

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



Jeff 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

A handwritten signature in black ink that reads "Jeffrey S. DeWitt".

DATE: **March 9, 2020**

SUBJECT: **"Children's Hospital Research and Innovation Campus Equitable Tax Relief Act of 2020"**

REFERENCE: **Bill Number 23-577**

Findings

The proposed legislation would exempt Square 2950, Lots 824 and 826 from certain real property tax, deed transfer and deed recordation taxes. The legislatively-granted exemptions will generally preserve the administrative exemptions of these properties that existed prior to the time that the properties were leased to certain Tax Credit Entities (as described more fully below in the Background section) in connection with a tax-advantaged financing transaction. The legislative exemptions would be in effect only during the time these properties are leased to the Tax Credit Entities. Lots 824 and 826 are owned by Children's National at Walter Reed, LLC (CNWR), a wholly-owned subsidiary of Children's National Medical Center (Children's National), and are leased to the Tax Credit Entities as a requirement of the financial structure set up for Children's National to receive tax-advantaged investment in connection with development of these properties.

The proposed exemptions are not financially necessary, as Children's National has sufficient resources to absorb the estimated tax liabilities of Lots 824 and 826. However, the financial benefit Children's National receives from the tax-advantaged investment will be substantially diminished or fully offset by the property tax liabilities incurred on Lots 824 and 826.

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

Background

Children’s National at Walter Reed, LLC (CNWR) is a wholly-owned subsidiary of Children’s National Medical Center (Children’s National). CNWR and Children’s National are nonprofit entities whose property is generally entitled to exemption from District real property taxation. Children’s National is a provider of pediatric services in the District and its metro area. Its mission is to excel in care, advocacy, research and education.

In 2016, CNWR received approximately 11.85 acres of land and buildings from the Department of the Army through an act of Congress. The property was conveyed with a restriction in the deed limiting its use to public health purposes, including research, with requirement that the property be owned by Children’s Hospital, an affiliate of Children’s Hospital, or another tax-exempt organization.

Children’s National plans to develop the property in multiple phases over several years, as the Children’s National Research & Innovation Campus (CNRIC).¹ CNRIC will pursue new, high-impact opportunities in pediatric genomic and precision medicine, anchored by partners including JLABS, Virginia Tech, and its Center for Genetic Medicine Research, Rare Disease Institute and molecular clinical lab. OCFO’s Office of Tax and Revenue (OTR) determined in that approximately 93 percent of the real property owned by CNWR at CNRIC was entitled to an administrative exemption. The taxable and exempt percentages of the property were determined based on the proposed usage of the buildings located on Lots 824 and 826 for commercial and exempt purposes.

Phase I of CNRIC is under construction. It consists of the renovation of three historic buildings to provide a world-class pediatric research and innovation facility and an outpatient pediatric health center operated by Children’s Hospital. Phase I also includes a structured parking garage. Table 1 below summarizes Phase I development.

Table 1. Phase I Development Summary

Square/Lot	Building	Use	Size (approx.)
2950/824	52	Outpatient, primary care and genetic services clinic	28,000 square feet
2950/824	53	Theater/auditorium to be used for Children’s National medical conferences as well as community meetings	18,000 square feet
2950/826	54	Biomedical research building focused exclusively on pediatric research and innovation	162,000 square feet
2950/827	3	Parking garage	970 spaces

¹ CNRIC is the name of the project, and CNWR is the Children’s National subsidiary and fee owner of the 11.85 acres conveyed by the Department of Army.

