerations under $400,000 and 1.45 percent each for considerations above $400,000. There is a small exemption for first time homebuyers.

This change will widen the gap between the District and the surrounding cities and counties. It is often hard to compare the cost of real estate transactions, as in addition to deed transfer and recordation taxes, which are generally a share of the consideration value, the parties involved in the transactions have to pay fees, some of which might be high. However, looking just at the rates show that when implemented, the deed taxes will be 2.1 percentage points higher in DC compared to the next highest jurisdiction (Montgomery County), as shown by the table below.

Table: Proposed increase in commercial deed taxes would widen the gap between D.C. and other jurisdictions in the metropolitan area.

Jurisdiction	*Combined deed recordation taxes for considerations over $2 million*
D.C. Commercial over $2 million, current	2.90%
D.C. Commercial over $2 million, proposed	5.00%
Montgomery County, MD	2.96%
Prince George's County, MD	2.51%
Charles County, MD	3.11%
Northern VA counties and cities	0.58%

Source: DC OCFO (2019) Tax Rates and Tax Burdens, Washington Metropolitan Area, available at https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2017%20DC%20Metro%20Area%20Tax%20Burden%20Study%20032019.pdf

In addition, the proposed budget reverses the December vote in the Council which would have reduced commercial tax rates for properties valued $10 million or more. This increases the amount of total tax obligations by $25 million.

Budgets have to pay for services, and the money has to come from somewhere. But I have two, big-picture concerns with the proposed budget.

The first is the source of growth in spending. With these changes, spending growth is no longer driven by increased incomes or better than expected economic fundamentals, but with past savings and new taxes. This is a shaky foundation on which to build the District's future.

As required by law, the Mayor's budget includes projections for revenues and expenditures for the next four years, and, again as required by law, they all balance in the proposed budget and financial plan. However, the projections show that total expenditures will increase only by $61,500 between FY 2020 and FY 2021 (0.6 percent) and operating expenditures are projected to go down. We have not seen the D.C. budget to decline unless it is a recessionary year. The projected revenues are growing, so we are not in a recession. This leaves us with unrealistic assumptions about expenditure control.

My second concern is the haphazard nature of the proposed tax provisions. Mayor Bowser has characterized the increase as "asking our commercial property owners to share the upside." If this is the intention, then we should look for where the value is. It turns out that much of this upside is capitalizing in existing homes, and not new construction. For example, between 2006 and 2018, the District's single-family housing stock, as tracked by its real property tax database, shows a net increase by a total of 1,820 units (2 percent growth), whereas condo units increased by 22,256 (50 percent growth). In contrast, the **assessed value of all single-family homes** (whether owner-occupied or rented) increased by $24.8 billion during this period (63 percent, or **31 times** the growth in the size of the stock) compared to $15.5 billion for all condominiums (140 percent or less than three times the growth in the size of the stock), as shown below.

