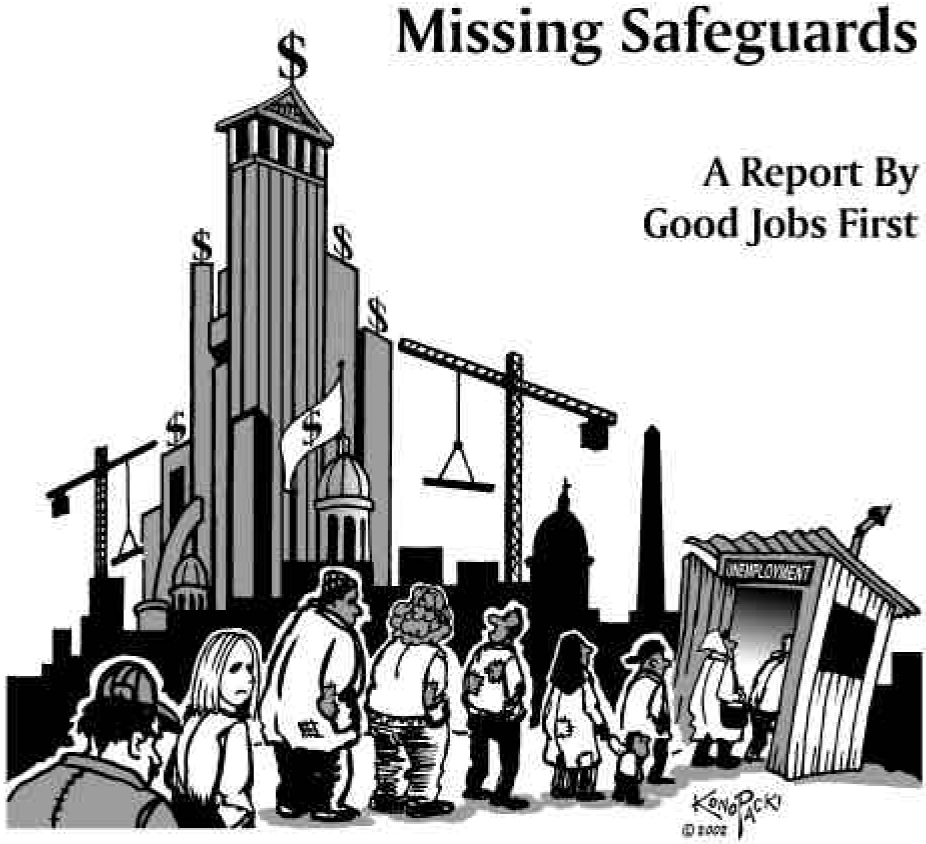
Economic Development In Washington, D.C.

High Costs, Unclear Benefits, Missing Safeguards

A Report By
Good Jobs First



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by

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Good Jobs First is a national non-profit resource center promoting best practices in state and local economic development. It was founded in 1998 by Greg LeRoy, author of *No More Candy Store: States and Cities Making Job Subsidies Accountable.*

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Acknowledgments

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Many of our findings are based upon the records provided by the District, which in some instances were incomplete or missing. Our conclusions represent our best effort to report on D.C.'s economic development with the information that was provided, along with other relevant sources.

Executive Summary

An analysis of 13 major economic development deals subsidized by the District of Columbia reveals a lack of safeguards to ensure the projects pay off for taxpayers, workers and communities. The 13 projects involve hundreds of millions of dollars in low-interest, tax-advantaged loans (revenue bonds) and diverted property and sales taxes (tax increment financing). Yet they lack basic accountability protections that have become commonplace in many states and other cities. As a result, it is unclear whether these massive subsidies are generating net public benefits. More specifically, D.C. projects fail to deliver in the following categories:

<u>Job Quality Standards</u> - Most project applications fail to include any job quality standards, such as wage or healthcare requirements. Job quality standards are also absent from virtually all enabling legislation approving each project. Without job quality standards, subsidized employers may pay poverty-level wages, which often result in additional hidden taxpayer costs such as food stamps, Medicaid and the Earned Income Tax Credit.

<u>Job-Creation Requirements and Local Hiring Benefits</u> - The District's Tax Increment Financing program (TIF) does not require any new jobs to be created in return for the subsidies. Companies receiving revenue bonds are supposed to take affirmative measures to ensure that D.C. residents are hired for both temporary construction jobs and permanent new jobs. Since, however, there are no laws requiring the creation of *any* new jobs, many projects result in very few new jobs, and often at a very high cost per job. A new requirement that a majority of jobs go to D.C. residents exempts non-profit corporations, including hospitals and universities, which have been among the largest beneficiaries of past assistance.

<u>Help for Distressed Areas or the Affordable Housing Crisis</u> - The District's economic development programs are not generally used in areas that have the greatest need for public stimulus to encourage private reinvestment. They are not tied to the construction of low- and moderate-income housing so desperately needed to address the City's affordable-housing crisis. Unlike many states and cities, D.C.'s TIF law does not include blight as criteria for qualifying a project. Instead, the case studies reveal massive subsidies going to private schools and companies with no discernible public benefits. One project actually subsidized hospital construction *in Baltimore!*

Money-Back "Clawback" Guarantees - Clawbacks, or recapture provisions, are not required under the D.C. Council's legislation awarding the subsidies. The District has not provided any project agreements showing a duty to recapture the subsidy in the event a company fails to meet job creation, job retention, wage, benefit, or dollar-investment obligations.

Use of Apprenticeship Programs - Several of the projects failed to use apprenticeship training programs for the construction work. For other projects, the District did not provide the records needed to determine whether apprenticeships were used.

Company Record-Keeping - Several companies failed to file regular monthly progress reports showing their efforts to hire D.C. residents. The keeping of applications, compliance reports and apprenticeship records is highly inconsistent.

Meaningful Public Input - Current law allows the District's Chief Financial Officer (CFO) to certify TIF projects without any community input before the projects are presented to the Council for approval. The CFO has tremendous discretionary authority over which TIF projects will be selected, whether to waive the requirement to build housing in the Downtown Area, and whether a project has "special merit" and would not otherwise be built but for TIF funding.

Public Records - Several District agencies have failed to comply with the District's Freedom of Information Act (FOIA). For the three TIF projects, the District initially responded to a request for the applications and agreements by providing some of the records on June 6, 2002. While the District agreed to disclose the remainder, those records have still not been provided – more than five months later. Inspection of apprenticeship records was delayed four months until the District's denial of a FOIA request for those records was reversed on appeal.

