

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: **February 6, 2018**

SUBJECT: **“University of the District of Columbia Leased Property Tax Abatement Amendment Act of 2017”**

REFERENCE: **Bill 22-0513**

Findings

The proposed property tax exemption for the University of the District of Columbia (UDC) would increase net income for UDC by reducing the property tax expense it has contractually agreed to pay. Because UDC, which is seeking the proposed property tax exemption, has demonstrated its ability to manage revenues and expenses, including real property taxes, the abatement is not necessary. As UDC is a component unit of the Government of the District of Columbia (the District) and receives an annual appropriation, the requested exemption is the fiscal equivalent of an additional appropriations request for UDC, and therefore the approval of the exemption is a policy matter that must be decided by the Council and Mayor.

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

Background

In April of 2010, UDC entered into a 17-year triple net lease¹ at 801 North Capitol Street, NE² to serve as the main branch campus of the community college. The building is owned by a for-profit entity and therefore subject to real property taxes. The lease has ten years remaining in its initial term, and

¹ Triple-net leases are common in leasing large portions of commercial buildings, and offer lower base rents to the tenant by requiring the tenant to pay maintenance, insurance, and property taxes.

² Known for taxation and assessment purposes as Square 676, Lot 0114.

UDC has an option to extend the lease by an additional ten years. UDC occupies the 87,883 square foot building with classrooms, laboratories, and academic support space.

Under the terms of the lease, UDC is responsible for paying property tax costs. As shown in the table below, the annual property tax liability for the building has increased since the inception of the lease and is estimated to be \$851,000 in 2018.

According to the attached memorandum from UDC to the Office of the Chief Financial Officer (OCFO), the proposed tax exemption is needed because their annual appropriation from the District is insufficient to meet student funding standards.

“The University opened the Community College with the expectation that the District would financially support the acquisition of the building and operational growth of the Community College. However, budgets in subsequent fiscal years have provided limited direct support for the Community College, and underfunding for the University of the District of Columbia overall. According to data from the National Center for Educational Statistics (NCES), UDC spends \$25,539 per full-time equivalent (FTE) student, whereas comparable institutions spend \$31,703 per FTE on average which means we are underfunded by \$19M.”

As shown in the table below, UDC’s real property tax liability at 801 North Capitol St, NE has generally increased³ as a proportion of District appropriations, but has recently decreased.

Year	Real Property Tax Liability (\$000)	District Appropriation to UDC (\$000)	<i>Tax as a Percent of District Appropriation to UDC</i>
2010	\$383	\$62,070	0.62%
2011	\$338	\$66,420	0.51%
2012	\$436	\$67,362	0.65%
2013	\$488	\$75,405	0.65%
2014	\$534	\$66,691	0.80%
2015	\$961	\$73,458	1.31%
2016	\$963	\$71,942	1.34%
2017	\$871	\$76,680	1.14%
2018	\$851	\$78,180	1.09%

UDC further commented in the attached memorandum that the real property tax rebate offered to charter schools which lease privately owned property is evidence that the District intended that educational facilities not be subject to real estate taxes. Similar to the process for charter schools, should the Council choose to provide the proposed tax benefit to UDC, the OCFO recommends maintaining the privately-owned property as taxable, and instead rebate the property taxes paid by UDC.

³ The tax increase from 2014 to 2015 was due to the change in assessment methodology for commercial property.

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 legislation would exempt the building at 801 North Capital Street, NE from real property taxation so long as it is leased by UDC.

(B) The Value of the Abatement

Value of Abated Taxes⁴

FY2018	FY2019	FY2020	FY2021	4 Year Total	20 Year Total
\$851,000	\$881,000	\$912,000	\$941,000	\$3,585,000	\$23,499,000

(C) The Purpose of the Abatement

According to UDC, the exemption is needed because their annual appropriation from the District is insufficient to meet student funding standards.

(D) A Summary of the Proposed Community Benefits

See the Community Benefits section of the attached memorandum provided by UDC.

Conclusion

As UDC is a component unit of the Government of the District of Columbia (the District) and receives an annual appropriation, the requested exemption is the fiscal equivalent of an additional appropriations request for UDC, and therefore the approval of the exemption is a policy matter that must be decided by the Council and Mayor. From a fiscal perspective, the abatement is not necessary because UDC has demonstrated its ability to manage revenues and expenses, including real property taxes. As proposed, the exemption is likely to have a fiscal impact of \$3,585,000 over the four-year budget and financial plan. As an appropriations request beginning in fiscal year 2019, the fiscal impact in fiscal year 2019 would be \$881,000 and an additional \$2,734,000 over the four-year budget and financial plan.

⁴ The proposed exemption would be effective so long as the building is leased by UDC. The existing lease has ten years of term remaining, plus one ten year extension option, therefore the table above shows the 20 year exemption value.

TO: Nate Cruz, Senior Analyst, Economic Development Finance,
Office of the Chief Financial Officer

FROM: Ronald Mason, Jr., President, University of the District of Columbia

DATE: **November 15, 2017**

SUBJECT: To exempt from taxation certain property leased to the University of the District of Columbia (UDC), a District of Columbia Instrumentality.

The University is seeking tax abatement legislation to exempt from taxation certain property leased to the University of the District of Columbia, a District of Columbia instrumentality.

Background/Context:

In March 2010, the University entered into a seventeen-year agreement to lease the building at 801 N. Capitol Street NE. There are ten (10) years remaining, and lease payments for those ten years total approximately \$46,131,325, and estimated operating expenses for the remaining years of the lease total \$24,000,000. UDC commenced using the building in August 2010 for classrooms, laboratories and associated academic support spaces. The building serves as the main location for the UDC Community College Branch Campus. The lease covers 87,883 square feet (SF) of rentable area on nine floors.