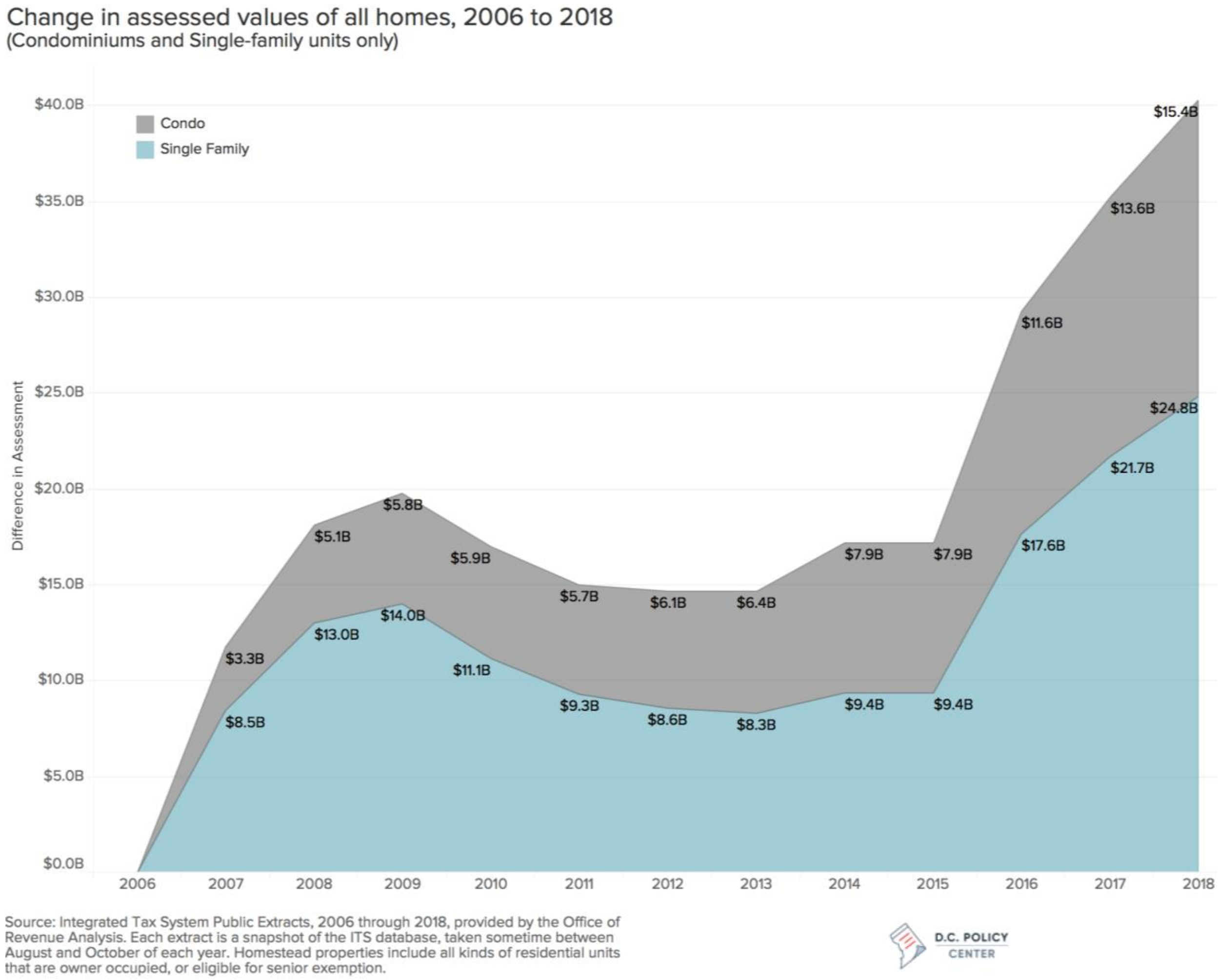

Chart source: Tax practices that amplify racial inequities: Property tax treatment of owner-occupied housing

Last year, when the Council made last minute changes to the commercial rate to generate more funding for arts and other priorities, I wrote that D.C. is moving away from sound tax principles. While the District is good at using Tax Revision Commissions to formulate tax policy, when under pressure, its tax policy collapses into an exercise in getting to a number to plug into the budget, with no demonstrated consideration for what will keep its tax regime simple, and little for maintaining a fair and competitive tax system.

We need to tax to pay for services and investments. But the District needs no reminder that public investments can continue to increase only if the city continues to grow. And poor tax policy that does not sufficiently weigh the importance of economic growth will frustrate government investments.

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FY 2020 BUDGET SUMMARY

Local fund expenditures grew three times faster than incomes.

The Mayor's FY 2020 budget proposes a total spending of $13.4 billion in operating funds. This includes $9.8 billion of the District's own resources (local funds, special purpose funds, and dedicated taxes), $3.6 billion in federal funds, and a small amount of private funds. Also in this mix is about $2 billion of enterprise funds (which include entities like DC Water and UDC), bringing the total gross spending to $15.5 billion.

