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**<br>**Mayor, District of Columbia**<br><br>**The Honorable Phil Mendelson**<br>**Chairman, Council of the District of Columbia** |
| **FROM:** | **Jeffrey S. DeWitt**<br>**Chief Financial Officer** |
| **DATE:** | **November 7, 2017** |
| **SUBJECT:** | **"National Community Reinvestment Coalition Real Property Tax Exemption Act of 2017"** |
| **REFERENCE:** | **Bill 22-521, as revised November 7, 2017** |

---

## Findings

The deed recordation and real property tax exemptions provided in the proposed bill are not necessary for the National Community Reinvestment Coalition and its subsidiaries (together NCRC) to continue its mission and maintain possession of its two office properties on 15th Street, NW. The real estate transactions the organization entered into in June of 2016 have resulted in a temporary hardship to NCRC, but given the initial fiscal strength of the organization and the value of the buildings it now owns, the OCFO finds NCRC is likely to be able to remain on a sound financial footing without the benefit of the tax subsidies provided by this bill.

## Background

The National Community Reinvestment Coalition is a national non-profit formed in 1990 by national, regional, and local organizations to increase the flow of private capital into traditionally underserved communities.[1] In 2005, NCRC purchased an office building at 727 15th Street, NW[2] (727 Building) to house its national operations, provide below-market rents to non-profit tenants, and generate lease revenue for the organization to fund its activities. At that time, NCRC sought and received a legislative real property tax

---

[1] Per the TAFA submission received from NCRC on October 20, 2017, NCRC members include community reinvestment organizations, community development corporations, community development financial institutions, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned businesses, and local and social service providers from across the nation.
[2] Square 222, Lot 20.

exemption for that property.[3,4] The exemption is limited to the portion of the property not used for commercial purposes, and approximately 80 percent of the 727 Building is currently leased to non-profit organizations.[5]

In June of 2016, NCRC, through its wholly-owned subsidiary NCRC 740, LLC, purchased, for $88.2 million, 740 15th Street, NW (740 Building),[6] a significantly larger building, which was previously owned by the American Bar Association. This new building is located one block south of McPherson Square and is across the street from NCRC's original building. The 740 Building, built in 1907 and rehabilitated in 2014, is an 11-story LEED GOLD Class A Office Building. The goal of the purchase, according to NCRC, was to "strengthen its financial stability and also to enhance its involvement with the District of Columbia community and non-profit organizations that conduct business in the District."[7]

To finance the purchase of the 740 Building, NCRC refinanced the 727 Building, took out a conventional mortgage, and took out on an additional short-term mezzanine loan. NCRC is now working with the Deputy Mayor for Planning and Economic Development (DMPED) to secure a Revenue Bond for $110 million[8] – an amount would be sufficient to pay off all three debt instruments, and stabilize its long-term debt profile.[9] If the Revenue Bond is approved and secured, the debt service for both buildings is expected to be approximately $6.4 million per year. NCRC has indicated some concern that, based on initial conversations with banks, it may not be able to secure the full $110 million. The total amount needed to pay off its current outstanding loans is projected to be about $105 million.[10]

In 2017, NCRC moved its national office from the 727 Building to the new 740 Building. The new building is currently 80 percent occupied and is expected to be fully occupied in the first quarter of 2018. According to NCRC, all non-profit tenants receive below market rents and many of the non-profit tenants receive free rent for some period at the beginning of their lease.[11] As a result, the building's cash flow in 2017 and 2018 is somewhat lower than it will be in 2019 and beyond.

In June of 2016, when NCRC refinanced the 727 Building, the deed of trust securing the loan was subject to the District's recordation tax.[12] Similarly, the deed conveying the 740 Building was also subject to recordation tax. The full recordation tax has not been paid for either of these transactions.[13] The proposed bill would forgive the unpaid recordation tax and provide NCRC an exemption from the District's recordation and

