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

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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:	**Glen M. Lee** **Chief Financial Officer**
DATE:	**November 13, 2024**
SUBJECT:	**Tax Abatement Financial Analysis- "1333 M Street, SE Tax Abatement Amendment Act of 2024"**
REFERENCE:	**Bill 25-0915**

Findings

The "1333 M Street, SE Tax Abatement Amendment Act of 2024" (the "Bill") would abate prospective real property taxes for the property located at 1333 M Street SE, known for tax and assessment purposes as Lot 2, Square 1048-S (the "Property"). The Bill would grant the Property an abatement of any amount of annual real property tax in excess of $150,000. The abatement would be in effect for a period of 15 consecutive years, beginning on October 1, 2028, and ending September 30, 2043, provided FRF Land Owner LLC (the "Owner" or the "Applicant") satisfies the terms of the abatement outlined in the Bill.

The purpose of the abatement is to allow the Owner to obtain the financing necessary to begin construction of the development identified in its approved Planned Unit Development ("PUD")[1], which consists of approximately 790,000 square feet of mixed-use residential and retail, along with public improvements and amenities (the "Project"). Based on an analysis of the project information submitted, the Office of the Chief Financial Officer ("OCFO") finds that the abatement is financially necessary for the first phase of the Project to proceed – as it shoulders much of the public infrastructure cost serving the entire Project – but is not expected to be financially necessary for subsequent phases of the Project to advance.

[1] Approved by the Zoning Commission pursuant to Z.C. No. 20-06, and amended and extended pursuant to Z.C. No. 20-06A, 20-06B, and 20-06C.

Background

The Property is a 2.9 acre triangular parcel located in the Navy Yard neighborhood in Ward 6, bounded to the north by M Street SE, to the south by Water Street SE/Anacostia Riverwalk Trail, and to the east by the unimproved right-of-way for Virginia Avenue. The site is mostly vacant, other than two small, abandoned commercial structures fronting M Street SE.

In November 2020, the Felice Development Group secured approval for a mixed-use development on the Property through the PUD process. The PUD permitted the development of approximately 900 multifamily units and 45,000 square feet of retail spread across three buildings, representing a total of 790,000 square feet of mixed-use development. Additionally, the PUD required that certain developer proffers related to public improvements, site amenities and a higher share of affordable units beyond Inclusionary Zoning requirements be delivered in conjunction with the first building (collectively, the "Phase 1 Proffers"). These include, but are not limited to roadway improvements, pedestrian and bike infrastructure, and public spaces/plazas, and represent the vast majority of developer proffer costs for the entire Project. After the Zoning Commission approved the PUD, the Owner (an affiliate of Felice Development Group) purchased the Property in June 2021 to begin redevelopment of the site.

According to the Applicant, the Project has been delayed due to higher construction costs, interest rates, and a tighter capital environment than originally assumed when the PUD application was filed in 2020, right before the onset of the COVID-19 pandemic. In response, the Applicant filed for and received a two-year extension on the PUD in 2022, enabling it to file a building permit application no later than April 23, 2025, with construction to commence no more than 12 months later.

However, the Applicant states that the economic feasibility of the Project remains challenged. In particular, the Applicant notes that key hindrances to securing financing for the Project include the significantly higher than originally projected cost of constructing the Phase 1 Proffers, as well as the inability of the Project to meet investor and lender underwriting standards. The Applicant believes that the tax abatement, as proposed, will reduce operating costs and enhance the value of the Project which will generate sufficient financial value that meets lender underwriting standards and investor "hurdle" thresholds needed to finance the Project.

Financial Analysis

(A) <u>Terms of the Abatement</u>

The Bill would limit annual real property taxes at the Property to **$150,000** and abate any excess thereof for a period of 15 consecutive years, beginning on October 1, 2028, and ending September 30, 2043, provided the Owner shall:

(1) "To the extent constructed, set aside a minimum of 12% of the residential gross floor area of the 1333 M Street, SE Project for households earning equal to or less than 60% of the median family income ("MFI")"
(2) "Have constructed or be in the process of constructing public space improvements that provide benefits of special value to the neighborhood, including:

(i) A neighborhood greenway on Water Street, SE, between 12th and M Streets, SE;
(ii) The Arrival Plaza, Waterfront Plaza, 14th Street Corridor Plaza, and Lower Retail Promenade, as those improvements are explained in the Planned Unit Development (“PUD”) approved by the Zoning Commission of the District of Columbia [pursuant to Z.C. Order No. 20-06, effective April 23, 2021, as amended and extended pursuant to 34 Z.C. Order No. 20-06A-20-06C];
(iii) A reconstructed Anacostia Bicycle Trail on M Street, SE;
(iv) A reconstructed Virginia Avenue, SE with bioretention facilities;
(v) The installation of 52 short-term bicycle spaces in public space on M Street and Virginia Avenue, SE.”

