

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: **December 11, 2018**

SUBJECT: **“Randall School Museum and Housing Development Real Property Tax Abatement Act of 2018”**

REFERENCE: **Bill 22-915**

Findings

The proposed bill would provide an abatement to the Randall School Museum and Housing Development project for a 20-year period beginning October 1, 2023, with a maximum annual amount of \$1.7 million for a total abatement value of \$34.0 million.

Based on information provided by the project developer, Lowe Enterprises (“Lowe”)¹, the OCFO finds that it is not likely that the project could be financed without an abatement. However, the 20-year term of the proposed abatement is more than necessary for the project to attract financing. If the Council chooses to support this project, the Council could reduce the term of the abatement to 10 years or reduce the annual amount of the abatement to \$1.1 million. Either reduction to the abatement would still increase the profitability of the project enough to attract financing.

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

Background

¹ In 2006, the District sold the Randall School to the Corcoran Gallery of Art for \$6.2 million. See Randall School Sale Approval Resolution of 2004, approved December 5, 2018 (D.C. Resolution 15-818; 52 DCR 250). According to the September 9, 2010 report from the Committee on Economic Development, the Corcoran Gallery of Art was unable to develop the site as planned and wanted to lease the property to TR Southwest LLC. In 2017, TR Southwest LLC selected Lowe to develop the project.

The Randall School Museum and Housing Development project is a \$200 million project to convert a vacant public school into an art museum and add a new 489-unit apartment building on the surrounding school grounds where 20 percent of the units will be affordable at 80 percent of Area Median Income. The project is led by Lowe in conjunction with the Telesis Corporation and the Rubell family.

The property is located at 820 Half Street, SW² and is currently owned by the Corcoran Gallery of Art. The Council previously provided a property tax exemption for the property, but that exemption would become ineffective once the current owner, the Corcoran Gallery of Art, transfers ownership to this new development team³. Construction is expected to begin in late 2019 and end approximately three years later.

Tax Abatement Financial Analysis

District of Columbia Code §47–4701 requires the analysis provided by the Office of the Chief Financial Officer (OCFO) to contain the following information:

(A) Terms of the Abatement

The proposed legislation provides a real property tax abatement for Lot 801 in Square 643-S in an amount not to exceed \$1.7 million per year for 20 years beginning in fiscal year 2023, so long as the property includes an art museum and 20 percent of the apartment units are affordable to households earning up to 80 percent of Area Median Income.

(B) Value of the Abatement

Table 1: Value of Abated Taxes (in \$millions)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023- FY 2042	TOTAL
Abated Real Property Tax	\$0	\$0	\$0	\$0	\$34.0	\$34.0

(C) Purpose of the Abatement

According to Lowe, the purpose of the abatement is to assist with restoration of the historic building by increasing the project’s profitability such that it attracts the necessary financing.

(D) Summary of the Proposed Community Benefits

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

² Known for taxation and assessment purposes as Lot 801 in Square 643-S.

³ The existing abatement is provided in DC Code § 47–4626, which exempts the property from real property tax for so long as the Trustees of the Corcoran Gallery of Art own the real property; provided, that the exemption shall cease once a certificate of occupancy issues for any part of the Randall School development project. See Fiscal Year 2010 Budget Support Act of 2009, effective March 3, 2010 (D.C. Law 18-111; 57 DCR 181).

(E) Financial Analysis and Advisory Opinion

The Exemptions and Abatements Information Requirements Act of 2011 requires the OFCO to opine whether or not it is likely that a development project could be financed without the proposed abatement.

Lowe provided the OCFO with a development finance plan and a pro forma. According to Lowe, the projected internal rate of return (IRR)⁴ of the project is approximately 11 percent. This rate of return is below the 15 percent IRR level typical for a project of this nature at this location.⁵

However, the proposed abatement would provide an excessive subsidy to the project such that the IRR would be approximately 17 percent⁶. Using Lowe’s pro forma, and reducing the abatement period to 10 years, the IRR would be 15 percent and represent a reasonable amount needed for the project to be financed. Similarly, reducing the annual maximum value of the abatement from \$1.7 million to \$1.1 million would also reduce the IRR to approximately 15 percent.