---

[3] National Community Reinvestment Coalition Real Property Tax Exemption Act of 2005, effective March 8, 2006 (D.C. Law 16-60; D.C. Official Code § 47-1071).
[4] NCRC, though exempt from income tax as an IRC § 501(c)(3) organization, is not eligible for, and was denied, an administrative exemption under D.C. Official Code § 47-1002(8), because its activities do not principally benefit the residents of the District.
[5] Any portion of this building that is leased to commercial tenants does not qualify for a real property tax exemption.
[6] Square 221, Lot 37.
[7] NCRC provided illustrative examples of its work in the District.
[8] This loan would be partially taxable as a result of the for-profit uses in the building, which include the for-profit office tenants and the ground floor restaurants.
[9] If NCRC secures the full Revenue Bond amount, it will also be able to fund a capital reserve that will allow NCRC to set aside funds for additional capital expenditures needed in the next few years. (see footnote 10).
[10] If NCRC is unable to fund an amount to refinance all of its debt with the Revenue Bonds, the debt service would increase but would still be well below current debt service of approximately $6.9 million per year.
[11] Per conversation with NCRC building manager.
[12] D.C. Official Code § 47-1071 only provides a real property tax exemption, and does not afford an exemption from recordation tax.
[13] A portion of the tax due on the deed to the 740 building was paid when the deed was recorded. Per the Office of Tax and Revenue, if no legislative exemption is received by December 31, 2017, payment of the outstanding recordation taxes will be expected and collection activities may be commenced.

transfer tax going forward for these two properties to the extent they continue to qualify for the real property exemption provided in the bill. The bill would also provide a real property tax exemption to the portion of the 740 Building that is occupied by non-profit organizations[14] as described below.

## 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 bill generally exempts the 740 Building from real property taxation beginning in July of 2016, and exempts deeds to or by NCRC from both recordation and transfer taxation so long as:

- The property is owned by NCRC, or a wholly-owned subsidiary of NCRC, and is used for the purposes and activities of NCRC, the subsidiary of NCRC, or the nonprofit tenants of NCRC or of its subsidiary;
- The property is not used for a commercial purpose;
- NCRC, or a subsidiary/affiliate of NCRC, invests at least $10 million into affordable housing development and preservation in the District of Columbia during the 10 years following the effective date of this bill; and
- NCRC submits to the Mayor at the end of the 10-year period a report on the status of those investments.

The proposed legislation also exempts deeds to or by NCRC on the 727 Building from recordation and transfer tax, respectively, to the extent the property qualifies for the real property tax exemption already provided under D.C. Official Code § 47-1071.

(B) The Value of the Abatement

As shown in Table 1, the estimated value of the exemptions to NCRC is approximately $4.1 million in FY2018, $8.2 million during the financial plan period, and approximately $50 million over the next 25 years. These amounts include refunds for taxes paid and forgiveness of taxes due.[15]

| **TABLE 1** | **Estimated Value of Proposed Tax Subsidies *(in 1000's)*** | | | | | |
|---|---|---|---|---|---|---|
| | FY2018 | FY2019 | FY2020 | FY2021 | 4-year total | 25-year Total |
| Recordation Tax 727 15th St | $211 | | | | $211 | $211 |
| Recordation Tax 740 15th St | $1,219 | | | | $1,219 | $1,219 |
| Real Property Tax 740 15th St | $1,190 | $1,262 | $1,340 | $1,422 | $5,214 | $47,266 |
| RPT Refunds for 2016 and 2017 | $1,529 | | | | $1,529 | $1,529 |
| **Total** | **$4,149** | **$1,262** | **$1,340** | **$1,422** | **$8,173** | **$50,225** |

[14] Non-profit organizations are expected to lease approximately 76 percent of the 740 Building. Any portions of the property leased to for-profit tenants will be taxable.

[15] These amounts do not include interest on unpaid recordation taxes, which will continue to accrue until the effective date of the legislation. These costs will be reflected in the Fiscal Impact Statement.

(C) The Purpose of the Abatement

The purpose of the proposed exemption is to strengthen the financial stability of NCRC, enhance its involvement with the District of Columbia community and non-profit organizations that conduct business in the District, and enable NCRC to meet its commitments as described in the Summary of Proposed Community Benefits (attached).

(D) A Summary of the Proposed Community Benefits

The Attachment, provided by NCRC, describes the community benefits.

(E) Financial Analysis and Advisory Opinion

The proposed exemptions[16] provided by the legislation are not necessary for NCRC to maintain and operate both buildings and continue its mission. NCRC was a financially strong non-profit organization, which made a real estate investment that has resulted in some significant expenses in the near-term. These expenses have created some financial strain for the organization. The national organization has invested almost $10 million of its own funds, and is expected to make additional investments in 2018 and 2019 before it can begin to rely on its real estate as a stable funding source to support its operations. Many commercial real estate owners experience cashflow issues from time to time, but the real estate investment NCRC made is likely to provide long-term financial benefits to the organization through both lease revenue and appreciation. The temporary financial hardship that NCRC is currently experiencing, can be managed in a variety of ways as detailed below.