Policy Options to Address Shortcomings

To address these shortcomings, the report concludes with a menu of policy options to provide safeguards that can ensure that the District's development deals really pay off. The key options include:

Using Economic Development Programs to Create Good Jobs for D.C. Residents

Job Quality Application Disclosure - Require that on project applications, developers specify the job titles and number of new jobs to be created, as well as the wage and benefit rates to be paid.

Job Quality Standards - Require any company that receives a subsidy to pay employees a family-sustaining wage and benefit rate.

Promote Local Hiring - Eliminate the local hiring exemption granted to non-profit corporations.

Targeting Subsidies to Disadvantaged Areas or to Create Clear Public Benefits

Target TIF to Needy Areas - Amend the tax increment financing law to require a finding of blight and distress in order for a TIF project to be eligible.

Codify TIF Eligibility and Housing Waiver Criteria - Amend the TIF law to tightly define the "special merits" that the CFO must find to approve a project or to waive the obligation to build housing.

Tighten the "But For" TIF Requirement - Amend the TIF eligibility criteria to allow a finding of special merits only when it can be clearly demonstrated that the project would not occur without or "but for" the TIF subsidy.

Tie Affordable Housing to TIF - Require TIF developers to either include low- and moderate-income housing in the project or contribute to the Housing Preservation Trust Fund.

Tie Subsidies to Access and Public Benefits - Deny a subsidy unless it clearly provides a public benefit that can be accessed at little or no cost to D.C. residents and meets a critical public need, such as affordable housing.

Monitoring Outcomes & Recapturing Subsidies when Commitments are not Met

Install a Meaningful Monitoring System - Establish and enforce a rigorous monitoring system for all subsidy agreements to ensure compliance with apprenticeship, job creation, and wage and benefit requirements.

Establish Clawbacks - Require each development agreement to include a clawback provision mandating the recapture of a pro rata share of the subsidy if a developer fails to comply with its job creation, wage or benefit obligations.

Overhauling the Process to Enable Meaningful Public Input and Oversight

Notify Interested Parties - Expand the system of public notice for a proposed subsidy deal prior to the Council's hearing on the proposal.

Advisory Task Force - Establish a task force consisting of representatives from the community, the Mayor's Office and the Council to discuss economic development proposals before they are adopted by the Mayor for presentation to the Council.

Comply with the Freedom of Information Act - Respond to requests to review subsidy applications, contracts, compliance reports and apprenticeship records by providing access in a complete and timely manner.

Chapter One: Shortcomings in D.C.'s Economic Development Subsidy Programs

The District of Columbia government awards millions of dollars in economic development subsidies to companies each year. Until 1998, the most common subsidies awarded were revenue bonds, under which the District helps developers secure low-interest loans for private construction and other capital projects proposed by the Mayor and approved by the Council. In 1998, an additional subsidy was enacted known as Tax Increment Financing (TIF). Under D.C.'s TIF program, the District provides direct funding to private economic development projects, under the assumption that new tax revenues generated by these projects will offset the subsidy cost. Already, three TIF projects have been approved in the District. This report covers all three TIF projects, as well as 10 revenue bond deals.

The District's economic development programs have the potential to be powerful tools to improve the economic conditions of neighborhoods and residents across the City. Government-sponsored economic development activities can promote development in depressed neighborhoods and commercial areas that have trouble attracting private investment. Successful economic development programs can generate jobs with good pay and benefits, promote neighborhood stabilization, and build a city's tax base.

In several ways, D.C.'s economic development programs are intended to meet these goals. TIF projects are expected to generate additional tax revenues; revenue bonds are supposed to be used to support projects that "… contribute to the health, education, safety, or welfare" of D.C. residents; and both programs are intended to generate job growth. Moreover, the District requires that developers receiving subsidies under these programs enter into a "First Source Hiring Agreement," under which they agree to use the District's Register of Unemployed Persons as their first hiring source for the project.

The need to use the District's economic development resources wisely and strategically is highlighted by a recent report from D.C. Agenda which shows that 20 percent of D.C. residents are poor—which means they live on an income of less than $14,000 for a family of three—and that the District's poverty rate rose in the 1970s, 80s, and 90s. The recent increase is particularly striking given the strong national economy of the late 1990s and the many signs of a strong economic recovery in D.C. Unfortunately, the benefits of this growth have not been shared by all. According to the report, 10 neighborhood clusters have poverty rates of 30 percent or more, and the number of high-poverty areas has increased over the past decade. Poverty rates are especially high among children. In Ward 8, for example, more than half of the children are poor.[1]

This report shows that D.C.'s economic development programs have failed to live up to their potential. In particular, the District is not using these programs to generate jobs with good wages and benefits for D.C. residents or to revitalize the neighborhoods most in need of economic development. Moreover, decisions over the use of economic development subsidies are not made with broad public input.

This chapter provides an overview of both the Tax Increment Financing and Revenue Bond programs. It also highlights the limitations in those programs revealed by a review of 13 economic development projects.

Tax Increment Financing (TIF)

The District's TIF law designates where projects may be built. TIF projects are limited to priority development areas, which include downtown, the Navy Yard area, the Georgia Avenue corridor, and the New York Avenue corridor. Alternatively, TIF projects can be built in any of the federally designated Enterprise Zones, census tracts with at least a 10 percent poverty level, or in contaminated areas.

Tax Increment Financing works in the following way. A small area is designated for redevelopment. As a result of that redevelopment, property values will rise and, therefore, the assessed value and property taxes will rise. When that happens, the tax revenues are split into two streams. The first revenue stream, set at the old property value (known as the "base rate") continues to go where it went before, typically to the school district and to a city's general fund for local services. The second revenue stream, pegged to the incremental increase in the property value (known as the "tax increment"), is diverted back into the redevelopment area (known as the "TIF District"). In some states, including D.C., the same diversion occurs with increased *sales* tax revenues as well.

TIF revenues typically are used to back bonds that are issued up front to private investors to generate a large sum for the developer. This is D.C.'s system. D.C. originally limited the area from which tax increment revenues could be captured to the project site itself. The District, however, was unable to sell bonds backed by its first project sites because private investors judged them too risky. To sell the bonds, D.C. had to greatly expand the geographic area from which the increment would back the bonds, spanning several neighborhoods and commercial centers.

