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

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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:	**June 18, 2024**
SUBJECT:	**Tax Abatement Financial Analysis- "Corporate Short-Term Stay Housing in Downtown Reversion and Rate Freeze Amendment Act of 2024"**
REFERENCE:	**Bill 25-0784**

Findings

The "Corporate Short-Term Stay Housing in Downtown Reversion and Rate Freeze Amendment Act of 2024" (the "Bill") would revert and freeze real property taxes for the property located at 1735 K Street NW, known for tax and assessment as Lot 849, Square 163 (the "Property"). Under the proposed tax abatement, real property tax due for the Property would revert to the tax year 2025 (the "Base year") amount and not increase for a period of 15 years, beginning on October 1, 2028, and ending September 30, 2043, provided BUAP 1735 K, LLC (the "Owner" and "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 start construction of the proposed office-to-extended-stay-housing conversion project in 2025. Based on an analysis of the financial information submitted, the Office of the Chief Financial Officer (OCFO) finds that the abatement is financially necessary for the conversion project to move forward. It is unlikely that the Owner would be able to secure the necessary financing to move forward with the proposed renovation and conversion project at the Property, under current market conditions, without the requested abatement.

Background

The Property is a 90,000 square foot mid-block office building centrally located in the District's CBD submarket. For more than 50 years, the building served as the headquarters of the Financial Industry Regulatory Authority (FINRA) and its predecessor agencies. In December 2023, FINRA relocated and downsized into 67,000 square feet at 1700 K Street NW as it shifted to a hybrid workplace operation, following the post-pandemic pattern of many larger office tenants in the District's urban core. Consequently, the Property is currently vacant.

As a functionally obsolescent building in a submarket with a historically elevated level of vacant inventory and depressed demand, the Property is considered uncompetitive, and is unlikely to be re-leased at a competitive rate in its current state.

The Applicant – a joint venture entity comprised of Bernstein Management Corporation, Placemakr Inc., and Urban Atlantic Development LLC – purchased the Property in November of 2022, and has proposed an extensive renovation and repurposing project that will convert the existing building use from commercial office into corporate housing and short-term stays. The completed project will offer 106 furnished extended-stay rental units available for stays as short as a single night up to one year in duration. The applicant has identified interns, students, families, tourists, and IMF/World Bank contractors as potential guests/tenants. In addition to the residential units, the property will rebuild 4,000 square feet of ground-floor space along the K Street frontage into retail space anticipated to be leased by a food and beverage tenant.

One of the ownership members – Placemakr Inc. – will operate and manage the Property. Placemakr is an established participant in the flexible-use multifamily/hospitality sector and already operates various extended-stay rental products such as these in the District, including *Placemakr Dupont Circle* and *2500 Penn, a Placemakr Experience*, which are both located within a mile of the Property. Placemakr's business model is to partner with developers, property operators, and investors to provide "apartment-like spaces" catering to "nightly, short- or long-term stays, as well as business, group and extended-stay travelers."

Financial Analysis

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

The Bill would revert and freeze real property taxes[1] at the Property to the Base year amount for a period of 15 years, beginning on October 1, 2028, and ending September 30, 2043, provided the Owner satisfies the following conditions:

[1] Although the Bill refers to the tax benefit as a "rate reversion and freeze", for purposes of this analysis, the benefit is being treated as freezing the real property taxes at the tax year 2025 level, rather than freezing the tax rate applied to the assessed value of the property at the tax year 2025 tax rate. The OCFO recommends that the Bill language be amended to reflect that that real property taxes are being capped at the tax year 2025 level.

(1) Convert the building to short-term housing with a total project cost of not less than $40,000,000;
(2) Operate or cause to be operated a minimum of 95 units at the Property;
(3) Have received a certificate of occupancy on the Property no later than 36 months after the effective date of the Short-Term Stay Housing in Downtown Abatement Amendment Act of 2024;
(4) Enter into an agreement with the District government that requires the Owner, or its designee or assignee, to, at a minimum, contract with certified business enterprises for at least 35% of the contract dollar volume of the construction of the project, in accordance with Subchapter IX-A of Chapter 2 of Title 2;
(5) Pay taxes, as applicable, under §§ 47-2002, 47-2002.02, and 47-2002.03; and
(6) Notwithstanding any other provision of law, enter into a First Source Agreement for the operation of the repositioned building.

(B) Value of the Abatement

The Bill's proposed tax relief for the Property will be $0 through the financial plan period and estimated to be **$13,515,004** through FY 2043, as presented in Table 1.[2] This estimate assumes that the Property will continue to be taxed at the Office of Tax and Revenue-designated Class 2 real property tax rate. There is a pending tax assessment appeal from the Owner claiming a lower value of the Property. If the appeal is successful, the value of the abatement would increase.

The abatement would continue as long as the conditions specified in the Bill are satisfied but would be reduced on a dollar-for-dollar basis if the taxes paid from all sources from the converted Property (including real property tax, gross sales tax, transient lodging/accommodation tax) are less than the value of the abatement.

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
1735 K Street NW (Lot 849, Square 163)	**$0**	**$0**	**$0**	**$0**	**$0**	**$13,515,004**

The Abatements and Abatements Information Requirements Act of 2011 requires disclosure of 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 25-0784, nor are any of its ownership entities involved contractually with the District of Columbia. Additionally, the Applicant indicates that none of its ownership entities (or principles thereof) have made any political contributions in the District since the introduction of Bill 25-0784.

[2] The value of the abatement is based on the difference between the Property's estimated tax liability for TY2025, based on its assessed value for TY2025, and the estimated real property tax liability of Property after conversion based on the Applicant's estimates.

