Government of the District of Columbia
Office of the Chief Financial Officer

Jeffrey S. DeWitt
Chief Financial Officer

TAX ABATEMENT FINANCIAL ANALYSIS

TO:	**The Honorable Muriel Bowser** **Mayor, District of Columbia** **The Honorable Phil Mendelson** **Chairman, Council of the District of Columbia**
FROM:	**Jeffrey S. DeWitt** **Chief Financial Officer**
DATE:	**June 26, 2018**
SUBJECT:	**"Penelope Hotel Lots 827 and 7000 and Square 0137 Real Property Tax Abatement Act of 2017"**
REFERENCE:	**Bill 22-592**

Findings

The proposed bill would provide a partial abatement of real property taxes over a 10-year period totaling $2.0 million. Based on information provided by the Penelope Hotel developer (Developer)[1], the Office of the Chief Financial Officer (OCFO) finds the likelihood of the project receiving construction financing is not dependent on an abatement and therefore, the proposed property tax abatement is not needed.

Please refer to the separate Fiscal Impact Statement for the effect of the proposed legislation on the District's financial plan.

Background

The Penelope Hotel project is a proposed conversion of an existing five-story commercial building into a 73-room boutique hotel. The property is located at 1337 Connecticut Ave, NW[2]. Constructed on a through lot just south of Dupont Circle, one side of the building fronts on the east side of Connecticut Avenue, NW and the other side fronts on the west side of 18th Street, NW.

Through various zoning actions, the Developer is entitled to convert the second through fifth floors of the existing building to inn use and to construct a sixth floor for inn use as well. The first floor is

[1] Originally acquired by Endeka Enterprises LLC in October 2000, the property has been jointly owned with 1320 Penelope LLC since May 2014 and will be developed by Valor Development.
[2] Known for taxation and assessment purposes as Lots 827 and 7000 in Square 137.

planned to house the lobby along with food and beverage operations for the hotel. The building also contains an eight-vehicle garage.

Tax Abatement Financial Analysis

The Exemptions and Abatements Information Requirements Act of 2011 requires the analysis provided by the OCFO to contain the following information:

(A) Terms of the Abatement

The proposed legislation provides a real property tax abatement for Lots 827 and 7000 in Square 137 in the amount of $200,000 per year for 10 property tax years beginning in FY 2020, so long as the property is principally owned by William L. Lansing and James G. Calomiris[3]. If the Council chooses to approve the proposed abatement, the OCFO recommends amending the bill to make the abatement contingent upon the hotel being open.

(B) Value of the Abatement

Table 1: Value of Abated Taxes

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023-FY 2029	TOTAL
Abated Real Property Tax	$0	$200,000	$200,000	$200,000	$1,400,000	$2,000,000

(C) Purpose of the Abatement

According to Valor Development, the purpose of the abatement is to assist with redevelopment of the building by increasing the hotel's profitability such that it attracts the financing necessary to convert the building. Valor is seeking conversion of the majority vacant building[4] to maximize the value and liquidity of the property.

(D) Summary of the Proposed Community Benefits

A summary of the proposed community benefits, as submitted by Valor Development, is attached to this analysis.

(E) Financial Analysis and Advisory Opinion

Valor Development provided the OCFO with a development finance plan, projected operating income and expenses for the hotel, and cash flow information for the overall investment.

[3] Lot 827 is currently owned by Endeka Enterprises LLC. Lot 7000 is currently owned by 1320 Penelope LLC. William L. Lansing is a Principal of Valor Development and the current governor of both Endeka Enterprises and 1320 Penelope LLC. James G. Calomiris is the past governor of Endeka Enterprises LLC and was registered agent for 1320 Penelope LLC.

[4] Current tenants of the building include The Gryphon bar and restaurant, Kabin Lounge, and a Crossfit gym.