The TIF approval process starts with the submission of a project application by the developer to the District's Chief Financial Officer (CFO). Among other things, the CFO must determine that the project will result in increased tax revenues, that the project has "special merit," and that TIF funding is critical to the project, i.e., that it would not occur without TIF funding. If the CFO certifies the project, it must then be approved through legislation enacted by the D.C. Council, which holds a public hearing. Following the Council's approval, notice of the proposed sale of TIF bonds must be published in the newspaper. If no objections from the public are raised, the bond sales can proceed.[2]

After a project is approved, the developer must enter into a First Source Hiring Agreement under which it agrees to use the District's Register of Unemployed Persons as its first hiring source for the project. For any projects of $100,000 or more built by for-profit developers after September 5, 2001, at least 51 percent of the new employees must be D.C. residents. Developers must also submit monthly compliance reports to show whether they are meeting this requirement. The 51 percent hiring requirement may only be waived in limited circumstances, such as where there are insufficient numbers of residents with the skills to do the work. Violations of these hiring and reporting requirements are punishable by a fine of up to 5 percent of the project's labor costs. Contractors and subcontractors that have contracts with the District of $500,000 or more are also required to have a registered apprenticeship program to provide training and employment opportunities for younger unemployed D.C. residents.

D.C.'s TIF program has several serious flaws:

TIF Is Not Focused on Creating Good Jobs for D.C. Residents. The TIF program is not designed to ensure the creation of a significant number of jobs with good wages and benefits. The TIF law provides no guidelines for the number of temporary or permanent jobs that should be created, and there is no requirement to use job creation as a criterion for evaluating or approving TIF projects. This means a project that will create 500 jobs is not more likely to be approved than a project seeking the same subsidy amount that would create 200 jobs. In addition, developers are not required by law to meet the job creation goals set out in their TIF application. There is no mandatory penalty if the number of jobs created is smaller than had been expected.[3]

Moreover, the TIF law does not set any standards for the wage or benefit levels of the new jobs that result from the projects. Except for certain construction and service jobs for which federal prevailing wages are required, the District can end up subsidizing the creation of low-wage jobs that do not allow workers to support themselves and their families adequately. This means added government costs such as food stamps and Medicaid.

TIF Projects Have High Costs Per Job. The three TIF projects approved to date have received sizable subsidies: $75 million for Gallery Place, $46 million for the Mandarin Hotel, and $6.9 million for the Spy Museum. The subsidy amounts are especially large considering the number of new jobs created, especially those going to D.C. residents.

Gallery Place is projected to create 1,058 permanent jobs. Its $75 million TIF award breaks down to $80,000 per job. If half of the jobs go to D.C. residents, the cost will be $160,000 for every job going to a D.C. resident.

The $46 million TIF subsidy for the Mandarin Hotel is expected to create approximately 500 permanent jobs, at a cost of $92,000 per job — or as much as $184,000 for every job that goes to a D.C. resident. The $6.9 million TIF subsidy for the Spy Museum is projected to create 139 jobs, which equals $49,460 per job. If half of the jobs go to D.C. residents, the cost would be $98,920 for each D.C. resident who was employed.

It is only reasonable that the District, with the poorest fiscal base and the greatest concentration of poverty of any jurisdiction in the region, should carefully shepherd its economic development resources into creating job opportunities for D.C. residents. Moreover, as a result of the commuter tax ban imposed upon the District by the federal government — under which persons employed in the District do not pay D.C. income taxes if they are not D.C. residents—the D.C. tax revenues generated from new jobs are miniscule unless D.C. residents get the jobs.

TIF Projects Do Not Pay for Themselves. The intent of the TIF projects is to produce increased tax revenue that is sufficient to offset the subsidy costs. Yet there is ample evidence that D.C.'s TIF projects do not meet that standard. All TIF projects have received additional District subsidies. The Mandarin Hotel project has received a $4 million tax deferral, which delays payment of its real property and sales taxes. The Gallery Place project received $7 million in property tax abatements. The Spy Museum received a $15 million low-interest revenue bond. Unlike the TIF portion of the subsidy, the other subsidies are not based on the assumption that additional tax revenues will fully offset the cost.

In addition, project areas are not considered safe to break even. In both the Gallery Place and Mandarin Hotel projects, the District could not sell the original TIF bonds because private investors were not confident that the projects' incremental sales and property tax revenues would be sufficient to pay off the bonds. To sell the bonds, the District modified its TIF legislation to back the bonds with future sales and property taxes from an area extending well beyond the project's boundaries. At Gallery Place and the Mandarin Hotel, for example, if incremental tax revenues from the project are insufficient, the District can pay off the bonds using incremental taxes from a massive "Downtown TIF Area" that encompasses the heart of the District's tax base, including parts of downtown, southwest D.C., and the Shaw, Logan Circle, Dupont Circle and Foggy Bottom neighborhoods. According to *The Washington Post*, the Downtown TIF Area produces half of all sales taxes collected in the District.[4]

TIF Is Not Used in Blighted Areas. In many states, TIF projects are restricted to areas characterized by economic blight. Because such areas have had trouble attracting private investment, targeting subsidies to them helps ensure that TIF funds really do support projects that otherwise would not occur. D.C.'s TIF law, however, has no such requirement. Instead, the law designates various geographical areas where a project may locate. These include some of D.C.'s most economically vibrant areas, such as downtown, as well as others with high poverty rates like the Navy Yard and the New York Avenue Corridor. Yet absent any true targeting to needy areas, all three TIF projects to date have gone to areas in or near downtown.

Moreover, while TIF programs in many states are used to develop affordable housing, the housing requirements in D.C.'s TIF law are limited. Only TIF projects located in the Downtown Area are required to include housing, and there is no requirement that any of it be affordable to low- or moderate-income residents. Housing units being built at Gallery Place are expected to have monthly rents of $1,800 and to be occupied by households with incomes of $90,000. The rents for housing at the Spy Museum range from approximately $2890 to $4800 a month. Finally, even this limited housing requirement for the Downtown Area may be waived by the CFO.

TIF Subsidies Lack Money-Back Guarantees - Even though TIF projects can be approved only if they are expected to generate additional tax revenues, D.C.'s TIF law does not require the District to recapture the subsidy if these goals are not met. Without any "clawback" provisions, developers are not required to repay the subsidy if the project does not generate the anticipated tax increases needed to offset the subsidy costs, or fails to create the projected number of jobs, or fails to hire a sufficient number of D.C. residents.

<u>Selection of TIF Projects Is Highly Discretionary</u>. The awarding of a TIF subsidy hinges on a finding by the CFO that a project has "special merits" and would not be developed without the TIF support. The term "special merits," however, is not defined by statute or regulation. Thus, it is not clear how the CFO determines whether TIF funding is critical to a given project. No public input is required before the Mayor selects a project or the CFO certifies it.