(B) Value of the Abatement

The Bill’s proposed tax relief for the Property will be $0 through the financial plan period and is estimated to be **$61,731,717** through FY 2043, as presented in Table 1. This estimate assumes the Project is constructed in accordance with the Applicant’s development program and proposed schedule and is taxed at the appropriate Office of Tax and Revenue-designated real property tax rates for its land, residential and commercial uses. The Property’s Capital Riverfront Business Improvement District Tax is not affected by the proposed abatement and will remain in effect.

Table 1: Estimated Value of the Proposed Tax Abatement

Real Property Tax Abatement	FY 2025	FY 2026	FY 2027	FY 2028	Total FY 2025-2028	Total FY 2029-2043
1333 M Street Se (Lot 2, Square 1048-S)	**$0**	**$0**	**$0**	**$0**	**$0**	**$61,731,717**

The Exemptions and Abatements Information Requirements Act of 2011 requires certain information from the Applicant pertaining to political contributions and contracts held by the Applicant if the total estimated value of the abatement or abatement is $250,000 or more. According to the Applicant, no political contributions have been made by any of its ownership entities since the introduction of Bill 25-0915, nor are any of its ownership entities involved contractually with the District of Columbia.

(C) Purpose of the Abatement

According to the Applicant, the purpose of the abatement is to enhance the financial viability of the Project, by reducing costs and risk, and generating improved returns in order to secure financing from lenders and investors.

(D) Summary of the Proposed Community Benefits

The community benefits provided by the Applicant are provided in Attachment A.

(E) Financial Analysis and Advisory Opinion

The OCFO's Office of Finance and Treasury reviewed the financial information provided by the Applicant for the Project, including cost estimates for the Phase 1 Proffers, as well as development cash flow projections and a construction schedule for the three buildings comprising the Project, anticipated to be delivered in 2028, 2030, 2031.

The Applicant is presently financing the first building of the Project, whose 499 units and 18,000 SF of commercial space constitutes roughly 60 percent of the Project's overall size. As a requirement of the PUD, the Phase 1 Proffers must be delivered before the first building can receive its Certificate of Occupancy and begin operations. The Phase 1 Proffers are currently quoted at $18M and estimated to add an extra 11 percent to the construction cost of the first building. Although the Phase 1 Proffers need to be financed in conjunction with the first building, its roadway improvements, pedestrian and bike infrastructure, and public spaces/plazas serve the entire Property and are designed to benefit future phases as well. While the still-to-be-financed second and third buildings in the Project also have proffer requirements before they can receive a Certificate of Occupancy, they are expected to be significantly less costly than the Phase 1 Proffers.

The OCFO's analysis of the financial information provided includes the use of input and growth assumptions from the Applicant as well as current market data. The analysis indicates the tax abatement as proposed is financially necessary for the development of the first building, which will reduce costs and generate the higher returns needed to attract debt and equity financing, respectively. The subsequent buildings are not expected to be constructed for another four to six years during which market conditions can change. However, the analysis presently indicates a tax abatement would not be financially necessary for the development of the proposed second and third buildings, which would be delivered after the Phase 1 Proffers are built.

Conclusion

Based on an analysis of the financial information for the Project, the OCFO finds that real property tax abatement as proposed in the Bill is financially necessary for the first building that the Applicant is presently financing, as it shoulders much of the infrastructure cost for the entire site and the Project. However, the OCFO currently does not find the abatement necessary for the development of the remaining second and third buildings in the Project, which do not carry this additional cost burden.

Attachment A: Summary of Community Benefits

(as stated by the Applicant)

The Bill's proposed Tax Cap of the current assessment and payment would begin Tax Year 2029. This offers an opportunity to make a commitment outside of the 4-year Budget Cycle by keeping the current tax revenue in exchange for the development over 800 residential units for over 1,200 residents.