Table 2: Development Sources and Uses

Sources	
Debt	$25,740,000
Equity	17,160,000
Total Sources	**$42,900,000**
Uses	
Land Contribution*	$17,600,000
Hard/Soft/FF&E/OS&E**	21,677,000
CPI and Reserves	1,851,000
Pre-Operations	500,000
Transaction Costs	1,272,000
Total Uses	**$42,900,000**

* The land cost reflects repaying a $10.9 million outstanding balance on an EagleBank loan secured by the property.

** Line item includes hard construction costs, soft costs (e.g., Architecture & Engineering, Third Party Consultants, Legal, etc.), furniture, fixtures and equipment (FF&E), operating supplies and equipment (OS&E).

Table 3: Hotel Operating Projections and Investment Cashflows ($ in 000's)[5,6,7]

	Construction	May Opening	FY 20	FY 21	FY 22	FY 23	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29
NOI without Abatement	**-**	**250**	**1,440**	**2,540**	**2,620**	**2,670**	**2,720**	**2,770**	**2,830**	**2,890**	**2,950**	**3,010**
Equity Investment	(17,160)	-	-	-	-	-	-	-	-	-	-	-
Construction Loan Payments	-	-	(1,710)	(1,610)	(26,840)	-	-	-	-	-	-	-
Permanent Loan Proceeds	-	-	-	-	24,890	-	-	-	-	-	-	-
Permanent Loan Payments	-	-	-	-	-	(2,140)	(2,140)	(2,140)	(2,140)	(2,140)	(2,140)	(23,630)
Asset Sale Proceeds	-	-	-	-	-	-	-	-	-	-	-	44,920
Total Cashflow w/o Abatement	**(17,160)**	**250**	**(270)**	**930**	**670**	**530**	**580**	**630**	**690**	**750**	**810**	**24,300**
IRR without abatement	5.7%											
Asset Sale Proceeds	-	-	-	-	-	-	-	-	-	-	-	47,900
Total Cashflow with Abatement	**(17,160)**	**250**	**(70)**	**1,130**	**870**	**730**	**780**	**830**	**890**	**950**	**1,010**	**27,480**
IRR with abatement	7.5%											

As shown above, the development is projected to achieve a 6 percent return without an abatement and an 8 percent return with an abatement. While these returns are lower than a typical hotel, the

5 Per Valor Development, permanent loan expected to be sized at the lesser of 80 percent of project cost, 75 percent loan-to-value or 1.25 debt service coverage ratio with a 7.0-7.5 percent interest rate and 25-year term. Permanent loan payments reflect a 7.0 percent interest rate.

6 Per Valor Development, asset sale price assumes 6.5 percent cap rate and 3.0 percent selling costs.

7 Internal Rate of Return calculations assume Valor Development holds the asset for the duration of the 10-year tax abatement period.

project is similarly profitable in either scenario and creates a property that could be sold. An abatement is not likely to have a significant impact on the project's ability to receive financing. More relevant to the ability to receive financing and ultimate success of the project will be its ability to position itself as a competitor to Upper Upscale or Luxury[8] properties such as a Ritz-Carlton or The Graham and achieve average daily room rates and occupancy levels that exceed city-wide averages.

Conclusion

While the proposed abatement would assist with redevelopment of the existing building by increasing the hotel's projected profitability, it is not the deciding factor in whether the development will receive financing and can achieve the owner's goal of maximizing liquidity of the property.

[8] As defined by STR's categorization system. The class segments are: Luxury, Upper Upscale, Upscale, Upper Midscale, Midscale and Economy. https://www.str.com/resources/glossary#S

Attachment: Applicant Provided Statement of Community Benefits

A summary of the proposed community benefits to be provided by the abatement, if known, including, but not limited to:

a. The number of affordable housing units to be developed, if any, including:

i. Level of Area Median Income (AMI) at which units will be affordable, if applicable; and;

Not applicable

ii. The projected financial value of the proposed subsidy based upon the difference between the value of a comparable market rate unit and a proposed affordable unit within the same neighborhood, if applicable.

