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:	**Jeffrey S. DeWitt** **Chief Financial Officer**
DATE:	**September 17, 2020**
SUBJECT:	**"2323 Pennsylvania Avenue Southeast Redevelopment Project Real Property Limited Tax Abatement Act of 2020"**
REFERENCE:	**Bill 23-753**

Findings

The proposed bill generally would extend the existing real property tax abatement to the 2323 Pennsylvania Avenue, S.E. redevelopment project known as The Grays of Pennsylvania (the Property) for an additional 41 or 40 years, to tax year 2062 or 2060.[1]

Based on the financial information provided by the applicant and projections of future operating revenues and expenses, a real property tax abatement for 41 or 40 years is not financially necessary. A real property tax abatement for a shorter duration of time is necessary for the Property to meet its fiscal needs. A continued abatement for a maximum of $2.5 million total over 24 years, from 2022 through 2045, is warranted if the District would like to support this project.

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

[1] One provision of the bill would amend the existing abatement, replacing the current 10-year abatement with a 51-year abatement, resulting in a 41-year extension, and another provision would add a new subsection (b) to the statute providing a 40-year abatement beginning with the bill's effective date if enacted, likely resulting in a 40-year abatement period. It is not clear which provision would take precedence, but this issue should be resolved when the bill is marked up.

Background

The Property, owned by 2300 Pennsylvania Avenue, LLC, a for-profit entity, is currently receiving a real property tax abatement in the amount of the tax liability in excess of $30,807, the amount of tax liability in tax year 2009. The current 10-year abatement began with tax year 2012 (commencing October 1, 2011) and will end with tax year 2021 (ending September 30, 2021).[2]

The Property is a 118-unit affordable housing development with 7,500 square feet on ground floor retail that was placed in service in 2010. It is located in Ward 7 and is known for tax and assessment purposes as Lot 55 in Square 5560.

The Property's maximum rents are restricted to 60 percent of the Washington, D.C. area's Median Family Income (MFI) for a 40-year period. The Property's development was financed in part with an allocation of Low-Income Housing Tax Credits and a $7.5 million subordinate loan from the District of Columbia's Housing Production Trust Fund. The ground floor retail space is currently occupied by Sukarno Glory Child Development Center.

Financial Analysis

District of Columbia Official Code § 47–4701 requires the analysis provided by the Office of the Chief Financial Officer (OCFO) to contain certain information. The required information is included below.

<u>Terms of the Exemption or Abatement</u>

The bill would extend the abatement of the Property's real property tax liability for 41 or 40 tax years beyond the end of the Property's existing 10-year abatement in excess of its 2009 tax year liability of $30,087, which became effective with tax year 2012 (commencing October 1, 2011), or for 40 years following the effective date of the law. The bill would add a new subsection (b) to the statute providing that the Property shall be deed-restricted in perpetuity to tenants with incomes that do not exceed 80 percent of the MFI.

<u>Annual Proposed Value of the Exemption or Abatement</u>

The table below provides the estimated value of the abatement. The estimated value is net of the 2009 tax year liability of $30,807 that the Property would continue to be required to pay annually.

Estimated Value of the Proposed Tax Abatement

	FY 2022	FY 2023	FY 2024	Total FY21-24	Total FY25-60	Total Value
Real Property Tax Abatement	$115,491	$119,441	$125,000	$359,931	$8,319,987	$8,679,919

[2] This abatement is provided by D.C. Official Code § 47-4638, which states that "[t]he tax imposed by Chapter 8 of this title with respect to the real property . . . currently described as Lot 55, Square 5560, and any improvements thereto, shall be abated for 10 years, beginning October 1, 2011, to the extent that it exceeds the amount of the tax imposed on the real property for tax year 2009."

Summary of the Proposed Community Benefits

A summary of the proposed community benefits as submitted by the applicant is attached to this analysis.

Financial Analysis

The Office of Finance and Treasury (OFT) within the OCFO reviewed 2300 Pennsylvania Avenue, LLC's audited financial statements for 2017, 2018 and 2019.[3] These financial statements contain revenue, expense, and cash flow information for the Property. In all three years, the Property had positive net operating income (NOI).[4] After deducting from the NOI the required principal and interest payments related to the Property's first mortgage and other required payments,[5] there was no available income to pay additional property taxes in those three years.[6].

By projecting the Property's future NOI, assuming modest growth in revenue and a similar percentage of revenues expended on operating expenses as in the three previous years,[7] there is no available income in tax year 2022[8] to pay real property taxes (when taking into account debt service and other required payments). Assuming projected NOI increases annually at a similar rate, projected NOI is enough to pay all projected real property tax liability, debt service, and other required payments by tax year 2045. These projections do not consider the potential for reductions of operating costs or any refinancing of existing debt, however such measures would likely also increase the net income available to fully pay property tax obligations and debt service payments.[9]

Conclusion

An abatement of all tax liability for an additional 40 or more years is not financially necessary. Instead, a real property tax abatement for a more limited duration is necessary for the Property to meet its fiscal needs. Based on financial statements provided by the applicant and OFT projections of future operating revenues and expenses, a continued abatement is warranted for 24 years, from

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[3] For a fiscal year ending December 31.

[4] Net operating income is the Property's revenue less the Property's operating expenses. NOI measures an income-generating property's net revenue before debt service or payments to equity investors. The Property's operating expenses include the real property tax payments of $30,807 with the current abatement in place.

[5] Other required payments include a replacement reserve escrow of $29,500 per year and a required investor payment of $7,500 per year. The Property's interest-only payments to DHCD, which are subordinate to its first mortgage, would be paid out of available cash flow, and can be deferred if cash flow is not available. Principal payments are due starting in 2038, out of available cash flow, and will accrue if not paid.

[6] Excluding the $30,807 in taxes paid, which are included in operating expenses. Financial statements indicate that the project had an additional $48,000 in one-time revenue in 2018 which the applicant stated was a "required investor contribution, rather than rental revenue, in order to cover debt service". Including that contribution, as well as interest income and other one-time non-rental income, there was approximately $25,000 of cash available in 2019 after debt service and other required payments.

[7] The projection assumes 1.3 percent annual growth over 2019 revenue, starting in 2022, and annual operating expenses equal to 56 percent of the annual revenue. These benchmarks are based on average recent revenue growth between 2017 and 2019, and the median ratio of operating expenses to revenue in 2017, 2018, and 2019. No revenue growth is projected in 2020 or 2021 due to the public health emergency.

[8] This is the first year of the abatement extension; the current abatement is in effect through fiscal year 2021.

[9] There is a mandatory refinancing of the first mortgage in 2029. The projection assumes that debt service remains unchanged.

2022 through 2045, up to a maximum of $2.5 million total during the abatement period, if the District would like to support this project.

Attachment: Summary of Community Benefits Provided by the Developer

The Grays on Pennsylvania is a 118-unit affordable housing development that was placed in service in 2010. The development received $1,789,821 in annual Low-Income Housing Tax Credits from the Department of Housing and Community Development (DHCD) in addition to $7.5 million in Housing Production Trust Funds. The partnership executed a 40-year affordability covenant with the District restricting maximum rents to 60% of Median Family Income ("MFI"); and a 10-year real estate tax abatement was approved in November 2010. The proposed real estate tax abatement restricts the maximum MFI limitation to 80% in perpetuity which ensures the preservation of 118 units of affordable and workforce housing in the District's Fairlawn section regardless of potential future demographic changes in the community.