Phase I will be located in a census tract that makes it eligible for federal New Market Tax Credits (NMTC), and certain buildings are eligible for federal Historic Tax Credits (HTC). Conforming to federal tax credit requirements, Children’s National formed two additional companies, one for each parcel in Phase I: Building 52/53 NMTC Borrower LLC and Building 54 NMTC Borrower LLC (the Tax Credit Entities). Children’s National is the managing entity and is the 90% owner of both LLCs. The tax credit investors would own the remaining 10%. The sole reason for creating the additional companies is to take advantage of the HTC and NMTC financing. However, in granting a long-term leasehold interest in Lots 824 and 826 to the Tax Credit Entities, Lots 824 and 826 are no longer eligible to receive the administrative exemption granted by OTR to CNWR.²

Phase II of CNRIC will consist of approximately 170,000 square feet of pediatric biomedical research and innovation activity in the balance of Building 54. It is expected to deliver by 2025. Future phases after Phase II will consist of up to 720,000 square feet of additional space, to be delivered over time. The cost and financing structure of Phase II and subsequent phases has not yet been defined.

Effective September 11, 2019 (D.C. Law 23-21), the Council and Mayor granted partial real property tax relief to Lots 824 and 826 in Square 2950 by temporary legislation. Children’s Hospital Research and Innovation Campus Phase I Temporary Amendment Act of 2019 allows the portion of Lots 824 and 826 to remain exempt from real property taxation to the same extent allowed by the administrative exemption covering these properties prior to the execution of the ground leases to Building 52/53 NMTC Borrower, LLC, and Building 54 NMTC Borrower, LLC. Bill 23-577 intends to continue this relief on a permanent basis.

Financial Analysis

The Exemptions and Abatements Information Requirements Act of 2011 requires the analysis provided by the OCFO to contain certain information. The required information is included below.

Terms of the Exemption or Abatement

The legislation provides an exemption to real property tax, deed transfer and deed recordation taxes on Square 2950, Lots 824 and 826. These exemptions will apply only during the time the properties are leased to Building 52/53 NMTC Borrower, LLC, and Building 54 NMTC Borrower, LLC. The exemptions will apply only to the portion of these properties subject to the administrative exemption determination by OTR. OTR has determined that Lot 824 is 98.67% exempt and 1.33% taxable based on the proposed use of the buildings located on that lot for exempt and commercial purposes. OTR has further determined that Lot 826 is 92.57% exempt and 7.43% taxable based on the proposed use of the building on that lot for exempt and commercial purposes. The portions of the properties determined to be taxable by OTR will remain taxable if the proposed legislation is enacted.

² The HTC and NMTC compliance periods end in approximately seven years, at which time the ground leases may be terminated and CNWR would again be eligible for the administrative exemption.

Annual Proposed Value of the Exemption or Abatement

The estimated value of the proposed exemptions on Phase I are summarized in the Table 2 below.³ The estimated value encompasses the period in which the Tax Credit Entities’ required leasehold ownership will trigger Lot 824 ad 826’s tax liability.

Table 2. Estimated Value of Proposed Exemption on Phase I

	FY20	FY21	FY22	FY23	FY24	Total FY 25-27	Total Value
Real Property Tax	1,202,763	1,202,763	3,498,265	3,512,331	3,526,833	10,672,080	23,615,035
Deed Recordation/ Transfer Tax	2,072,258	0	0	0	0	1,601,758	3,674,015
Total Value	3,275,021	1,202,763	3,498,265	3,512,331	3,526,833	12,273,838	27,289,051

Purpose of the Exemption

According to Children’s National, it is seeking the proposed exemptions because the benefits of the Historic Tax Credits utilized as part of the funding of the CNRIC will be substantially reduced by the tax liability incurred by the taxable entities required to be created as part of the financing structure to utilize the tax credits.

Summary of the Proposed Community Benefits

A summary of the proposed community benefits, as provided by Children’s National, is attached to this analysis as Attachment A.

Financial Analysis for Development Projects

Review and analysis of the financial condition of the recipient of the proposed exemption or abatement and of the financing proposal submitted by the recipient and an advisory opinion stating whether or not it is likely that the project could be financed without the proposed exemption or abatement.