Valor is projected to invest a total of $39 million from the original acquisition in 2014 and the improvement of the property to build upon and renovate and existing office building and transform it into a 73-room hotel. The project will generate an estimated $1.7 million in taxes in its first year and over $9.5 million over the first 4 years of operations (including the real property tax abatement of $4 per sq. ft.). The hotel will create approximately 60 full time equivalent positions in the first year of operations. The hotel expects to have approximately 17,772 hotel nights in the first year with 104,393 hotel nights over the first 5 years.

b. The proposed number of jobs to be created by the project, if any, including:

i. Whether the jobs are temporary or permanent (permanent jobs are those involved in the ongoing operation of the commercial property);

The project's approximately 60 full-time equivalent (FTE) positions will be permanent jobs. Approximately 40 construction jobs will be created as a result of the project.

ii. Full-time or part-time (full-time jobs are those working at least 35 hours a week);

The project is estimating hourly FTE employees of 46.8 and approximately 13 salaried positions. The project expects to create 60 full-time equivalent positions within its first year of operations.

iii. The estimated wages and benefits for each job; and

Approximately 48.8 of the project's FTE's are expected to earn at least $31,200 per year or $15/hour, the District's required minimum wage required by 2020. The additional 11 full-time positions are expected to pay an average of at least $50,000 per year.

iv. The number of jobs that are committed to District residents.

While it is hard at this time to approximate the number of positions that will be filled by District residents, Valor Development expects at least 51% of the positions will be filled by District residents. Valor will also plan to host a job fair and reach out to the community to help attract District residents to apply for open positions at the hotel.

c. Description of any other public policy goal(s) the exemption or abatement is meant to address and expected results.

The summary should delineate which community benefits and amenities are already required by law through the zoning process (e.g., inclusionary zoning, planned-unit-development approval) or regulations (e.g., environmental standards).

Valor is projected to invest a total of $39 million from the original acquisition in 2014 and the improvement of the property to build upon and renovate and existing office building and transform it into a 73-room hotel. The project will generate an estimated $2.2 million in taxes in its first year and over $9.5 million over the first 4 years of operations (including the real property tax abatement of $4 per sq. ft.). The hotel will create approximately 60 full-time equivalent positions in the first year of operations. The hotel expects to have approximately 17,772 hotel nights in the first year with 104,393 hotel nights over the first 5 years. Please see Exhibit A – Economic Impact Overview.

Valor Development expects at least 51% of the positions will be filled by District residents. Valor will also plan to host a job fair and reach out to the community to help attract District residents to apply for open positions at the hotel.

Additionally, ownership has committed through its BZA approvals to commit to the following as it relates to Loading and Transportation Management Plans.

Loading Management Plan:

1. Vendors and on-site tenants shall be required to coordinate and schedule deliveries.
2. Trucks accessing the site shall be limited to a maximum of 30 feet in length.
3. All tenants shall be required to schedule any loading operation using a truck 20 feet to 30 feet in length.
4. Deliveries shall be scheduled to ensure curbside capacity is not exceeded. Unscheduled delivery vehicles shall be directed to return at a later time when loading space is available.
5. Inbound and outbound truck loading movements will be monitored to ensure trucks do not block the alley. Tenants shall ensure that trucks will not be allowed to park on 18th Street for deliveries.
6. Trucks using the loading docks will not be allowed to idle and must abide by the DDOT Freight Management and Commercial Vehicle Operations regulations and use the primary access routes listed in the DDOT Truck and Bus Route System map.

Transportation Demand Management (TDM) Program:

1. A member of the property management group shall serve as the Transportation Management Coordinator (TMC) responsible for coordinating and implementing the TMD provisions, preparing informational promotional brochures to residents and visitors and coordination trash and loading activities. The contact information will be provided to DDOT and Zoning Enforcement with annual contact updates.
2. Real time transit information shall be presented on a display in the hotel to provide guests real time transportation information. In addition, the TMC will make printed materials for guest and employees up request.

3. The Applicant shall register as a member of the Capital Bikeshare Bulk Membership program for hotels and provide initial free daily Capital Bikeshare passes for hotel guests in perpetuity, not to exceed $5,000 per year.