On the revenue side, the Mayor started with a total local revenue of $8.1 billion (per the **February revenue estimates**). Added to this in the budget are $127.9 million of new revenue proposals, $24.3 million of other resources, and $339.9 million of fund balance use. That is, of the $802 million growth in the local portion of the budget:

- Growth due to economic growth is $294 million, accounting for 37 percent of the change;
- New revenue generated by new taxes is $144 million (including sports betting), accounting for 18 percent of the change; and
- One-time money used from our piggy-banks accounts for 42 percent of the change.

The overall budget grew at 6 percent, and the local portion of the budget (paid for by District's own resources) grew by 9.3 percent. This is three times faster than the growth in personal income (3.5 percent, observed in the third quarter of 2018) and wage and salary earnings (2.2 percent).

The following two sections include breakdowns of the budget in terms of revenue and expenditures.

REVENUE OVERVIEW

Overall, new revenue initiatives are generating $127.9 million on the net with most new taxes hitting the commercial property sector.

- The Mayor is proposing to undo the commercial property tax reduction the Council approved in December. The Council had voted to reduce the rate on commercial properties valued at $10 million or more to $1.86, and had paid for it using the revenue linked to the internet sales tax court decision. The Mayor is proposing to go back to the 1.89 rate, generating a recurring revenue of $25 million.
- The Mayor is also proposing to increase deed taxes from their current level of 2.9 percent (combining transfer and recordation taxes) to 5 percent. This would generate over $92 million; of this amount, $13 million (or 15 percent per current D.C. Law) will go the Housing Production Trust Fund.

The CleanEnergy DC Omnibus Act is being implemented.

- With full implementation, the stricter Renewable Energy Portfolio standards will take effect, and DDOE will begin developing the building energy performance standards (estimated cost related to program start up and management is $1.2 million in FY 2020). In addition, the agency will commission three studies—one on building performance, one on energy management for D.C. Government buildings, and one on clean vehicle transition—for a total of $750,000.
- Sustainable energy surcharge increases per the Clean Air Act generating $24 million, doubling the current revenue. Of this new revenue, $15 million will go to the new Green Finance Authority, and $7 million is set aside for low-income residents and workforce development.
- An exemption for electric vehicles from excise tax costs $132,000.
- The remainder of the revenues will largely offset the costs of the bill to the government, including increasing utility bills.

Other revenue generators are small—and in most cases, dedicated to a certain use.

- Hotel rooms get a new fee of 80 cents per night to pay for 911 and 311 programs - $7.3 million dedicated to the Office of Unified Communications.
- Improved income compliance measures at the Office of Tax and Revenue generate $3.2 million.
- Better parking enforcement during rush hour and on bike lanes is expected to generate $2.7 million (but some of this would be spent to hire enforcement officers).

The Mayor also proposes the following tax expenditures:

- Exempting diapers from general sales reduce revenue by $3.5 million.
- Expanding the schedule H program—the "circuit breaker" program that allows low-income households to take a credit against their personal income taxes if their mortgage or rent is too high—reduces revenue by $5.2 million.
- Last year's budget included a one-time tax credit of $1,000 per child tax for children enrolled in daycare. The budget proposes to make this tax credit permanent, reducing revenue by $2.5 million.
- There is also a small tax break for performing art venues ($375,000).

Reversing money dedicated to arts generates more money for general operations.

- Last year, the Council dedicated 5 percent of the general sales tax revenue to the Commission on the Arts and Humanities, generating an annual revenue of $30 million beginning in 2020. The Mayor has taken this away. The Commission on the Arts and Humanities received this dedication in FY 2019, but was not able to spend much of it. Its budget will receive a one-time transfer of $28.1 million in FY 2020, which represents this unspent amount from FY 2019.
- The Mayor has also taken away the FY 2019 funding of $14 million for the Arts Commission that was paid for by a portion of the back-pay of the internet sales tax obligations.
- The Council had also dedicated all excise taxes related to the sports betting to three programs: The first $200,000 to an addiction prevention program under the Department of Behavioral Health, and the remainder split equally between the Birth-to-Three for All program (the adopted but unfunded universal childcare program) and the Neighborhood Safety and Engagement Fund. The budget reverses these dedications, except for the $200,000 for addiction prevention.