According to Children’s National, the construction of Phase I is funded through a combination of resources from Children’s National Medical Center, philanthropy, sale proceeds and tax credit investments by private entities outside of Children’s National Medical Center. In this structure, CNWR or Children’s National did not finance the development nor will it repay debt on the construction from subsequent revenues generated by the buildings.⁴

The estimated cost to complete construction of Phase I is over \$200 million. The sources and uses of funds for Phase I, provided by Children’s National, is summarized in the Table 3 below.

³ CNWR has not yet determined the cost or financing structure of Phase II, located in a portion of Building 54, and therefore the value of any exemption on Phase II is not estimated.

⁴ Because the project does not include debt financing and funding is already committed, the financial analysis considers the financial condition of the recipient and whether the recipient could be reasonably expected to meet its fiscal needs without the proposed exemption or abatement.

Table 3. Phase I Sources and Uses

Sources (in \$Thousands)	
Philanthropic Gifts	31,000
Tax Credit Investor Proceeds	28,500
Proceeds from Sale of Parking Garage Levels to District	20,000
Children's National Medical Center	130,080
Total	209,580
Uses (in \$Thousands)	
Construction Costs	157,493
Soft Costs	22,144
FF&E	13,295
Permits, Fees, Staffing	3,913
Contingencies	12,736
Total	209,580

Once operating, the buildings in Phase I will generate revenue from leases to private entities and from parking receipts, but these revenues will not fully offset the buildings’ operating expenses. As a result, Children’s National estimates that Phase I of CNRIC will operate at a loss of \$7.2 million in fiscal year 2022⁵, its first full year of operation, and its annual operating loss will increase to \$7.4 million in its fiscal year 2023.^{6,7} Real property tax liability for Lots 824 and 826 would generate an additional operating loss for that will need to be covered by Children’s National.

A review of audited financial statements for Children’s National and its subsidiaries indicates that it is a large, financially healthy institution with sufficient resources to bear the additional cost of the real property tax liability that Lots 824 and 826 would incur without the proposed legislation. Therefore, the proposed tax exemption is not fiscally necessary. However, based on the estimated tax liability of Lots 824 and 826 in summarized Table 1, the financial benefit of the tax credit investment to Children’s National will be substantially diminished or fully offset by the property tax liability incurred on Lots 824 and 826 due to the required tax credit structure.⁸ According to Children’s National, the objective of seeking HTC and NMTC investment in Phase I of CNRIC was to reduce the funding required from Children’s National to construct the project, and allow those resources to be instead devoted towards the patient care and research priorities integral to its mission.

⁵ Children’s National Medical Center and its subsidiaries (including CNWR) operate on a fiscal year starting July 1 of the previous calendar year and ending June 30.

⁶ These operating losses do not include depreciation, which is a non-cash expense.

⁷ The operating loss covers building operations only and excludes the operation of the research and patient care facilities within the buildings.

⁸ According to Children’s National, the net benefit of the \$28.5 million tax credit investment in Phase I is approximately \$22 million.

**Attachment A
Statement of Community Benefits Provided by the Applicant**

The benefits of the Children’s National Research & Innovation Campus reach beyond the research and health care missions to deliver economic benefits as well. Throughout our 150-year history, Children’s National Hospital has provided quality health care for children and families in Washington, DC. We are recognized for our expertise and innovation in pediatric care, and are also a strong voice for children through advocacy at the local, regional and federal level. In addition to offering expert pediatric care at our community-based primary care centers and specialty outpatient centers located throughout the Metropolitan area, Children’s National addresses broader community needs through our community health needs assessment. As evidence of our commitment to our nonprofit mission, Children’s National invested more than \$123 million in total community benefit in our Fiscal Year 2018. This includes free and highly subsidized health care; training the next generation of pediatric health care professionals; research; and community-based health improvement initiatives

Specific to the Children’s National Research & Innovation Campus, an independent economic analysis conducted by McKinsey & Company estimated that completion of Phase 1 this year will produce an economic impact of up to \$150 million (as measured by incremental GDP). As we further develop our programs and implement new partnerships, the impact is expected to grow to up to \$6.2 billion in cumulative economic activity by 2030.