Table 2: IRR Scenarios

	No Abatement	10 Years \$1.7M Per Year	20 Years \$1.1M Per Year	20 Years \$1.7M Per Year
IRR	11%	15%	15%	17%

Conclusion

The OCFO finds that it is not likely that the project could be financed without an abatement. However, the 20-year term of the proposed abatement is more than necessary for the project to attract financing. If the Council chooses to support this project, the Council could reduce the term of the abatement to 10 years or reduce the annual amount of the abatement to \$1.1 million. Either reduction to the abatement would still increase the profitability of the project enough to attract financing.

⁴ IRR is technically defined as the discount rate at which future cash flows equals zero. More broadly, it is used as a metric to assess return on investment over time.

⁵ In November 2017, Lowe requested tax increment financing (TIF) for the Randall School project in an amount which would have resulted in an IRR of 15.5 percent. That request was not certified by the OCFO because the projected tax increment would have been insufficient to repay the TIF bonds.

⁶ The OCFO notes the actual IRR to the project is likely slightly higher. Lowe’s pro forma underestimates the impact of the abatement to the resale value of the property by discounting the future abatements at a rate equal to the weighted cost of capital assuming the purchase is 60 percent debt and 40 percent equity. A more accurate approach would be to either (a) assume a more typical debt amount of 75 percent of the purchase price when calculating the weighted cost of capital or (b) to use the more traditional method of forecasting a sales price of net operating income (increased by the abatement value) divided by the capitalization rate for residential investors. Either approach would result in a higher IRR.

3. A summary of the proposed community benefits to be provided by the abatement

A. Affordable Housing

i. Level of AMI at which units will be affordable: 20% of units at 80% AMI

ii. Projected financial value of proposed subsidy:

	Apartments	
	Market Rate	Affordable
Avg GSF/Unit	898	903
Avg RSF/Unit	737	740
\$/RSF/Mo	3.68	2.11
\$/Unit/Mo	2,710	1,564
Annual Rent/Unit	32,518	18,770
Vacancy Rate	5.0%	3.0%
Less: Vacancy	(1,626)	(563)
Effective Rent/Unit	30,892	18,207
Less: Expenses per unit	(8,325)	(8,325)
NOI/Unit	22,567	9,882
UW Capitalization Rate	5.00%	5.00%
Market Value/Unit	451,339	197,640
Market Value/GSF	502	219
Market Value/RSF	613	267

This calculation assumes 20% affordable units (98 units). The present value of the tax abatement is \$11,212,100

**Analysis does not include parking income or additional income. Real estate taxes are included in Expenses per*

B. Job Creation

As a result of the construction and development of Randall School, approximately 924 temporary jobs will be created in the District. At full build-out, the project is expected to create approximately 101 full-time equivalent positions. All jobs projected to be generated by the project development will be located on site. The project is located adjacent to an enterprise zone. According to U.S. Census Bureau statistics for the District, approximately 28.6% of employees live and work within the District. As a result, it is anticipated that **approximately 28 of the new jobs created by the project will be held by District residents.**

Table 1 below provides the permanent employment impacts resulting from Randall School. Table 2 provides the total temporary construction jobs to be created during buildout of the project. Direct jobs

are within the project; indirect jobs are jobs created within the District but not at the project. Jobs are shown as full-time equivalents. Temporary jobs are assumed to have a duration of one year.