EXPENDITURE OVERVIEW

Investments in affordable housing take center stage.

- The mayor is proposing to increase Housing Production Trust Fund (HPTF) contribution to $130 million – up by $30 million from FY 2019.
- The Public-Private Affordable Housing Preservation Fund, created in FY 2019 following recommendations from the Preservation Strikeforce, gets $15 million, up by $5 million from last year.
- There is also $20 million for middle-income or workforce housing that is designed to leverage $200 million in private investment.
- D.C. Housing Authority gets $16.6 million, but there is no funding for **repairing public housing.**
- The New Communities program receives $75 million in capital funding.

In education, per-pupil funding is up 2.2 percent.

- The proposed per-pupil funding increase, at 2.2 percent, is greater than what was baked into the financial plan (1.9 percent) but less than what many advocates have been asking for (3 percent).
- Combined with enrollment growth, the increase in per pupil funding will result in a total instructional budget of $894.97 million for the District of Columbia Public Schools, and $747.35 million for the public charter schools. Charter schools will receive $150.64 million for facilities allowances in fiscal year 2020, bringing the collective public charter school local budget to $898.49 million.
- The budget also sets aside $6 million for mental health programs at schools, and $4.6 million for buying laptops or tablets for DCPS students.
- In early childcare, there is an additional $5 million for child care provider rate increases, and $52 million in capital funds to build 3 new early child education centers in three unused buildings (Old Miner, Old Randle Highlands, and Thurgood Marshall).

Significant investments address homelessness and strengthen family supports.

- $37 million in new funding for the Homeward DC program, which includes $26 million in capital funds housing units and $11 million in operating costs for 3 new short-term family housing centers
- Families First program managed by Child and Family Services receives $4.4 million in non-personnel services funding to award grants for staffing and programming at each of the ten Family Success Centers.

The largest investments in public safety are in capital funds.

- The proposed budget sets aside $65.4 million in capital funds to purchase Fire and EMS trucks, accompanying $3.5 million in operating funds to add four ambulance units. It also sets aside $77.4 million for the D.C. Jail, and $5 million towards the design of a new jail.
- Notable community initiatives include $2.5 million for community-based grants for violence interruption, $1.6 million to build three pilot sites for place-based trauma-informed care services, and $500 thousand to increase community-based services provided to returning citizens.

Spending related to economic development programs is muted.

- The bulk of economic development spending in the proposed budget is on capital projects, including McMillan, St. Elizabeth's, and Hill East.
- There is a new fund with $5 million established to provide a one-to-three match to grants Community Development Financial Intuitions make to cultural non-profits to pay for space; another fund with $2 million will provide a one-to-two match for such grants for operating expenditures.

Transportation and the environment expenditures focus on design improvements.

- Design improvements include $122 million for K Street, $188 million for completing the planned street care extension to the Benning Road Metro Station, and $240 million for streetscapes and improvements, including the reconstruction of the Dave Thomas Circle.
- Vision Zero gets $63 million in capital funds over the next six years to improve safety. Additionally, part of the revenue from increased parking enforcement during rush hour and in parking lanes is going to pay for additional enforcement ($2.8 million).
- The Mayor proposes to a new Circulator route in Ward 7 for $13 million, and makes the Circulator free, at a cost of $3.1 million.

Other expenditures: Public election campaigns, immigrant legal services, DCRA.

- Other expenditures that are relatively small but significant include funding of the public election campaigns ($3.2 million) and an additional $1.6 million for the Immigrant Justice Legal Services grant program, bringing the total amount of funding to $2.5 million.
- There is also $208 million in capital funds to improve procurement, and funds to improve DCRA operations.