Although the TIF law requires that the project could not be built without TIF, some sites would have received new development even without TIF money. That development would have generated tax revenue to the general fund instead of diverting revenues to new public debt. For example, a D.C. official has noted that the Gallery Place site, near a Metro station and the MCI Arena, would have been developed without TIF funding, probably as office space.[5]

<u>Public Input Is Not Sought Prior To Selection of TIF projects</u>. Given the high costs of the TIF program and the desperate needs of many D.C. neighborhoods, it would be appropriate to have vigorous public debate on how TIF funds should be used and the worthiness of each proposed project. Yet opportunities for public input are limited, occurring only when the Council holds a public hearing prior to approving a TIF project. By then, the location of the project has already been chosen and discussions with the developer are underway. For example, each of D.C.'s three TIF projects were approved as "Emergency Resolutions" rather than as permanent legislation, which would have involved a far more deliberate review process by the Council. As a result, costly and controversial economic development deals have been approved without a meaningful opportunity for public comment.

Revenue Bonds

Revenue bonds are private transactions laundered through public agencies, which makes their interest tax-free. Investors who buy the bonds are granted this tax break because the bonds are meant to serve the public good by promoting economic development. With the proceeds from bond sales, the District provides low-interest loans to private corporations (both for-profit and non-profit) for various purposes, including major construction projects.[6] As under TIF, the bond proceeds are transmitted to the company that will undertake the project. But unlike TIF bonds, which are repaid with D.C. tax dollars, revenue bonds are repaid by the private recipient of the funds. However, since the interest received on the bonds by investors is exempt from both federal and D.C. income taxes, the interest rates are far lower than taxable corporate bonds.

Thus, the cost of the revenue bond program to District taxpayers is much lower than under TIF. By providing low-cost financing, the revenue bond program can be a powerful economic development tool and since 1994, the District has approved more than $3.9 billion for revenue bond projects. The 10 revenue bond projects analyzed here include private elementary schools, a private consulting firm and a retail store, among others.

The law governing the revenue bond program specifies that it should be used to support projects that "… contribute to the health, education, safety, or welfare … or the creation or preservation of jobs for residents of the District" or for the "economic development of the District."[7] D.C. law allows revenue bonds to be used for many purposes including housing, health, transit, manufacturing, entertainment, public infrastructure, educational facilities and loan programs, as well as parking, industrial and commercial development.

Companies seeking revenue bond financing must submit an application to the Mayor's Office. Proposals approved by the Mayor are then submitted to the Council in the form of a resolution. As with TIF legislation, the Council holds a public hearing prior to approving a bond proposal. The Council may add to the terms and conditions proposed by the Mayor for the sale, payment and other obligations of the bonds.[8]

Revenue bond regulations require that a company applying for a bond must take affirmative steps to provide construction and permanent jobs for D.C. residents, and provide contracting and business opportunities for minority-owned businesses.[9] As in TIF, developers receiving revenue bonds are subject to the First Source Hiring rules that require them to attempt to hire unemployed

District residents from the First Source Register, and to file monthly compliance reports. Our research finds that many developers have failed to consistently submit monthly First Source Hiring reports. Although last year the Council authorized a penalty for projects that fail to comply with the First Source hiring and reporting rules, the penalty only applies to projects by for-profit companies started after September 5, 2001.[10] Furthermore, D.C. law does not require the District to recapture the bond proceeds if a company fails to fulfill its job creation or wage and benefit obligations.

D.C.'s Revenue Bond Program has several accountability flaws:

Recipients Are Not Required to Create Any New Jobs or to Adhere to Job Creation Projections. Revenue bond regulations require developers to "take affirmative steps" to create jobs for D.C. residents, but there is no requirement that those "steps" actually produce any specific outcome. Of the 10 revenue bond projects reviewed for this analysis, only one specified in its application that the project would create *any* jobs. For example, George Washington University received a $380 million revenue bond in 2000, even though its bond application did not indicate that the project would create any jobs.

Ultimately, nine of the 10 organizations receiving revenue bonds did expand employment, but often by small amounts. Most of the jobs created did not go to D.C. residents. MedStar Health, which received $903 million in revenue bond financing between 1996 and 2001, hired approximately 8,700 new employees during that period, but only 25 percent were D.C. residents. In fact, only one of the 10 revenue bond recipients reviewed -- the Lowell School -- reported that all of its new jobs went to D.C. residents. The school's $6 million subsidy, however, only generated 7 new jobs.

There Are No Job Quality Standards. Applicants for revenue bond financing are not required to meet any wage or benefit targets for either new or retained jobs, except for certain construction or service jobs for which federal prevailing wages are required. Most developers do not report wage or benefit information in required filings, which means there is no indication that the revenue bond program is contributing to the creation of good jobs or reducing dependence on government family-assistance.

Projects Often Have Limited Public Benefits. As noted above, D.C.'s revenue bond program is intended to support projects that will promote economic development or improve the health or welfare of District residents. Yet a review of the 10 revenue bond projects shows that many were approved with little evidence that they would provide a public benefit or address a critical public need. For example, a significant number of private schools have received revenue bond financing, but their applications failed to identify any specific public benefits that would result from the project. Efforts to obtain information about any scholarships awarded by the schools to low-income D.C. students were unsuccessful.[11] In a highly unusual case, MedStar Health received revenue bond financing to support construction of nine hospitals, but 6 of them are *in Baltimore!* Finally, George Washington University has received substantial revenue bond financing despite the fact that at least one of its contractors ignored D.C. requirements to have an apprenticeship program.

D.C. Fails to Monitor and Enforce Revenue Bond Program Requirements. As noted, all revenue bond projects are expected to benefit the District through the creation of new jobs, and the District's First Source Hiring Law requires companies receiving revenue bonds to try to fill these jobs with unemployed D.C. residents. Many recipients of revenue bond financing, however, failed to indicate in their application whether the project will create new jobs, and several failed to establish that a significant number of the jobs created went to District residents. A new requirement, which states that on future projects 51 percent of the new employees must be D.C. residents, only applies to for-profit companies. This deficiency is particularly troubling since a vast majority of revenue bond recipients are non-profit organizations, which are exempt from D.C.'s hiring requirements.

No Known Recapture of Bond Subsidies if a Company Fails to Deliver. D.C. law does not require the repayment of revenue bonds if a developer does not fulfill its job, wage or benefit obligations. The District has not provided any records to show that its agreements with developers mandate recapture of the subsidies if these obligations are not met.

The Revenue Bond Process Provides for Limited Public Input - The public has no opportunity to comment on revenue bond projects until after they are approvedby the Mayor and presented to the Council. By then, developers often have started to seek financing and need the Council's approval quickly. As a result, revenue bond projects, including the 10 in this report, are adopted as "Emergency Resolutions." This process leaves the public as well as the Council with less time to consider the projects before they are voted upon.