The University opened the Community College with the expectation that the District would financially support the acquisition of the building and operational growth of the Community College. However, budgets in subsequent fiscal years have provided limited direct support for the Community College, and underfunding for the University of the District of Columbia overall. According to data from the National Center for Educational Statistics (NCES), UDC spends \$25,539 per full-time equivalent (FTE) student, whereas comparable institutions spend \$31,703 per FTE on average which means we are underfunded by \$19M. We have submitted three (3) years of audited fiscal statements to your office for review.

The operational costs to the University have included the real estate property taxes and in recent years, the business improvement district taxes. Increases between the tax years 2015, and 2017 have created significant consequences for the University, which is focusing its limited resources on meeting our teaching and learning goals. This matter will be compounded by redevelopment of the surrounding neighborhood. If the five-year average increase of 24% is maintained, the University anticipates the tax burden to increase by \$230,743 to \$1,192,170 for 2017.

During the first four years of its lease at 801 North Capitol Street, N.E., the University was subject to an average annual property tax increase of 12%. After the property was sold to a new owner in 2013, the assessed value of the property increased by nearly \$15M. As a result, the real estate tax increased by 80% between tax years 2015 and 2016. The premises, which contain

approximately 87,883 rentable square feet of space located at 801 North Capitol Street, N.E., Washington, D.C., are identified for purposes of assessment and taxation as Lot 114 in Square 676 (“the Lease”). The lease is between the University of the District of Columbia (“University”) and BREOF 801North Capitol REO LLC.

Other Considerations:

The University has engaged in ongoing efforts to backfill or find alternative tenants for the 801 North Capital (801NC) location. The lease payments average \$5M - \$6M per year. While the 88K SF facility was newly renovated in 2010 and has been well maintained, the need to retrofit the building would require additional renovations to convert classroom space to typical office space or space design to specifically meet an agency needs. This has stalled the search for an alternative tenant, and the taxes make it even more prohibitive.

Finally, a review of all exemptions the CFO has considered since 2011 reveals the need for a remedy related to the uniqueness of the University’s request. Organizations applying for exemption from DC real property tax must own the real property for which the request is made, and qualify under DC Official Code § 47-1002. Property leased by the government (rather than owned by a government) is not automatically exempt. The taxability of that property depends on who owns it, not who leases it. However, evidencing the District’s intention that educational facilities not be subject to real property taxes is the public charter school rebate process which provides a mechanism whereby charter schools that leases a school facility from an entity subject to taxes receive a rebate of that portion of the tax that represents the public charter school’s pro rata share of the lessor’s tax on the property.

A similar exemption was granted to Washington Latin in 2012 which leased a school from the District for 25 years. The twist was they applied for the exemption on behalf of the Latin LLC, which was created to receive tax credits to fund the renovation of the school. They were a lessee from the District. The LLC was necessary to comply with federal law for the tax credits, and the school was leased to the LLC which in turn subleased to Washington Latin as it was the ultimate lessee and taxpayer, as well as the entity that operated and managed the school.

<https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/Tax%20Abatement%20Analysis%20-%20Washington%20Latin%20Public%20Charter%20School.pdf>

Likewise, the University would qualify for an exemption under DC Official Code § 47-1002 (2) (3) or (10) absent the “belonging to” requirement as we satisfy the “and operated by” requirement. We operate the building by lease, rather than ownership, which is atypical of most state public universities. They own the property in which they operate and are thus exempt from state property taxes. This result in the anomaly that the District’s public university leased property is not exempt from real property taxes despite its operation as an educational facility. The charter schools evidence the District’s intent not to tax educational facilities and the University’s structural relationship to the District require a similar exemption remedy.

The uniqueness of the University’s existence precludes it from qualifying via traditional legal doctrine. The University “owns” no land under the current structure of the District government in

the conventional sense that the statute requires. The legislation addresses an issue within the tax code, whereby this University's physical assets were provided by the federal government during the period before the District was granted control over the land. Thus, it requires the creation of a unique exemption. The legislation allows the Council to decide whether a tax exemption based on the use of the building for administrative offices, classrooms, laboratories and associated academic support spaces is appropriate in this instance. The Council is correcting a historic omission in the DC tax code regarding the treatment of the District's only public university.

Summary of Community Benefits –

This abatement strengthens the University and Community College's ability to provide the type of community and citywide benefits that only a higher education institution can provide. For decades, the District of Columbia had deliberated over the best way to provide District residents with access to high-quality, affordable associate degree education - including workforce development programs and opportunities for lifelong learning. In August 2010, UDC -CC opened its doors at 801 N. Capitol Street, NE.

Today, the Community College is viewed as an integral part of the educational and training landscape in the District. It serves over 1875 students in academic programs and more than 4000 in various workforce development programs. The Community College Workforce Development program offers DC residents these training programs at **no cost** to them. Since 2009 to date, the community college through its various programs has served residents throughout the District. The workforce program receives no direct subsidy from the District (unlike other states) and absorbs the \$9M cost of the program from the \$77M appropriation;. Although, the University is limited in our ability to expand these valuable programs without any further investment by the District, we are seeking all means such as this abatement to help fund these other programs that have benefited well over 10,000 district residents so far. The Wards primarily served are 8 (36%), 7 (24%) and 5 (15%). The community college's collective vision of providing courses and programs tailored to the District's various communities needs is the very definition of community benefits.