NCRC submitted to the Office of Economic Development Finance (EDF) three years of audited financial statements (2014-2016), unaudited financial statements through August 2017, and ten-year operating proforma summaries for both of its properties (for 2018 – 2028). EDF reviewed both the financial health of the organization, and its ability to absorb the costs going forward of owning and maintaining both office buildings. The audited financial statements indicate that, as of the end of 2016, six months after the purchase and refinance, the organization was a financially stable, though highly-leveraged, non-profit. Additional expenses associated with debt, fit-out, lease-up, and operations of the 740 Building in 2017 has reduced cash on hand to a level below acceptable thresholds for this type of non-profit organization. Therefore, the requirement to make recordation tax payments of over $1.4 million on the two June 2016 transactions, could be a one-time financial burden.

NCRC has been making real property tax payments on the 740 Building since the time it purchased the building in June of 2016. The operating proformas of the two buildings indicate positive net operating income for both buildings beginning in 2018. Once debt service, and planned capital expenditures[17], are added to the cost side, the picture is somewhat different, as shown in Table 2.

[16] Including forgiveness and refund of taxes.
[17] For the purposes of this analysis, depreciation was not considered, as it is a non-cash expense and does not provide a tax advantage to a non-profit organization and is therefore unlikely to have an impact on the financial health of the organization in the near term. However, according to NCRC, as GAAP financials form the basis of their financial reporting to funders, those funders will include the depreciation expense in their assessment of NCRC.

| **TABLE 2** **Summary of Combined Costs for 727 and 740 15th Street** ***(in $1000s)*** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 [18] | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Operating Income (including RPT Payment) | $3,936 | $6,196 | $7,379 | $7,747 | $7,813 | $5,791 | $7,707 | $8,651 | $8,936 | $9,009 |
| Capital Expenditures | $470 | $470 | $470 | $470 | $470 | $470 | $470 | $470 | $470 | $470 |
| Revenue Bond Debt Service | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 | $6,385 |
| Cash Flow After Debt Service | -$2,919 | -$659 | $524 | $892 | $958 | -$1,064 | $852 | $1,796 | $2,081 | $2,154 |

While overall cash flow for NCRC's real estate is projected to be positive over the upcoming 10-year period, options for NCRC to manage losses associated with its real estate investments in any given year include:

- performing planned capital improvements for the two buildings in years when the buildings' income or NCRC itself can better sustain the costs;
- utilizing excess proceeds from the District's Revenue Bonds to fund capital expenditures;[19]
- structuring the Revenue Bond debt with a variable interest rate for two or three years prior to stabilization;[20]
- utilizing unrestricted net assets of NCRC to pay shortfalls during the lease-up period; and
- selling the 727 Building to capitalize the new flagship 740 Building.[21]

In any scenario, there may be years when net income from the NCRC buildings will be limited. This situation is not unusual for commercial office building owners after acquiring properties or investing in renovations. It is a short-term cash flow problem, not a long-term financial one. Given the underlying financial strength of the organization, NCRC is likely to be able to sustain the ownership of these assets, and the ownership of the properties over time will improve NCRC's long-term financial picture.

## Conclusion

While NCRC may be experiencing high expenses associated with its purchase, lease-up and fit-out of the 740 Building, the underlying financial strength of the organization, combined with the long-term expectations of the two buildings it now owns, are such that the proposed real property tax exemptions and refunds, as well as the deed recordation tax exemptions and forgiveness, are not needed to sustain the organization's operations and its ability to continue its mission in the District and across the country.

[18] NCRC states that the 740 Building has leases that expire in 2023 and re-filling the space is projected to require additional lease-up and fit-out expenditures.
[19] If available, see footnote 10.
[20] According to DMPED, non-profits often structure their revenue bonds with a variable interest rate prior to stabilization to reduce costs during construction, or lease-up.
[21] Selling the property would generate between $6M and $8M (after paying off the mortgage for the building) and would remove from NCRC's books an older, more slowly appreciating property which is in more immediate need of capital expenditures.