Chapter Two: TIF Projects

Gallery Place

In 1999, the Council approved $75 million in TIF bonds for Gallery Place, a mixed-use facility located in Chinatown at the corner of 7th and F Streets, NW, that was initially intended to include apartments, a multiplex movie theater, a parking garage, and retail stores.[12] The developers had difficulty securing tenants and private investors, however, and in 2000, the project plans were modified to include some office space.[13] That same year, the Council also approved up to $7 million in property tax abatements and $2 million in infrastructure improvements to aid the project.

The District encountered difficulties selling the TIF bonds. The bonds were initially backed by future increases in sales and property taxes from only the Gallery Place project site. Investors, however, were not willing to bet on the success of Gallery Place and the bonds did not sell. In 2001, the Council modified the TIF legislation so that the bonds would be backed by future sales and property taxes from the aforementioned “Downtown TIF Area” including parts of downtown, Southwest D.C., and the Shaw, Logan Circle, Dupont Circle and Foggy Bottom neighborhoods.[14] The sale of the TIF bonds was completed in the spring of 2002. The project is expected to open in the fall of 2003.

Gallery Place is located on the northeast fringe of downtown D.C. - one of the country's hottest office markets. According to one D.C. official, without TIF funding, the site would have been developed, but it probably would have been devoted to office space.[15] In that area, office space has a higher rate of return for investors.

Gallery Place is located in an area designated in the TIF law as the “Downtown Area.” TIF projects in this area are required to include a residential component, so the mixed-use facility will include 173 market-rate apartments. Given the market and high-end amenities in that neighborhood, the rents of these apartments will undoubtedly be high. According to a feasibility study conducted for the District, the apartments are expected to rent for $1,800 per month, to tenants whose average household income is expected to be $90,000 per year.[16]

Gallery Place is projected to create 1,058 full-time permanent jobs. The District has not provided any records to indicate the level of wages and benefits to be paid to the permanent employees. The developers have signed a First-Source Hiring Agreement requiring that 51 percent of all new permanent employees will be D.C. residents.[17] According to records provided by the District, several of the subcontractors for the project do not use apprenticeship programs for the construction.

Mandarin Hotel

In March 2000, the Council authorized $40 million in TIF bonds for the Mandarin Oriental Hotel to be located at 1330 Maryland Avenue, SW.[18] The project will include a 400-room luxury hotel, two restaurants, a fitness center, and a parking garage. Since then, the developers of the hotel have returned to the Council twice to request additional funding. In December 2000, the Council approved another $6 million in TIF funds for the project.[19] In December 2001, the Mandarin developers requested a deferral on their tax payments during the construction of the project. This request was approved by the Council and the Mayor in the spring of 2002, and the deferral is limited to $4 million.[20]

As with Gallery Place, the District had trouble selling TIF bonds for the Mandarin Hotel. In 2001, the Council expanded the boundaries of the TIF district in which both projects are located.[21] Unlike Gallery Place, the Mandarin Hotel project is not located in the Downtown Area, so no housing construction is required.

The Mandarin project is expected to create approximately 500 permanent jobs.[22] The hotel has entered into a First Source Hiring Agreement with the District and has also agreed to provide a training program for the D.C. residents who are hired. In its First Source Hiring Agreement, the developer included its proposed wages for new employees, but omitted mention of any benefits. According to the agreement, only 18 percent of the proposed wages meet the self-sufficiency standard of $33,924 for a family with one adult and one pre-schooler. [23]

The International Spy Museum

The International Spy Museum, located on F Street between 8th and 9th Streets, NW, is the District's most recent TIF project. The Museum opened in July of 2002. In addition to the Museum, the project includes a restaurant, a café and bar, and retail space. The developer built the Museum within a larger three-story mixed-use structure, which is being developed by a different company Douglass Jemal.

The Council approved the Spy Museum in 2000 and authorized $6.9 million in TIF funding.[24] That same year, the Council also approved an additional $15 million in tax-exempt enterprise zone bonds to fund the project.[25]The Spy Museum is located in the Downtown Area, but the requirement to build housing has been waived, in part because Jemal is providing apartments in his sections of the same building.[26]

The Spy Museum is expected to create 139 full-time jobs, with at least half of those jobs expected to be held by D.C. residents.[27] While the developer did list its proposed wages for permanent employees, the District failed to provide any records indicating the benefits to be paid. According to the First Source Agreement entered into by the Museum's developer, only a quarter of the jobs meet the self-sufficiency standard for wages for a family with one adult and one preschooler.[28] A First Source compliance report provided by the District indicated that there was no registered apprenticeship program for the project.

The Museum is expected to provide a learning experience for students and the developer has promised to provide free admission to school groups during certain regular tours, with preference given to schools from the District.[29] Other stated public benefits include an increase in taxes and jobs, the renovation of a historic building, attracting tourists to the downtown, special event space for non-profit groups and the creation of a "living downtown."

Chapter Three: Revenue Bond Projects

14th and Irving Ventures

14th and Irving Ventures was formed to develop a parcel of land near the Columbia Heights Metro station at the corner of 14th and Irving Streets NW. The company received a revenue bond for $2.8 million in 2001 to purchase land where it would build and furnish an approximately 25,000 square-foot retail building.[30] The location of the project is an area of the District that is currently undergoing substantial redevelopment. According to *The Washington Post*, various proposals to develop land parcels in this neighborhood have met strong resistance from community residents.[31] The company did not propose any job creation or wage and benefit rates in its First Source Hiring Agreement, nor did it submit any compliance reports. Therefore, it is unknown whether the project created jobs, laid off employees or was subject to wage or benefit obligations.

HF Enterprises

HF Enterprises (HF) was formed by the owners of DTI Associates (DTI), a government-consulting firm located in Arlington, Virginia. DTI has provided services for the Navy, NASA, the General Services Administration, the Department of Defense and the Department of Education.[32] To further its consulting work with the Navy, DTI purchased a three-story, 32,000 square-foot building across from the Navy Yard to be operated by HF Enterprises. [33] HF received a $4.8 million revenue bond from the District in 2000 to construct office space and parking facilities for DTI and other tenants, as well as restaurant space. The public benefit stated for the project included an increase in jobs and taxes, demolition of blighted residences, increased attractiveness and prosperity in the site area, economic stimulus, and the creation of a critical mass of technology. In its bond application, HF projected that 10 new jobs for D.C. residents would be created three years after the project was completed. HF Enterprises submitted one First Source Hiring compliance report, which showed that 12 jobs had been created, none of which went to D.C. residents. No wage or benefit rates were included in the application, the First Source Hiring Agreement or the compliance report.

