Government of the District of Columbia
Office of the Chief Financial Officer

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Acting 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:	**Fitzroy Lee** **Acting Chief Financial Officer**
DATE:	**February 18, 2022**
SUBJECT:	**"Square 5539 Tax Abatement Act of 2021"**
REFERENCE:	**D.C. Bill 24-0452**

Findings

In general, the Square 5539 Tax Abatement Act of 2021, D.C. Bill 24-0452 (the Bill) would provide a real property tax abatement, capped at $500,000 for the first year and escalated by 3 percent annually, to Lots 835 and 840 in Square 5539 for a term of 40 years. Receipt of the abatement would be subject to meeting Certified Business Enterprise and residential housing affordability requirements defined in the Bill. The proposed abatement would support the development of a residential project consisting of approximately 170,000 square feet of multi-family residential space, with approximately 188 rental units of workforce housing with accessory parking in Ward 7.

Based on an analysis of the financial projections provided by the applicant, the Office of the Chief Financial Officer (OCFO) finds that a partial abatement of real property taxes is financially necessary for the project to proceed. An abatement of $362,000, escalated by three percent annually over the proposed 40-year term, would provide for sufficient investor return without over-subsidizing the project.

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

Background

Jair Lynch Real Estate Partners (the Applicant) is seeking the proposed real property tax abatement for Lots 835 and 840 in Square 5539 (the Property).[1] The Property is a portion of the redevelopment project located at 3200 Pennsylvania Avenue, SE, at the intersection of Pennsylvania and Branch

[1] Applicant is the Managing Member of 3200 Penn Ave PJV, LLC, the entity that is the owner of the property.

Avenues, SE in Ward 7 (the Project). The Project includes the Shops at Penn Branch, a neighborhood commercial center. The Property currently serves as additional surface parking in the rear of the Shops at Penn Branch. The Applicant purchased the property associated with the Project, completed a full renovation and lease up of the Shops at Penn Branch, and is advancing the redevelopment of the Property with approximately 188 units of mixed-income housing (the Residential Redevelopment). Units will be affordable to households earning at or below 80 percent of MFI (the Workforce Units), with affordability covenants recorded on the deed in connection with a portion of the development financing sought by the Applicant. In addition, ten percent of the units will have deeper affordability restrictions and be affordable to households earning at or below 60 percent of Median Family Income (MFI) in fulfillment of Inclusionary Zoning requirements. According to the Applicant, the Property is zoned for the proposed use, will start construction by the end of calendar year 2022, and will be completed in 2024.

Financial Analysis

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

(A) Terms of the Abatement

The Bill would provide an abatement for up to 40 tax years, commencing with the Property's receipt of a certificate of occupancy for a residential building of no less than 100 units, but no earlier than Tax Year 2026 (October 1, 2025). The project shall be a residential building consisting of approximately 170,000 square feet of multi-family residential space, with approximately 180 to 200 rental units of workforce housing with accessory parking. Receipt of the proposed abatement is conditioned upon meeting the following additional requirements during the term of the abatement:

1. The Applicant shall contract with Certified Business Enterprises (as defined in the Bill) for at least 35 percent of the contract dollar volume for the construction and operation of the residential building.
2. The housing units are affordable to and rented by households earning at or below 80 percent of MFI (as defined in the Bill), and no households may earn more than 100% of MFI.
3. Recordation in the land records of a binding covenant requiring compliance with the affordability condition.

The cap on the annual abatement proposed by the Bill is $500,000, increasing by three percent annually after the first year of the abatement. Unused amounts of abatement in excess of annual real property taxes would not carry forward to future tax years.

(B) Value of the Abatement

As shown in the table, the value of the proposed abatement as provided by the Bill, is estimated to be $29.8 million over the 40-year term through 2065.[2]

[2] The $29.8 million represents the estimated amount of taxes abated over 40 years, which is less than the sum of 40 annual payments of $500,000 indexed at three percent. This is because OCFO expects property taxes to increase more slowly than the abatement due to the asset type. In an affordable housing project, household incomes determine the rent levels, which are an important component of the valuation of the property. The annual abatement is expected to grow to completely cover the annual property taxes during the abatement period, at which point the abatement will equal the property tax amount.