Table 1: Permanent Jobs

<i>Permanent Employment Impacts</i>	Permanent Jobs from Randall School (Full time Equivalents and Wages)		
	Permanent Jobs	Annual Compensation	Wage per Employee
Museum - Office:			
Direct impacts (full time equivalents)	53	\$4,786,106	\$90,987
Indirect impacts (full time equivalenten)	13	\$925,268	\$71,554
Sub-total impacts	66	\$5,711,374	
Museum - East Wing:			
Direct impacts (full time equivalents)	7	\$315,722	\$43,261
Indirect impacts (full time equivalenten)	1	\$94,475	\$84,144
Sub-total impacts	8	\$410,198	
MOCA Museum:			
Direct impacts (full time equivalents)	11	\$579,506	\$54,556
Indirect impacts (full time equivalenten)	3	\$244,779	\$85,592
Sub-total impacts	13	\$824,285	
Apartment Management:			
Direct impacts (full time equivalents)	14	\$547,224	\$39,966
Indirect impacts (full time equivalenten)	3	\$210,326	\$65,833
Sub-total impacts	17	\$757,550	
Total direct impacts	82	\$5,968,283	\$72,748
Total indirect impacts	19	\$1,431,241	\$75,667
Total permanent impacts	101	\$7,399,524	

Table 2: Temporary Jobs

<i>Temporary Construction Employment Impacts</i>	Temporary Jobs from Construction (Full time Equivalents and Wages)		
	Temporary Jobs	Annual Compensation	Wage per Employee
Temporary:			
Direct impacts	619	\$51,630,001	\$83,425
Indirect impacts	305	\$18,060,053	\$59,208
Total temporary impacts	924	\$69,690,053	

C. Additional Community Benefits

Removal of Blight and Revitalization – The Randall School closed in 1978. Since then, the site has never been fully utilized and has continued to deteriorate due to a lack of sufficient capital improvements. The buildings were fully vacated in 2004, have remained vacant since that time,

and currently exist in an uninhabitable condition. This vacancy has created a blighted condition at this pivotal location in Southwest.

This presents a public safety hazard, deflates real estate values, generates no tax revenue and keeps the project out of productive contribution to the District. Given constraints imposed by the District and those of general applicability due to the current condition of the site, the project will continue as a blight on the economic progress of Southwest DC until redevelopment occurs.

The proposed redevelopment of the Randall School will have a catalytic impact on Southwest, bringing increased vibrancy and economic activity, including office workers, apartment residents, museum patrons and tourists to the neighborhood. This activity will create a vibrancy and establish Southwest as a creative district, which is likely to spur additional economic benefits. What is special about this proposal is the unique *type* of activity that will occur. In addition to new office workers and residents, the centerpiece of the Randall School is a new world-class contemporary art museum to be housed in the renovated center and east historic buildings fronting on Eye Street. This unique development will provide significant benefits to the immediate neighborhood and the District, both economically and culturally.

The three existing (connected) buildings on Eye Street, SW have been granted Landmark Status on the National Register of Historic Places and are therefore required to be preserved. Because of the Landmark status and the poor and contaminated condition of these buildings, the cost to return them to active use is significantly higher than what their simple “replacement cost” would be. Time is of the essence to ensure that these buildings do not further deteriorate, as this will only increase the cost and complexity of the project.

Non-Profit Arts Component – When the District originally disposed of the vacant Randall School property in 2006, it imposed a requirement for a significant arts component. Lowe has responded to this requirement by partnering with one of the best private collectors of contemporary art in the world, the Rubells. The Rubells also happen to be proven and experienced museum operators with a 25-year track record of success. Without question this museum will better the cultural, economic, educational and social condition of the District of Columbia. It will be free to all District residents, provide significant arts educational programs, have a measurable impact on cultural tourism, and bring one of the most coveted private contemporary art collections in the world to the District – all without the need for any public operational subsidy.

The Randall School is also the right place for such a use, given that the site was conceived as an arts-driven project since its original disposition. The site has such strong community support that specific language was placed into the 2015 Southwest Neighborhood Small Area Plan to reinforce the site’s importance in making Southwest DC an arts and culture destination. Furthermore, legislation was passed by the City Council of the District of Columbia that requires a significant arts component be included in any Randall School redevelopment plan. The site is also steps from the US Capitol, the Mall and other arts and cultural institutions including Arena Stage, the Blind Whino, the Hirshhorn, the Freer and Sackler gallery, the Anthem, and the Museum of the Bible.