George Washington University

George Washington University is the largest university in the District of Columbia with a total enrollment of 21,474 students and a workforce of 5,902 employees. Undergraduate enrollment alone has increased from 6,582 in 1995 to 9,523 in 2001.[34] To accommodate this growth, the Council approved a revenue bond in 2000 for $380 million to renovate 26 buildings on campus, improve network connectivity, install a financial accounting system, and refinance a $30 million revenue bond awarded in 1981.[35]

Residents of the surrounding neighborhood have objected to the University's expansion into residential areas by filing lawsuits to stop the development.[36] Labor unions also objected to the University's failure to comply with the requirement that all of the contractors on the project have a registered apprenticeship program.[37]

George Washington University is the largest private employer in the District, yet the First Source Hiring Agreement projected no job creation and stated only that it was "to be determined." No wage or benefit rates were provided, and the compliance reports provided by the District show that 17 permanent employees were hired, including three D.C. residents, and there were two terminations. Additional employees were hired for construction of the project.

MedStar Health

MedStar Health is a non-profit, community-based healthcare organization comprised of 25 integrated businesses, including seven major hospitals in the Baltimore-Washington area. MedStar Health hospitals and healthcare organizations serve more than half a million patients each year. [38] MedStar Health was formed when the Medlantic Healthcare and Helix Health companies merged in 1998. [39] The merged companies were awarded six revenue bonds by the District totaling $938 million between 1985 and 2000. [40] A revenue bond awarded to Medlantic in 1995 in the amount of $233 million was used to refinance Medlantic's prior revenue bond debt. [41] In 1998, Medlantic received a $400 million revenue bond to finance the acquisition and equipping of 14 health care facilities, and only five of which are located in Washington, D.C. [42]

In 2000, the Council authorized a $150 million revenue bond for MedStar Health to refinance the acquisition of and make improvements at Georgetown University Hospital. The stated public benefits of the bond include the price maintenance of health services, retention of employees, improving financial stability, and assisting hospital vendors. The debt refinancing was necessary due to reduced Medicaid and Medicare reimbursements, a loss of revenue from suburban patients who do not use city hospitals, an increased managed care rate, and increasing malpractice insurance costs.

MedStar's First Source Hiring Agreement includes no job creation projections or wage and benefit information. MedStar filed compliance reports showing that from 1996 to 2001, 8,703 new employees were hired including 2,008 or 25 percent from D.C., and that at least 2,235 employees were either terminated or resigned. We cannot draw any firm conclusions, however, about the number of permanent jobs created because the District did not provide us with all of the compliance reports for these years. Nine out of 22 quarterly compliance reports are missing between 1996 and 2001. Several of the First Source Hiring compliance reports provided by the District indicate that there was no apprenticeship program for the project.

Arnold and Porter

The law firm of Arnold and Porter, located at 555 12th Street, NW, received an $11.25 million revenue bond from the District in 1999 to expand and furnish its existing office space, including construction costs, furniture and equipment.[43] According to its website, the firm has been ranked as the second largest and the most profitable law firm in the Washington, D.C. metropolitan area.[44] It is expected to continue to grow at an annual rate of over 19 percent.[45] Despite that projected growth, neither the firm's revenue bond application nor its First Source Hiring Agreement contain any job creation projections. According to the First Source Hiring compliance reports filed by the firm for the period of April to June 2002, Arnold and Porter hired 994 new employees, including 330 D.C. residents or 35 percent of the total hired. This total, however, does not necessarily represent the number of new permanent jobs created from the project. A number of the positions, for example, were summer or temporary jobs. Neither the bond application, the First Source Agreement nor the compliance reports indicate the wages or benefits paid to new employees.

Field School

Field School is a college preparatory school attended by approximately 213 students in grades 7 through 12, and is located at 2126 Wyoming Avenue, NW.[46] In 2001, the Council approved a revenue bond in the amount of $36 million to fund the acquisition and construction of secondary school facilities including academic, administrative and athletic space.[47] The 2001-02 tuition was $18,700 and the school awarded financial aid to 20 percent of its students.[48] The school's project application did not indicate that the revenue bond subsidy would be used to provide scholarships to low-income students from D.C., and also failed to project any job creation or provide wage and benefit information. Under the school's First Source Hiring Agreement, the bond project proposed to create seven new jobs, five of which met the self-sufficiency standard for a family with one adult and one preschooler.[49] No First Source Hiring compliance report was provided by the District.

Beauvoir School

Beauvoir School, also known as the National Cathedral Elementary School, educates 387 students from pre-kindergarten through grade 3. The school is located at 3500 Woodley Road, NW, and is operated by the Protestant Episcopal Cathedral.[50] In 1999, the Council authorized a revenue bond in the amount of $9 million to enable the school to fund renovations and additions for classrooms, a library and technology center, a gymnasium and an administrative center.[51] The school's 2001-02 tuition was $15,800, and during that period approximately $594,000 was awarded to 16 percent of the student body to cover 10 to 85 percent of the tuition.[52] The school's project application did not indicate that the revenue bond subsidy would be used to provide scholarships to low-income students from D.C., and it also failed to propose any job creation or wage and benefit rates for new employees. This information was also omitted from the school's First Source Hiring Agreement. Compliance reports indicate that 254 new employees have been hired, of whom 114 or 47 percent are District residents. The actual number of new jobs may be lower, however, after taking into account employees who may have left the school.

Lowell School

Lowell School provides education at grade levels 3 through 6 for approximately 345 students from diverse ethnic and national backgrounds. The school leased crowded space in a church on 16th Street NW for years, until it received $6 million in revenue bonds from the District in 1998 to acquire the land and buildings at its current home at 1640 Kalmia Road, NW.[53] In 1999, the Council also authorized a property tax exemption for Lowell after the school learned that the property it had purchased was not tax exempt. The estimated initial loss in property taxes resulting from the exemption was $107,323.[54] Tuition for 2001-02 ranged from $9,575 to $15,990 and an unknown amount of financial aid was provided. [55] The school's project application did not indicate that the revenue bond subsidy would be used to provide scholarships to low-income students from D.C., and further failed to project any job creation. In its First Source Hiring Agreement, the school projected the creation of seven new jobs with wages ranging from $25,000 to $30,000 per year.[56] These wages fall short of the self-sufficiency standard for one adult and one preschooler.[57]The school filed a First Source Hiring compliance report showing that seven new employees were hired, all of whom were D.C. residents.

