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 Vincent C. Gray** **Mayor, District of Columbia** **The Honorable Kwame R. Brown** **Chairman, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	**March 15, 2012**
SUBJECT:	**"Parkside Parcel E and J Mixed-Income Apartments Tax Abatement Act of 2012"**
REFERENCE:	**Draft Legislation**

Findings

If the District would like for the owner of the Parkside parcels to construct two market-rate residential buildings in the Parkside location, it is likely that the owner will need a partial tax abatement. In the absence of the partial abatement, the owner would likely have insufficient cash flow to attract the equity necessary to finance the construction of the buildings.

The value of a 50 percent tax abatement, beginning when the buildings receive their Certificates of Occupancy, and ending at the earlier of ten years or when the owner refinances or sells the parcels, totals an estimated $3.6 million. Please refer to the Office of the Chief Financial Officer's (OCFO) separate Fiscal Impact Analysis for the effect of the proposed legislation on the District's FY 2012 through FY 2015 budget and financial plan.

Background

The proposed legislation would grant a real property tax exemption for two parcels of land located in the Parkside neighborhood of Ward 7, in Square 5041, Lot 808 and Square 5056, Lot 811. The parcels are owed by Parkside Residential, LLC. The development plan calls for two, 174-unit apartment buildings.

The parcels are part of the Parkside Planned Unit Development (PUD), which allows for up to 50,000 square feet of retail, 750,000 square feet of office space, 2,000 residential units, a 1 acre park, and a new pedestrian bridge spanning I-295. According to the PUD, 20 percent of the overall residential units for the entire project must be affordable. Because the parcels identified above are some of the first to be developed, it is not clear whether they will contain any of the affordable units. The entire 20 percent requirement could be encompassed in future construction phases. As such, the *pro forma* assumes all market rate rents.

The owner purchased the parcels as part of a bundle of properties in 2004 and 2006. The owner intends to either sell the parcels to a residential developer or enter into a joint venture with a residential developer. The owner is asking $9.5 million for the parcels. In the absence of an appraisal on the parcels and with very few comparables in the neighborhood, the $9.5 million price cannot be verified.

Financial Analysis

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

A separate fiscal impact statement will be prepared on the proposed legislation.

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

The legislation has not yet been finalized. The OCFO expects that the legislation will state that the parcels shall be subject to 10-year abatement from real property taxation, beginning in the year that the buildings receive their final certificates of occupancy.

2. <u>Annual Proposed Value of the Exemption or Abatement</u>[1]

The OCFO estimates the value of the proposed exemptions to be:

FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	Total
$545,925	$674,782	$692,326	$710,327	$728,795	$747,744	$767,185	$787,132	$807,597	$828,595	$7,290,407

If the Council authorizes a 50 percent tax abatement, the estimated value would be:

FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	Total
$272,962	$337,391	$346,163	$355,163	$364,398	$373,872	$383,593	$393,566	$403,799	$414,297	$3,645,203

3. <u>Summary of the Proposed Community Benefits</u>

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

[1] These values are subject to change based on a review by the Office of Revenue Analysis.

4. <u>Financial Analysis for Development Projects</u>

A. Review and Analysis of the Financing Proposal Including Advisory Opinion Stating Whether or Not It is Likely that the Project Could Be Financed Without the Proposed Exemption or Abatement

Based on the OCFO's analysis of the information provided by Parkside Residential, LLC, we expect that the proposed project could not be financed and completed in the absence of a 50 percent abatement from real property taxes. The developer proposes to finance the $68 million project with approximately $47 million in conventional debt and $21 million in equity. If the owner was required to pay annual real property taxes in the full amount owed, the cash flow from the property would be reduced, thereby reducing the return to the equity providers.

Given that this project would be one of the first non-Low-Income Housing Tax Credit or affordable projects in the Parkside neighborhood, equity providers will likely require a higher return than those typically required in more established market-rate locations. The owners of the parcels are attempting to create an entirely new housing product for the Parkside neighborhood. With a 50 percent property tax abatement, cash flow should be sufficient to attract the equity necessary to construct the project. If a small gap still remains, the owners could lower their requested sales price of $9.5 million for the parcels. A reduced sales price would reduce the amount of equity required, and increase the return on the equity invested in the project.

A full property tax exemption would likely over-subsidize the project, providing the developer and equity providers with above-market returns.

B. Estimate of the Amount of Exemption or Abatement Necessary to Enable the Project to Be Financed

Based on our analysis of the materials provided, the OCFO advises that a ten-year 50 percent tax abatement is likely necessary in order for the project to be financed. We expect that the abatement will not begin until the buildings receive a final Certificate of Occupancy.

The tax abatement will likely not be necessary for future owners of the project. Once the units are rented and the building is stabilized, the risk decreases greatly. As a result, once the owner chooses to refinance or sell the property, the stabilized cash flow should be sufficient to pay operating costs and debt service and to provide a market rate return to equity investors. Therefore, we recommend that the tax abatement end at the earlier of ten years or when the owner refinances or sells the property.

We further recommend that the tax abatement authorization expire if the project does not receive a Certificate of Occupancy by September 30, 2018.

C. Assessment of the Developer's Documentation of Efforts to Seek Alternate Financing and the Factors that Limit the Developer's Ability to Obtain Adequate Financing

The proposed project is a market rate project. As a result, many types of alternative financing are not available for the project.