



New DC Budget Reduces Commercial Tax Rates – Slightly!



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The city recently adopted a budget that for the first time since 2002 includes commercial property tax relief. Commercial property owners and developers can thank the city for this needed action. This article lays out what the tax reduction is and how it was achieved.

The commercial tax rate reduction represents a significant benefit to small commercial property owners and a minor benefit to large property owners. The commercial tax relief discussion in this year's budget process (FY '09 Budget) signals a willingness of both the Administration and the DC Council to address further tax relief for commercial property owners who are at a competitive disadvantage compared to properties in the surrounding jurisdictions, particularly large commercial property owners who pay 64% of the city's total commercial property taxes.

The DC government budget for fiscal year (FY) 2009 (October 1, 2008 through September 30, 2009) lowers the commercial tax rate from 1.85% to 1.65% for the first \$3 million of a commercial property's assessed value (a savings of \$6,000 per year on all properties assessed at \$3 million or more). At this time, it is not clear how the city will deal with the incentive for large property owners to sub-divide buildings in multiple \$3 million properties; however, the city has until September 30, 2008 to take further action on this point. In addition, the city has instituted a cap on commercial property tax revenue growth at 10% per year. Any commercial property tax revenue growth above 10% will be used to reduce the commercial property tax rate

further on the first \$3 million of assessed value subject to a minimum tax rate of 0.90%. This is very important given that the city has relied on commercial property taxes to fund much of its recent spending growth. Commercial property tax revenues have grown at an average annual rate of 15% over the past six years; 20% over the past two years.

As with many municipal budgets around the country, a weak economy and turbulent financial markets have reduced significantly DC government revenue estimates. Nevertheless, it is important to note that DC revenue projections are still increasing for FY 2009 – although not as robustly as in previous years. Thus, the commercial tax rate changes for FY 2009 must be looked at through the lens of a relatively tight revenue year, with revenues projected to increase \$119 million in order to produce a local revenue budget of approximately \$5.4 billion – or 2 % revenue growth.

FY 2009's commercial property tax rate relief is also the first relief since 2002, when the rate was reduced from 1.95% to 1.85% (Councilmembers Jack Evans and David Catania sponsored the Tax Parity Act at that time, which lowered the commercial property tax rate from 2.15% to 1.85% and several other DC tax rates over a series of years). In recent years, the DC government's tax relief was targeted primarily to residents and residential properties. In fact, for the next fiscal year, DC's topmarginal individual income tax rate of 8.5% will be lower than both Montgomery and Prince George's counties at 8.7% (5.5% state rate and 3.2% county rate).

DC Tax History for Selected Taxes for Fiscal Years 1996-2009

(* Indicates a Tax Decrease, and + Indicates a Tax Increase)

	Office Real Property Tax Rate		Residential Real Property Tax Rate ^(a)		Vacant Property Tax Rate	Deed Recordation & Transfer Tax Rate	Corporate Income Tax Rate	Individual Tax Rate Range
	Property With and Assessed Value < \$3 MM	Property With and Assessed Value > \$3 MM	Multifamily	Single				
1996	2.15%	2.15%	1.54%	0.96%	5.00%	2.20%	9.975%	6.0% - 9.5%
1997	2.15%	2.15%	1.54%	0.96%	5.00%	2.20%	9.975%	6.0% - 9.5%
1998	2.15%	2.15%	1.54%	0.96%	5.00%	2.20%	9.975%	6.0% - 9.5%
1999	2.15%	2.15%	1.54%	0.96%	5.00%	2.20%	9.975%	6.0% - 9.5%
2000	2.05%	2.05%	1.34%*	0.96%	2.05%*	2.20%	9.975%	5.0% - 9.5%*
2001	1.95%*	1.95%*	1.15%*	0.96%	1.95%*	2.20%	9.975%	5.0% - 9.3%*
2002	1.85%*	1.85%*	0.96%*	0.96%	1.85%*	2.20%	9.975%	5.0% - 9.3%
2003	1.85%	1.85%	0.96%	0.96%	5.00%+	3.00%+	9.975%	5.0% - 9.3%
2004	1.85%	1.85%	0.96%	0.96%	5.00%	3.00%	9.975%	5.0% - 9.3%
2005	1.85%	1.85%	0.96%	0.96%	5.00%	2.2%*	9.975%	5.0% - 9.0%*
2006	1.85%	1.85%	0.92%*	0.92%*	5.00%	2.20%	9.975%	4.5% - 8.7%*
2007	1.85%	1.85%	0.88%*	0.88%*	5.00%	2.90%+	9.975%	4.0% - 8.5%*
2008	1.85%	1.85%	0.85%*	0.85%*	5.00%	2.90%	9.975%	4.0% - 8.5%
2009 ^(b)	1.65%*	1.85%	0.85%	0.85%	10.00%+	2.90%	9.975%	4.0% - 8.5%

(a) Residential property taxes are currently limited to a 10% annual increase in taxable assessments, and a 8% cap on total residential property tax revenue growth. In addition, over the past several years, the homeowner's exemption was increased from \$30,000 per residential property to \$64,000.

(b) Commercial property taxes now limited to a 10% cap on total commercial property tax revenue growth.

