

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: **August 24, 2018**

SUBJECT: **Unfoldment, Inc. Real Property Tax Relief Act of 2018**

REFERENCE: **Bill 22-789**

Findings

The proposed bill would exempt Lot 826, Square 6129 and Lot 804, Square 5984 from real property taxation, provided the property continues to be owned by Unfoldment, Inc. (Unfoldment or the Applicant) and used in carrying out the purposes and activities of Unfoldment. The exemption will apply to all property taxes assessed from October 1, 2018 onward.

Based on information provided by Unfoldment, the Office of the Chief Financial Officer's (OCFO) analysis indicates that 1) the requested exemption is not financially necessary for Unfoldment to maintain its properties under their current use and 2) plans for redeveloping Unfoldment's property to provide affordable housing and other services are not sufficiently developed to determine whether an exemption is financially necessary.

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

Background

Unfoldment is the record owner of Lot 826 in Square 6129, located at 3825 South Capitol Street, SW, and Lot 804 in Square 5984, located at 546 Newcomb Street, SE (collectively known as the Properties). The South Capitol Street property features a detached two-story home of approximately 2,556 square feet and an accessory building on a 1.7-acre lot. Its 2019 tax year assessment is \$764,220. The Newcomb Street property features a detached home of approximately 1,535 square feet on an 8,000 square foot lot and is assessed for the 2019 tax year at \$250,890. Unfoldment took title to the South Capitol Street property in 1988 and to the Newcomb Street property in 1991.

According to the application prepared for the tax abatement financial analysis (the Application), Baker Morten and his daughter Kemi Morton founded Unfoldment in 1977. According to the Application, activities undertaken by Unfoldment have included youth after school and summer programs, substance abuse treatment programs at Lorton prison, housing (at the Newcomb Street property) for men who had successfully completed the substance abuse treatment program and had been released from prison, and housing as youth rehabilitation group homes (at both the South Capitol Street and Newcomb Street properties). Activities described in the Application ran at various times during Unfoldment’s operation, but all had ended by the late 1990’s, and the properties became vacant for several years.¹

According to the Applicant, Unfoldment currently uses the South Capitol Street property as its administrative offices; provides a unit used as a residence for Unfoldment’s President and General Counsel Kemi Morten; and offers two separate units made available to volunteers to occupy on a long-term basis for free or for greatly subsidized rent. The Applicant rents out the Newcomb Street property at below market-rate to low income households with children.

The Application states that Unfoldment intends to redevelop the South Capitol Street property in partnership with Lincoln Westmoreland, Inc. into 60- to 90-units of affordable multifamily housing. The development, as currently envisioned, would include housing for seniors and larger units for families, with rents targeted to the 30 to 60 percent of Area Median Income range. Development will require a zoning reclassification from R-2 to RA-1 in order to allow the density level desired for the development. The use of the Newcomb Street property, according to the Application, could change to a senior or infant affordable day care center.

Tax Abatement Financial Analysis

The Exemptions and Abatements Information Requirements Act of 2011² requires the analysis provided by the OCFO to contain the following information:

(A) Terms of the Exemption

The introduced legislation calls for the Properties to remain exempt from taxation indefinitely, provided that the property is:

1. Owned by Unfoldment;
2. Used in carrying on the purposes and activities of Unfoldment; and
3. Not used for any commercial purposes, except that the property may be rented out to other persons as long as any revenue from the property rental is used for property maintenance and preservation.

¹ The Properties were granted real property tax exemption when Unfoldment’s charitable programs were active; however, the exemptions were revoked in 2001 after the properties became vacant. The Properties have not subsequently qualified for exemption, although taxes for the period 2002 through mid-2006 were forgiven by special legislation. In June 2015, Unfoldment applied for a new exemption for the Properties, but the applications were denied by Office of Tax and Revenue, and the denials are currently being appealed to the Superior Court.