Maret School

Maret School is the only co-ed day school in Washington, D.C. with all students in grades K-12 on a single campus. It is located at 3000 Cathedral Ave., NW and includes a student body of approximately 600 students from the Washington, metropolitan area and from other countries.[58] In order to accommodate Maret's growing enrollment, the District approved a $16 million revenue bond in 1998 to fund improvements, additions, and renovations to the school.[59] The 2001-02 tuition ranged from $15,630 to $18,550, with approximately 12 percent of Maret's students receiving financial aid. In 2001, the school distributed $728,852 in financial aid.[60] Twelve percent of 600 is 72, suggesting an average level of about $10,000 per student in financial aid. The school's project application did not indicate that the revenue bond subsidy would be used to provide scholarships to low-income students from D.C., nor did it propose any job creation, or indicate the wages and benefits that would be paid to new employees. The school's First Source Hiring Agreement did not propose to create any new jobs. According to a compliance report filed in April of 2002, Maret has hired 71 employees since receiving the bond, and more than half of these employees are D.C. residents. The report also indicated that no apprenticeship program was used for the project.

Washington International School

Washington International School provides classes for 818 students from pre-kindergarten through grade 12.[61] In 1999, the Council authorized a revenue bond in the amount of $11 million to construct and equip a new primary school at 3601 Reservoir Road, NW, as well as an arts and athletics center for the middle and upper school at 3100 Macomb Street, NW. [62] The tuition for 2001-02 was $16,400. The school provided $795,300 in financial aid to 11 percent of its students. Grant amounts vary depending on a family's need, but all families pay some portion of tuition and fees.[63] The school's project application did not indicate that the revenue bond subsidy would be used to provide scholarships to low-income students from D.C. No projection of job creation or wages and benefits was included in the application. In its First Source Hiring Agreement, the school proposed to create seven jobs ranging from $20,000 to $35,000 per year. Only some of these jobs meet the self-sufficiency standard for a family with one adult and one preschooler.[64] The First Source Hiring compliance reports provided by the District show that 126 employees have been hired, of whom 44 percent are D.C. residents, and that there was no apprenticeship program. There is no indication of the wages and benefits paid.

Conclusion: Proposed Policy Solutions

Based upon our findings and the best practices used in many states and other cities, we offer the following menu of policy options to improve the effectiveness of D.C.'s economic development programs:

<u>Use Economic Development Programs to Create Good Jobs for D.C. Residents</u>

Job Quality Application Disclosure. On project applications, require developers to specify the job titles, number of new jobs to be created, and wage and benefit rates to be paid.

If developers provide this information early in the process before a project is voted upon, then D.C.'s Chief Financial Officer, residents and Council Members would be better able to weigh costs vs. benefits, and evaluate whether a proposed project can adequately support D.C. employees and their families. This information would also help officials to better monitor the developer's compliance with the project agreement.

Job Quality Standards. Require any company that receives a subsidy to pay employees an established wage and benefit rate.

The only known wage and benefit standards that the District uses for economic development projects are prevailing wages and benefits for temporary construction jobs, which are required under the federal Davis-Bacon Act. For permanent jobs, no wage and benefit standards are applied, except for certain service jobs for which prevailing wages and benefits are required under the Federal Service Contract Act.

At least 37 states, 25 cities and four counties now apply job quality standards to private recipients of economic development subsidies. The standards range from mandated wage levels and incentives for health insurance coverage to full-time hour requirements. The standards are attached to virtually every kind of development incentive. State and local governments believe that job quality standards reduce added taxpayer costs by reducing the need to help poverty-wage workers with Medicaid, food stamps, the Earned Income Tax Credit or other assistance. The District is in the minority of states by failing to require job quality standards. The self-sufficiency standard is the preferred wage standard. It will ensure that working families living in Washington, D.C. have sufficient income to meet their basic needs of housing, food and other essentials without having to rely on public or private assistance.

Promote Local Hiring. Enforce apprenticeship requirements. Eliminate the local-hiring exemption granted to non-profit corporations.

D.C.'s local hiring and apprenticeship program participation rules have been loosely monitored and enforced. A new law requiring that most new jobs go to D.C. residents exempts non-profit corporations (such as hospitals and universities) that have historically been very large subsidy recipients. Reversing these program flaws would ensure that future projects actually create jobs for D.C. resident-taxpayers.

<u>Target Subsidies to Disadvantaged Areas or to Create Clear Public Benefits</u>

Target TIF to Needy Areas. Amend the tax increment financing law to require a finding of blight in order for a TIF project to be eligible.

D.C.'s law is different from many state laws that require a finding of blight distress for a TIF project to be eligible. Such a requirement is intended to ensure that a project leverages private investment in an area that has suffered disinvestment. Although some of the areas designated by law for TIF development in D.C. are in blighted areas, none of the three TIF projects approved to date fit this criterion. Absent a blight finding, all or most of D.C.'s TIF projects will be able to use tax money for development that does not revitalize blighted areas. Over time, this will result in a steady redistribution of tax revenue away from areas that are most in need.

Codify TIF Eligibility and Housing Waiver Criteria. Amend the TIF law to narrowly define the "special merits" that the CFO must find to approve a project or to waive the duty to build housing.

Currently the CFO has very broad discretion to find "special merits" in whatever way he chooses. As a result, three TIF projects have been approved which have been the subjects of controversy over issues including funding, location, diversion of public resources from education and other services, and the lack of public benefit to low-income residents. The TIF law could be amended and "special merits" defined to include circumstances that take into consideration all of these competing interests for public money. Without clear criteria, the awarding of subsidies is inevitably vulnerable to allegations of favoritism and political influence.

Establish a Clear "But For" TIF Requirement. Amend the TIF eligibility criteria to allow a finding of special merits only when it can be clearly demonstrated that the project would not occur without the TIF subsidy.

In addition to finding that a proposed project has special merits, the CFO must find that there is a "reasonable probability" that those special merits will not be achieved without TIF funding. By only requiring a "reasonable probability," more projects can be approved than if it were necessary to show that the project would not proceed "but for" the TIF, which is the prevailing standard among the states. The current threshold is so low it has enabled projects such as Gallery Place to proceed, even though a District official has publicly acknowledged that other economic development would have occurred at the same site without TIF. The current law favors projects that have less need, thereby reducing opportunity for economic development in low-income neighborhoods.

Tie Affordable Housing to TIF. Require TIF developers to construct low- and moderate-income housing or contribute to a Housing Preservation Trust Fund.

The current law only requires developers to build housing as a condition of their subsidy award when TIF projects are located in the "Downtown Area" sections of the District. This requirement, however, does not require the construction of low-income housing. Although housing is included in the two TIF projects that are located in a Downtown Area – Gallery Place and the Spy Museum – the rent is at market rate.

Deny a subsidy unless it provides a public benefit that can be accessed at little or no cost to lower-income D.C. residents and meets a critical public need.

Most of the subsidies awarded by the District support services that lower-income taxpayers will not be able to access, or from which they will not receive any kind of benefit. Some projects may occasionally offer a service to low-income persons for free or at a reduced cost. Since public money is being used to finance the projects, the Council should require that it be the rule, rather than the exception, that publicly financed projects result in real benefits to D.C. residents. If private schools receive bond financing, for example, they should be expected to increase scholarship assistance to D.C. students or otherwise provide some benefit to the community. Projects should also respond to the critical needs of the District such as the lack of affordable housing.