## Attachment
## Summary of Proposed Community Benefits
## (as provided by NCRC)

**NCRC Community Benefits Summary**

NCRC is prepared to deepen and enhance its commitment to DC residents and the District in furtherance of our mission to provide access to credit and capital, affordable housing, workforce development, small business incubation and financing, and financial coaching. As enumerated below, NCRC is investing in affordable housing in low- and moderate-income neighborhoods or on behalf of low- and moderate-income persons and families, with the commitment of a $10 million revolving investment (see "Affordable Housing" below). In addition, NCRC is committed directly to providing opportunities for un- and under-employed DC residents to work on these affordable housing developments and, indirectly, through workforce development programs created or enhanced by NCRC's initiatives (with a particular emphasis on helping returning citizens find living-wage careers). Women-owned businesses and African-American-owned businesses will continue to be an emphasis for NCRC's work with DC residents during the abatement period as well. In addition, NCRC has dedicated a portion of its building to the support and assistance of DC-focused nonprofits and the DC Government. Specific objectives are further enumerated below.

1. NCRC will take 10% of the abatement and apply it to providing community space for nonprofits and DC Government to do training programs, conferences, webinars, board meetings and related community meetings on the 3rd floor of NCRC's building at 740 15th St. Amenities include five conference rooms with seating ranging from 10 to 100 persons. Coordination of those activities and fitting out the space to meet community needs as well as the management and maintenance of that space will consume approximately 10% of the annual tax abatement. Full service facility with two kitchens and catering hosting capacity. High tech video conference capabilities, post meeting cleaning service and complimentary WIFI.

2. NCRC's Housing Counseling Program will provide emergency and long-term housing counseling to at least 500 District of Columbia homeowners in the next 10 years.

3. NCRC's Training Academy will provide at least 350 District of Columbia professionals with trainings over the next 10 years.

4. The DC Women's Business Center will assist at least 5,000 women and minority entrepreneurs (all of whom will be located in the District of Columbia) in growing their business. These services will help clients secure government contracts and financing.

5. The NCRC Business Division will provide business counseling to 1,000 entrepreneurs and 1,000 disadvantaged entrepreneurs in Wards 5, 7 and 8.

6. In the next 10 years, NCRC's CDFI will provide at least $1,000,000 in loans to DC-based small businesses.

7. NCRC's annual conference of its membership has grown about 10% year over year for the last five years, with 1000 participants in 2017. 70% of these participants are non-local; a typical out-of-town participant stays in the District for three days. The total direct impact of the conference (sleeping revenue at the conference hotel and other DC hotels, food and beverage revenue at the conference hotel, etc.) over the next 10 years is $22 million. The total fiscal impact (tax revenue) of the conference (tax revenue at DC hotels on sleeping rooms, tax

revenue on other attendee spending) over the next 10 years is $1.8 million. The total combined economic impact of NCRC's annual conference on the District of Columbia over the next 10 years is $26.7 million. We have a contract with the Washington Hilton to host NCRC's Annual Conference through 2020. Should we not get the abatement to cut expenses, we would likely need to move our conference to nearby Virginia. Should we get the abatement, NCRC commits to keeping our conference in the District of Columbia.

**Affordable Housing**

In partnership with DCHFA and DHCD, NCRC is creating a revolving fund of $10 million to invest in DC's greatest housing need: affordable single and multi-family housing (creation or preservation) for low- and moderate-income DC residents. The partners expect to produce a range of units of 125-500 units over a 10-year period. Accordingly, NCRC's own investment will be between $50-$150 million over 10 years of the abatement, $125-$375 million over 25 years. The units will be affordable at 80% or less than Area Median Income. The renovation of these houses is expected to produce 58,000 hours of work over 10 years, 145,000 over 25 years.

> **i. Level of Area Median Income at which units will be affordable ---** 80% or less of Area Median Income.
>
> **ii. 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 --** Difficult to formally assess because multiple neighborhoods will be targeted. The projected difference in Ivy City/Trinidad, for example, would be approximately $200,000-$250,000 per unit, while the difference in Anacostia would be less. NCRC's development fund currently owns a property at 15th and Q NW and rents out the four units at a 15-25% discount to comparable units in the same neighborhood. Assuming a conservative difference of $100,000 per property, the cumulative difference over 10 years would range from $12.5 million to $50 million, with the likelihood of a difference of $25 million if 250 units are completed in 10 years.

**Jobs**

Two sets of jobs will be created by this project: those committed to the building and those committed to the affordable housing work proposed. For the former, two (2) full-time jobs have been created paying $45 dollars per hour and combined salaries up to $175,000 dollars per year. These are permanent jobs involved in the ongoing operation of the building at 740 15th Street. One new job was created for a District resident.
On the latter, for existing single family homes, renovation will take three-six months, depending upon the depth of the renovation work and whether any historic preservation is required. We project that the single family initiative will produce 58,000 hours of work at 250 homes in 10 years.