² Exemptions and Abatements Information Requirements Act of 2011, effective September 14, 2011 (D.C. Law 19-21; D.C. Official Code § 47-4701 et seq.).

The proposed exemption excludes Unfoldment’s obligation to pay back taxes and penalties and interest assessed in tax year 2018 or earlier years, currently totaling \$52,439.³

(B) Value of the Exemption

The estimated value of the proposed exemption, assuming continued operation of the Properties in their current use, is summarized in Table 1.

Table 1: Estimated Value of Exempted Taxes, Current Property Use

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023- FY 2029	TOTAL
Exempted Real Property Tax	\$8,628	\$9,051	\$9,422	\$9,809	\$80,893	\$117,804

The estimated value of the proposed exemption, assuming delivery of a stabilized affordable housing project on the South Capitol Street property in fiscal year 2023 assessed at \$22 million⁴ and no change to the assessed value of the Newcomb Street property, is summarized in Table 2.

Table 2: Estimated Value of Exempted Taxes, Redevelopment of South Capitol Street property

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023- FY 2029	TOTAL
Exempted Real Property Tax	\$8,628	\$9,051	\$9,422	\$9,809	\$1,501,465	\$1,538,375

Purpose of the Exemption

The purpose of the proposed exemption is to reduce the costs of operating the Properties in their current use and in the event of any redevelopment of the Properties for affordable housing and affordable day care services.

(C) Summary of the Proposed Community Benefits

A summary of proposed community benefits, provided by Unfoldment, is attached to this analysis.

³ According to the Office of Tax and Revenue, as of July 2018, Unfoldment owed \$7,489 in current year taxes, past year taxes, and penalties and interest on the South Capitol Street property and \$45,058 in current year taxes, past year taxes, and penalties and interest payments on the Newcomb Street property.

⁴ The Application indicates Unfoldment and its development partner have not yet undertaken a financial pro forma or design plans in pursuit of an affordable housing redevelopment on the South Capitol Street property. However, the Application states a projected development cost between \$31 million and \$39 million and a property tax assessment of \$22 million. No timeline is proposed for the development, though the Application estimates a period of four and a half to five years before construction is complete. Additionally, there is no information on how a change of use of the Newcomb Street property would potentially impact its assessed value or property tax liability.

(E) Financial Analysis and Advisory Opinion

Current Use of the Properties

Regarding the current use of the Properties, this analysis examines the extent to which the current revenues and expenses associated with the Properties can accommodate payment of the Properties’ annual property tax obligation. Unfoldment receives rental income and some income from legal fees. Unfoldment pays the cash expenses associated with the operation and upkeep of the Properties, as well as expenses associated with provision of legal services and other activities of the organization. Unfoldment reduces its cash expenses through in-kind donations of legal services and other unpaid volunteer services, including services offered by volunteers in exchange for free or deeply subsidized rent at the South Capitol Street property.

Based on the analysis of Unfoldment’s revenues and cash expenses associated with the Properties, an abatement is not necessary. Unfoldment can pay its annual property tax obligations and other property expenses with the revenue it receives from the Properties. In the year ending September 30, 2017, income of \$28,800 from the Properties could cover basic property expenses of approximately \$17,300.⁵ Expenses include utilities, property maintenance, and repairs, in addition to 2017 property taxes (excluding penalties and interest) of \$7,981.⁶ Real property taxes comprise the largest expense related to the Properties. Excess revenue over expenses can offset Unfoldment’s administrative and overhead expenses, fund a maintenance reserve, or cover other unanticipated expenses or unexpected rental revenue losses.⁷

According to unaudited financial statements provided by Unfoldment, the organization runs at an operating deficit. In the year ending September 30, 2017, Unfoldment’s administrative expenses, including staff salaries and office-related expenses but excluding housing-related expenses described above, totaled over \$37,000, while revenue from sources other than rent only totaled \$6,800.⁸ As mentioned above, Unfoldment also has a significant unpaid tax liability on the Properties from current and previous years. Exemption of taxes would reduce but not eliminate the operating deficit.