Monitor Outcomes and Recapture Subsidies When Commitments Are Not Met

Install a Meaningful Monitoring System. Establish a rigorous monitoring system for all subsidy agreements to ensure compliance with job creation and wage and benefit requirements.

For projects begun after September 5, 2001, the District's amended First Source Hiring Law requires for-profit companies to hire at least 51 percent of D.C. residents and to file monthly compliance reports. The need to monitor all subsidy agreements for compliance with job and wage obligations, however, applies with equal force. At least nine states disclose deal-specific data, and many more states and cities conduct monitoring that is not published. Without monitoring, taxpayers and the Council cannot determine whether job creation and wage promises, if they exist, are being fulfilled. Absent monitoring, there is no way to know if taxpayer investments are paying off.

The First Source Hiring Agreement that developers must sign requires them to include only the salary range to be paid to new employees. By mixing management salaries with hourly wages, such a range is insufficient to determine if all employees are paid a self-sufficiency wage. A disaggregated agreement that lists each occupational category and compensation level would enable such an analysis. Further, the compliance reports used by the District do not require developers to state the wages and benefits actually paid. Requiring this information to be included in all compliance reports would enable taxpayers to see whether projects are creating good family-wage jobs.

Clawbacks. Require each development agreement to include a clawback provision mandating the recapture of a pro rata share of the subsidy if a developer fails to comply with its job creation, wage or benefit obligations.

Clawback provisions are increasingly common tools used by state and local governments throughout the country. At least 18 states have enacted such laws, and we estimate that more than a hundred cities have adopted ordinances or policies requiring recapture in the event a company fails to meet its obligations. Clawbacks provide insurance to taxpayers that their money will not be lost if a company fails to live up to the purpose of the deal. As the District finances larger projects, the risks to taxpayers of a failed deal grow as well. Effective clawbacks clearly designate the agency responsible for enforcing the recapture.

Overhaul the Process to Enable Meaningful Public Input and Oversight

Notify Interested Parties. Expand the public notice of a proposed subsidy deal prior to the Council's hearing on the proposal.

Currently, notice of a Council hearing on a revenue bond or TIF proposal is published once in the legal section of Washington's newspapers. Notice may also appear electronically on the Council's website. This form of notice, while meeting narrow legal requirements, fails to reach a significant number of persons or groups interested in commenting on a proposal. An expanded notice system is an "Interested Parties' Registry" which requires the governing body to send a hard copy of the hearing notice to any organization or individual that enters its name in the Registry. In 1999, Illinois enacted a law that establishes such a Registry for all proposed TIF projects. The Registry enables interested parties to stay informed about the use of their communities' TIF program, and provides them with adequate time to review and prepare for the public hearing. With the use of e-mail becoming much more common, an e-mail-based notice system can also be added.

Advisory Task Force. Establish a task force consisting of representatives from the community, the Mayor's Office and the Council to discuss economic development proposals before they are adopted by the Mayor.

To make the District's economic development process and policies fairer and more acceptable to its residents, the planning process should be more inclusive. A task force on economic development would allow representatives from neighborhood, labor, business, and faith-based organizations to take part in shaping the District's economic future. Currently, there is no opportunity for public input prior to the presentation of a revenue bond or TIF proposal to the Council.

Close the "Emergency Legislation" Loophole. Require that economic development proposals be enacted as permanent rather than emergency legislation, so that there is adequate review before projects are put into motion.

By using "emergency resolutions" to approve TIF projects, the Council has cut short the opportunity for the public, as well as the Council, to review and debate proposals that are costly and controversial. By enacting development proposals as permanent rather than emergency legislation, an appropriate period of review and comment would take place before actions involving public expenditures are taken.

Comply with the Freedom of Information Act. Respond to requests to review subsidy applications, contracts, compliance reports and apprenticeship records by providing access in a complete and timely manner.

District officials generally responded in a timely manner to our requests for revenue bond applications, First Source Hiring Agreements and compliance reports. The bond applications were made available for inspection, although several were missing. Monthly First Source Hiring compliance reports were provided, but the reports for several companies were missing, which may be due in part to the companies' failure to file their reports. The law passed by the Council last year allowing the imposition of penalties for willful failure to file compliance reports will hopefully address this problem.

District officials, however, failed to respond to a Freedom of Information Act (FOIA) request in May of 2002 for TIF applications and agreements after initially agreeing to provide these records. Officials also denied a FOIA request in June of 2002 to inspect apprenticeship records to see whether contractors and subcontractors using revenue bond and TIF money have registered apprenticeship programs. These failures to respond violated the intent of the District's FOIA to enable the public to review agency records and actions. Shielding these records from the public eye only raises more questions about the District's economic development practices and the lack of accountability in the expenditure of public funds.

Both denials were appealed. In mid-October, the District's denial of apprenticeships records was reversed and most but not all of the records were made available for inspection. An appeal dated August 5, 2002 from the denial of the TIF records is still pending.

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[2] D.C. Code Section 2-1217.09
[3] Since the District failed to provide copies of the TIF development agreements, it is unknown whether those agreements obligate developers to create a certain number of jobs, or require the District to recapture the subsidy in the event of non-compliance.
[4] Spinner, Jackie. "District Can't Sell Bonds for Big Projects; TIF Policy Changed To Reassure Investors." *The Washington Post,* November 12, 2001.
[5] Interview with Michael Jasso, Special Assistant, Office of the Deputy Mayor for Planning and Economic Development for the District of Columbia, June 6, 2002.
[6] Revenue bonds are tax-exempt, which means that investors who purchase the bonds are not required to pay federal income tax on the interest earned on the bonds. There also is no requirement for D.C.

residents who purchase the bonds to pay D.C. income taxes on that interest. The tax advantage of revenue bonds allows the bonds to pay a lower interest rate than other bonds, such as corporate bonds, where the interest earned is taxed.

[7] D.C. Code section 1-204.90(a)(1)

[8] D.C. Code section 1-204.90(e)(60)

[9] 10 D.C.M.R. sections 5001.5, 5001.6

[10] D.C. Code section 2-219.03 (e) and (f)

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[28] Pierce and Brooks, 1999.

[29] D.C. Council R13-788.

[30] D.C. Council R13-633, "Fourteenth and Irving Ventures Revenue Bond Project Emergency Declaration Resolution of 2000."

[31] "Columbia Heights Decision a Travesty" (editorial), The InTowner, Sept. 1999.

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