An affiliate of one of the Applicant's ownership entities - BDC Q Street LLC, (also affiliated with Bernstein Management Company) holds a lease with District of Columbia Courts for 8,063 square feet at 118 Q Street NE. The lease was executed on October 16, 2012, and a second amendment was signed on November 15, 2022, extending the lease term to March 31, 2022.

(C) Purpose of the Abatement

As stated by the Applicant, the purpose of the abatement is to allow the Owner to secure the financing necessary to start construction of the proposed office-to-short term housing conversion project in 2025.

(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

OCFO's Office of Finance and Treasury (OFT) evaluated the financial cash flow projections for two scenarios of the proposed conversion project (one including and one without the abatement) submitted by the Applicant. The evaluation reviewed financial assumptions of the project, including but not limited to construction costs, income projections (e.g. rents and room rates), operating expenses, debt financing, and investor return requirements.

Based on information from comparable projects and industry market data, the project's operating income, expense, and debt financing assumptions are reasonable compared to buildings of similar type and use (hospitality and/or residential). Construction cost assumptions were also determined to be reasonable for an office conversion (which are typically close to but still less than the cost of new development). As a result, the investor returns – the rate of return needed to attract investor equity to close the funding gap – were considered acceptable (albeit on the lower end) with the tax abatement, but unlikely to attract investment without the tax abatement, which would make the conversion economically infeasible.[3]

Conclusion

Based on the inability of the proposed project to generate a return necessary to attract capital investment without the requested abatement, the OCFO finds that the abatement is financially necessary for the proposed conversion and renovation of the Property to move forward.

[3] OCFO's analysis assumes that property taxes will be frozen based on the $13,515,004 assessed value currently proposed by OTR for the base year (TY 2025). However, there is a pending tax assessment appeal from the Owner claiming a value of $9,823,276. If the base year property value is reassessed at this lower value and taxes are reduced accordingly, OCFO's conclusion on the financial necessity of the requested abatement would remain unchanged.

Attachment A: Summary of Community Benefits

(as stated by the Applicant)

The Project is in direct conformance with the goals and objectives of the Mayor's Downtown Action Plan ("DAP"), which envisions the revitalization of Downtown DC through activation and conversion of obsolete office buildings. As such, it will result in a broad array of community benefits including:
(1) Substantial new tax revenue for the District when compared to the status quo;
(2) Economic growth within Downtown;
(3) Substantial net new jobs – both permanent and temporary;
(4) Support of District residents and small businesses through the execution of CBE and First Source agreements;
(5) Conversion of antiquated and obsolete office buildings into new productive uses;
(6) Activation of vacant street-front retail;
(7) Increasing Downtown foot traffic to support local and small businesses, and;
(8) Increasing the District's variety of hotel options to attract new visitors to the District and Downtown.

With regards to economic impact, the Project (*Placemakr Premier White House*) **will significantly increase tax revenues from all sources by nearly $43 Million over a 25-year period** (see chart below), as compared to the project remaining a Class-C office building.

	Corporate Housing/Short Term Stay Residences vs. Office Use Impacts		
Comparison of Impacted Revenues	Corporate Housing/ Short Term Stay Residences	Office Use Impact[6]	Variance
Primary Revenues:			
Real property tax revenues (with PILOT - See Schedule IV)	$19,869,761	$11,598,971	($8,270,790)
Sales & use tax revenues	$4,071,885	$0	($4,071,885)
Occupancy tax revenues	$30,640,120	$0	($30,640,120)
Projected revenues	**$54,581,766**	**$11,598,971**	**($42,982,795)**

Furthermore, the Project is anticipated to generate significant new temporary and permanent jobs. Current forecasts assume **23 net new permanent jobs** from the Project and **215 net new temporary jobs** created by the construction, as illustrated in the above table.

	Permanent Jobs from the Development[3] (Full-Time Equivalents and Income)				
Permanent Employment Impacts	Permanent Jobs	Annual Compensation	Income per Employee	Annual Wages	Wage per Employee
Corporate housing/short term stay residences:					
Direct impacts (full-time equivalents)	11	$295,637	$26,366	$256,496	$22,876
Indirect and induced impacts[4]	1	$96,885	$156,421	-	-
Restaurant:					
Direct impacts (full-time equivalents)	9	$607,233	$69,896	$539,215	$62,067
Indirect and induced impacts[4]	2	$224,837	$104,913	-	-
Total direct impacts (full-time equivalents)	20	$902,870	$45,370	$795,710	$39,985
Total indirect and induced impacts	3	$321,722	$116,462	-	-

	Temporary Jobs from Construction[5] (Full-time Equivalents and Income)				
Temporary Construction Employment Impacts	Temporary Jobs	Annual Compensation	Income per Employee	Annual Wages	Wage per Employee
Temporary:					
Direct impacts (full-time equivalents)	188	$14,929,285	$79,463	$12,577,436	$66,945
Indirect and induced impacts	27	$2,784,558	$103,590	-	-

MuniCap, Inc. *https://municap.sharepoint.com/sites/ALLSTAFF/CONSULTING/Urban Atlantic/1735 K Street/EIA/[1735 K Street Project (5.24.24) V2.xlsx]S1*
24-May-24

Beyond the substantial economic impact of the Project, *Placemakr Premier White House* will cater to a broad array of underserved transient stay profiles seeking larger, furnished apartment-style accommodation, including business travelers, visiting students, families in need of larger accommodations, seasonal interns, etc. These visitors will substantially increase foot traffic in the heart of Downtown throughout the entirety of the week at multiple times of the day, directly benefiting local retail and small businesses, while improving perceived public-safety through increased street-level activity. These transient stay profiles cannot currently be accommodated within the District's existing hotel stock due to the lack of furnished apartment-style residences within the District. As such, we believe that this unmet demand will result in a significant net new yield in hotel room nights for the District.