All are aware the aftermath of COVID-19 has caused unprecedented spikes in costs, interest rates, and devastating impacts to commercial real estate, especially in cities. The above, along with national press and perception of the District of Columbia has frozen the capital markets from being interested in investing in DC.

Capping the RE Tax line item in the project's underwriting gives certainty to the lenders of costs. This typically uncontrollable expense item at a set amount will give the investors a cap rate required now to commit to this project.

It is important to note, the **Capital Riverfront BID tax is not affected by the tax cap**. Only capping the RE Tax assessment and portion.

The first phase (499 units) is in for permits and once completed, would **produce $10 million of income** and sales taxes from the new residents to the District each year. Twice that when fully built out.

More immediately, a 1.45% recordation tax of a $150,000,000 construction loan would be $2,175,000 to the District.

<u>The community benefits from construction to public space:</u>

Shown below #1 shaded area - Newly constructed **M Street and Virginia Avenue** roadways, sidewalk, streetlights, etc. to DDOT standards. Also, in #1 a new 10' wide **bike path** north of M Street.

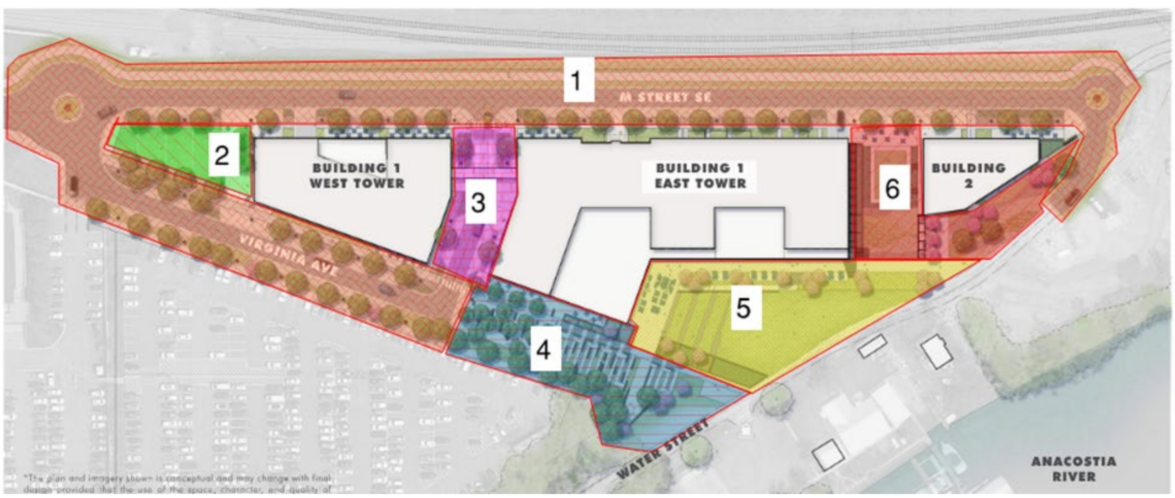
Item #2 is improvement of **public space** to include bike share station, hardscape and landscaped plaza.

Item #3 is the shared private road that will serve buildings, but also **provided a view corridor** for neighborhood to north as well as sidewalk to get to Virginia Ave.

Item #4 is the **monumental stair that connects Virginia Ave to Water Street and retail below**.

Item #5 is the **green lawn which will be programmed for public events** by the Capitol Riverfront BID, ala The Yards.

Item #6 is another **view corridor and public access** to area #5. OP and DDOT envision the planned pedestrian/bike bridge over SE Boulevard to be positioned north of #6 and M Street to connect with new sidewalk, bike path (#1) and **add access to the river**.



<u>Additional benefits from Developer, ANC 6B and Zoning Commission via PUD process and outlined in ZC Order 20-06.</u>

- 12% affordable housing at 60% AMI. 12% is 50% more than required during the PUD approval process.
- Two 2-Bedroom units at 50% AMI per ANC request.
- Extensive bike share, storage and EV charging capacity in an around buildings.
- $25,000 to DC Parks & Rec for their Senior Adult Programs at local center in Ward 6.
- $225,000 to non-profit Capitol Hill Village for Senior Adult Daycare programing efforts.
- LEED Gold level design and construction.
- Collaborate with DDOT to develop a new concept/design/uses for Water Street.

Also, with slowing construction and in the coming years, there would be 350 jobs/workers on each building benefiting the local economy.