⁵ According to the unaudited Statement of Receipts and Expenditures for the year ending September 30, 2017, Unfoldment received total cash revenues of \$35,600. Ms. Morten indicated that \$18,000 came from rental income on the Newcomb Street property, \$10,800 came from contributions made by a volunteer occupying a unit in the South Capitol Street property, and the remainder (\$6,800) came from legal fees paid by Unfoldment clients.

⁶ Property taxes were not included in the unaudited 2017 Statement of Receipts and Expenditures provided by Unfoldment. Housing-related expenditures identified in the Statement of Receipts and Expenditures included \$5,330 in utility costs (water, gas, electric, and internet) and \$4,000 in maintenance and repairs.

⁷ Section 2 of the bill allows for the commercial use of the Properties, provided that rent or other income generated from the Properties is used for the maintenance and preservation of the Properties.

⁸ Expenses included salaries of \$24,000 for the Executive Director and \$4,500 for an Administrative Assistant, \$4,213 for auto and liability insurance, and the remainder for supplies, travel, phone, services, and fees. The unaudited 2017 Statement of Receipts and Expenditures also includes as revenue \$51,500 in in-kind donations. According to Ms. Morten, these services do not offset the cash expenditures reported in the Statement of Receipts and Expenditures. Some of the expenses defined in this analysis as non-housing related or administrative could be considered indirect or overhead costs associated with the operation of Unfoldment’s affordable housing in the Properties. Conversely, the Properties provide office space for Unfoldment and the organization’s administrative expenses are reduced by the categorization of utility expenditures as housing-related expenses.

Potential Redevelopment of the Properties

Plans for the proposed affordable housing development on the South Capitol Street property and the potential change in use of the Newcomb Street property are not yet sufficiently developed to accurately assess whether a property tax exemption is necessary. In order for a proposed affordable housing project to receive the financing necessary for construction, the development team will need to demonstrate that the building’s projected net operating income will meet the lender’s debt service coverage requirements. Whether or not property tax obligations will have a substantial impact on net operating income will depend on many factors, including the housing units’ depth of affordability, development cost, and availability of gap financing sources. Unfoldment anticipates utilizing Low Income Housing Tax Credits as part of its sources of construction capital, and therefore the project would also likely qualify for an administrative real property tax exemption under the Nonprofit Affordable Housing Developer Tax Relief Act of 2012. The Department of Housing and Community Development certifies compliance with such Act, and such certification commences the real property tax exemption.⁹

Conclusion

The requested exemption is not necessary for the Properties to achieve financially sustainable operations given the current revenue the Properties generate, even as below-market-rate rental property. Absent information demonstrating that a specific, proposed affordable housing redevelopment plan is not financially viable without the reduction in operating expenses provided by a property tax exemption, the analysis suggests that an exemption is not a necessary requirement for development to proceed.

⁹ Nonprofit Affordable Housing Developer Tax Relief Act of 2012, effective September 20, 2012 (D.C. Law 19-168; D.C. Official Code § 47-1005.02).

Attachment: Applicant Provided Statement of Community Benefits

The Developer, Lincoln Westmoreland, Inc., in partnership with Unfoldment, Inc., is actively engaged in predevelopment activities in preparation for the construction and operation of a senior affordable housing complex with 60 to 90 units (and a number of multi-family 3-4 bedroom units) for the benefit of Ward 8 and other District of Columbia low-income residents. We estimate that eighty (80) construction jobs and four (4) permanent operating jobs will be created with the new development with preference in hiring and subcontracts given to District residents and particularly those residing in Ward 8.

As with all affordable housing development in expensive urban regions, like the District of Columbia, this project will require deep financial subsidies to operate sustainably and provide affordable housing to area seniors. A permanent real property tax abatement will enable us to devote project rental income to project expenses and debt service, thereby enabling the project to proceed to and to operate with positive cash flow.