Estimated Value of the Proposed Tax Abatement

	FY 2022	FY 2023	FY 2024	FY 2025	FY2022-FY2025	FY2026-FY2065	Total Value
Real Property Tax Abatement	$0	$0	$0	$0	$0	$29,800,000	$29,800,000

(C) Purpose of the Abatement

According to the Applicant, the abatement will allow for the development of new, Class A rental housing that will be available at workforce housing affordability levels by providing a subsidy that makes the Residential Redevelopment financially feasible.

(D) Summary of the Proposed Community Benefits

The applicant's summary of community benefits is attached in Attachment A.

(E) Financial Analysis and Advisory Opinion

The Applicant's proposed financing for construction of the Residential Redevelopment includes equity, a senior loan, and a subordinate loan in the approximate proportions below.

Funding Source	Percent of Development Cost
Senior Loan	60%
Subordinate Loan (Mezzanine Debt)	35%
Equity (from Development Sponsor)	5%

The subordinate loan significantly reduces the amount of equity required to fund the development cost and thereby improves the rate of return to the equity investors by providing the same cash flow with a lower level of investment. This financing structure allows this project to be profitable with lower rent levels, aligning with the anticipated market rents in this neighborhood and the affordability restrictions that will be required by both the subordinate lender and the conditions of the proposed abatement. However, this financing structure does not completely make up the gap in returns that the sponsor equity investor would typically require, which has resulted in the Applicant requesting a tax abatement. A real property tax abatement will reduce the operating expenses of the building, increasing the net cash flow that flows to the equity investor annually, as well as increasing the value of the property (and cash flows to investors) when refinanced or sold.

The OCFO's Office of Finance and Treasury (OFT) has reviewed the pro forma cash flow model provided by the Applicant. Based on the information provided, OFT finds that a partial abatement of real property taxes is financially necessary. An abatement of $362,000 in real property tax liability, escalated by three percent annually over the 40-year term (equal to about 90 percent of the estimated tax liability) will allow the Residential Redevelopment to achieve an equity return needed to attract investment.[3] The $26.4 million value of this recommended abatement over the 40-year term would be a $3.4 million decrease from the value as proposed in the Bill.

Conclusion

OFT finds that it is not likely that the Residential Redevelopment could be financed without an abatement. However, a full abatement of taxes over 40 years is more than is necessary to attract investment. By capping the abatement at $362,000, escalated at three percent annually, the Residential Redevelopment of the Property can provide workforce housing and attract sufficient investment at a lower cost to the District.

[3] OFT evaluated the internal rate of return, or IRR, an analytical tool that measures the discount rate at which future cash flows equal zero. Applicant's sponsor equity return threshold target of 25 percent corresponds to a high level of cash flow risk that the relatively small amount of developer's "sponsor equity" must bear.

Attachment A

3200 Penn Ave Parcel 2 – Summary of Community Benefits

1. Affordable Housing – The Project will include 10% of the residential rentable square footage (approx. 19 units) set aside for families earning at or below 60% of Area Median Income as required by DC Inclusionary Zoning.

2. Market Rate and Workforce Housing – The Project will include 90% of the residential rentable square footage (approx. 169 units) set aside for families earning at or below 80% of Area Median Income. These units will be covered by a private affordability covenant that will remain in place for a minimum of 50 years. While capped at 80% of AMI, the current market rents for the submarket are below the 80% AMI threshold thus allowing the project to generate new Class A market rate housing that will limit future rent increases beyond the 80% AMI threshold should market rents escalate. No workforce (80% AMI) residential units are required by law thus 90% of the units will exceed DC requirements without any other forms of local or national subsidy (e.g., LIHTC or HPTF).

3. Job Creation – The Project is estimated to generate 187 new construction jobs and 6 permanent residential property management and maintenance jobs.

4. Revenue Generation – The Project is forecast to generate nearly $800,000 (in current year dollars) in annual revenue for the District through income and retail sales taxes. This exceeds the annual maximum of the tax abatement of $500,000 (in current year dollars) thus the proposed tax abatement is a net positive in revenue for the District.

5. CBE Developer and CBE Participation – The Project will require 35% CBE participation in both construction and operations. Additionally, the Project sponsor, LDP Holdings, LLC (b/b/a/ Jair Lynch Real Estate Partners) is a CBE entity (CBE#: LR68689122022).

6. Advances Goals of Small Area Plan – The Project will advance the goals set forth in the Pennsylvania Avenue SE Corridor Land Development Plan, a Small Area Plan adopted by the DC Council in July 2008, which envisioned the subject property as a key opportunity to meet the substantial demand for higher quality housing in the neighborhood and Pennsylvania Ave SE corridor.