For citizens with a net taxable income of \$40,000, the marginal individual income tax rate in DC will be 6% as compared to 7.95% in both Montgomery and Prince George’s counties.

Although DC commercial tax rates remained constant from 2002 through 2008, surrounding Virginia jurisdictions reduced their commercial property tax rates overall from 1.1% to 1.2% in 2000 to 0.80% to 0.90% in 2008 as the assessed values of commercial properties rose. The surrounding Maryland jurisdictions maintained their commercial property tax rates at approximately 1.1% as assessed values rose. From a competitive point, the difference in commercial property taxes per square foot (SF) between the District and the suburbs then rose to a range of \$5 to \$11 per SF, or \$5 million to \$11 million on a 100,000 SF, 10-year lease. Fortunately for the District, surrounding Virginia jurisdictions have increased their commercial property tax rates to a range of 0.845% to 1.03 % for the upcoming fiscal year to fund slight increases in their county budgets, while surrounding Maryland jurisdictions have not changed their commercial property tax rates. Today, commercial property taxes per SF of office space in DC are \$11 to \$14 per SF for a Class A Downtown office building, and \$7 to \$10 per SF for a Class A office building in DC’s emerging office markets (Mount Vernon Triangle, NoMa and Capitol Riverfront) – compared to \$3 per SF for a Class A office building in Crystal City and Silver Spring.

Regional Comparison of Commercial Office Property Taxes per Square Foot

As of June 2008

	Commercial Property Tax Rate ^(a)	Estimated Class A Office Space Assessments Per SF	Commercial Office Property Taxes Per SF	
			\$	% of DC Established Markets
District of Columbia ^(b)				
Established Office Markets	1.85%	\$600	\$11.10	100%
Emerging Office Markets	1.85%	\$400	\$7.40	67%
Virginia				
Alexandria	0.845%	\$400	\$3.38	30%
Crystal City	0.973%	\$325	\$3.16	28%
Reston	1.030%	\$425	\$4.38	39%
Maryland				
Bethesda	1.184%	\$400	\$4.74	43%
Silver Spring	1.099%	\$300	\$3.30	30%
Prince George’s County	1.072%	\$250	\$2.68	24%

(a) Tax rates are for upcoming fiscal years.

(b) Tax rates shown are for assessed value over \$3 million per property. For fiscal year 2009, the DC commercial tax rate for the first \$3 million of assessed value is 1.65%

The new commercial property tax rate of 1.65% for the first \$3 million of a property’s assessed value is a compromise between the Council’s January legislation that would have reduced the commercial tax rate from 1.85% to 0.91% for the first \$3 million of

assessed value, and Mayor Fenty’s initial FY 2009 budget proposal, which included a commercial tax rate of 1.70% for all properties with an assessed value of \$3 million, and a reduced rate for all commercial properties with an assessed value over \$3 million from of 1.84%. Mayor Fenty proposed additional commercial tax rate reductions for FY 2010 and 2011; however, these are contingent upon: (1) the continued need for commercial tax relief, and (2) the DC government’s ability to produce a balanced budget. Mayor Fenty’s contingent commercial property tax rate reductions were (1) 1.55% in FY 2010 and to 1.40% in FY 2011 for properties with an assessed value of less than \$3 million; and (2) 1.82% in FY 2010 and to 1.80% in FY 2011 for properties with an assessed value of \$3 million or more. The Council’s January legislation would have reduced FY 2009 revenues by \$96 million. Mayor Fenty’s initial FY 2009 budget would have reduced revenues by \$17 million, and by an additional \$24 million in each of FYs 2010 and 2011 – totaling \$65 million in 2009 dollars. The compromise commercial property tax rate reduction is estimated to reduce FY 2009 revenues by \$22 million.

As stated earlier, the primary beneficiaries of the new commercial tax rate are the many small property owners in DC. The 7,515 commercial properties with assessed values below \$3 million will receive an 11% reduction in their taxes. And, the 353 owners of the largest commercial properties will receive an estimated 0.2% reduction in their taxes, and only 10% of the total commercial property tax relief while paying more than 64% of DC’s commercial property taxes.

Commercial Property Analysis by Assessed Value

Commercial Property Assessment Value	Number of Properties (a)	%	Total Assessed Value (b) (millions)	%
Under \$500,000	4,039	45%	\$2,020	4%
\$500,000 - \$1 million	1,906	21%	1,430	3%
\$1 million - \$2 million	1,118	12%	1,677	3%
\$2 million - \$3 million	452	5%	1,130	2%
\$3 million - \$5 million	379	4%	1,516	3%
\$5 million - \$10 million	305	3%	2,288	4%
\$10 million - \$50 million	453	5%	9,060	17%
Over \$50 million	353	4%	33,888	64%
Total	9,005	100%	\$53,008	100%

(a) Provided by the DC government.

(b) Estimated by the Downtown Business Improvement District.

In conclusion, it is clear that both the Mayor and the Council are now focused on commercial tax relief and its importance in making DC commercial properties (large and small) more competitive with our regional competitors. Commercial property owners and developers can look forward to working with them on future DC budgets. ▲