During construction, Phase 1 of the CNRIC is estimated to produce 200 total FT jobs, as outlined below:

Position Type	# of hours/week	Salary Range/hour	# of employees	Minimum Education Required
Administrative (Full Time)	40	\$17.51 - \$20.00	25	High School Diploma
Managerial (Full Time)	40	\$35.01 - \$37.50	50	2-Year Associates Degree
Manual / Physical (Full Time)	40	\$12.51 - \$15.00	100	High School Diploma
Professional (Full Time)	40	> \$47.51	25	4-Year Bachelor’s Degree

As of January 31, 2020, the project has committed construction contract values to MBE/WBE/CBE firms as follows:

- MBE: \$ 13,329,680
- WBE: \$ 4,420,349
- CBE: \$ 12,360,136

Once completed, Phase 1 is estimated to produce 110 permanent full time jobs, as detailed below:

Position Type	Hours / Week	Salary Range / Hour	# of Employees	Minimum Education Required
Administrative (Full Time)	40	\$20.01 - \$22.50	30	High School Diploma
Managerial	40	\$37.51 - \$40.00	20	4-Year Bachelor’s Degree
Manual / Physical	40	\$15.01 - \$17.50	10	High School Diploma
Professional	40	> \$47.51	40	More than a 4-Year Degree
Technical	40	> \$47.51	10	4-Year Bachelor’s Degree

Children’s National Hospital is committed to making best efforts to hire District of Columbia residents and estimates that 25% of these individuals will be low-income persons and/or residents of low-income communities.

As part of its Job Training Outreach, Children’s National Hospital has entered into relationships with the following local workforce development organizations to hire individuals with job barriers:

- Genesys Works – An intern program that provides a pathway to career success for high school students in underserved communities through skills training, meaningful work experiences, and impactful relationships.
- SOME (So Others Might Eat) – A partnership that provides vocational and career training for individuals on public assistance. Offer assistance with career training, dress, and interview help through career fairs and onsite interviews.
- Carlos Rosario School – An adult Vocational School that works with immigrants and offers vocational programs in the arts, culinary, CNA. It is a free school and also offers other assistance such as obtaining a GED.
- LatPro Diversity and Bilingual Career Fairs – Children’s National does extensive marketing of its events and outreach efforts are tailored to attract high-quality professionals who are relevant to job openings. The added benefit is that candidates are Hispanic, African American, Asian, military veterans, women, disabled, LGBT, bilingual and multicultural. This has been an outstanding event for attracting bilingual candidates for Language Services, Clinic Operations Rep positions for Ambulatory Services, Welcome Desk and Patient Access.
- Capitol Hill Pregnancy Center – This is a new partnership that provides tangible resources and counseling for women/men who don't have resources to address needs for their children / families.
- Ivymount – This school partnership serves over 200 students with developmental disabilities including autism spectrum disorders and other related disabilities. 2 interns have been hired through this partnership.
- DC Career Academy Network (DC CAN) – This organization’s mission is to reshape Washington, DC’s workforce by effectively preparing District students for college and careers through the use of the NAF educational design, i.e. academy development and structure; curriculum and instruction; advisory board, and work-based learning.

Other partnerships include the Eleanor Holmes Residence, the DC Court Services and Offender Agency, Mary’s Center, A Wider Circle, the Ana G. Mendez University System, the Hispanic Nurses Association, the Black Nurses Association, Diversity Nursing, Winners Chapel and Year Up. Children’s National will be attending career fairs and other similar opportunities for these partnerships.

In addition to the economic impact and creation of new jobs, the project will bring direct pediatric and adolescent clinical care services to a medically underserved area. Well over 50% of the patient population served by Children’s Hospital is Medicaid eligible, and we expect that a large percentage of patients seen at the primary care facility located on the Research & Innovation Campus will come from low-income families. A state-of-the-art auditorium is also part of the project and will be used for education programs, innovation summits, research and medical symposiums and community gatherings. It will serve as the most prominent gathering place on the campus for external audiences.