

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

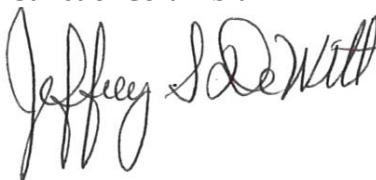


Jeffrey S. DeWitt
Chief Financial Officer

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: **Charter School Property Tax Clarification Amendment Act of 2018**

REFERENCE: **Bill 22-1008**

Findings

The proposed bill would exempt certain properties currently operated as charter schools or by other specified non-profit entities (collectively, the Properties), owned or leased by four separate entities (collectively, the Applicants), from real property, possessory interest, and deed recordation and transfer taxes for the period that the Properties are occupied by public charter schools. The proposed exemptions apply retroactively beginning from the time each of the Applicants acquired its ownership or leasehold interest in its respective property.

The Office of the Chief Financial Officer (OCFO) finds that the tax exemptions proposed by the bill are partially necessary, if the District would like to support the continued operation of public charter schools in the Properties. Based on financial information provided, the OCFO finds that:

- Imposition of taxes, both prospectively and retroactively, would pose a financial hardship for Saint Paul on Fourth Street, Inc. (St. Paul), owner of Square 3648, Lots 1068 and 1069, given its current financial condition.
- Shaed School, LLC (Shaed), lessee of Square 3552, Lot 816, does not have the financial means to pay retroactive tax obligations, but could pay its estimated annual tax obligation in the current and future years without financial hardship.
- Imposition of prospective and retroactive tax obligations on 5601 East Capitol, LLC (5601 East Capitol), lessee of Square 5283, Lot 153, would not cause a financial hardship, given the entity's current financial condition, and an exemption is not financially necessary.
- No financial information was provided by Mamie D. Lee, LLC (Mamie D. Lee) regarding the current operation of its leased property, Parcels 124/136 and 124/160. Absent any evidence

demonstrating financial hardship, OCFO finds that exemption of taxes on this property is not financially necessary.

The estimated value of the proposed tax exemptions, retroactively and through 2034, is approximately \$10.9 million.

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

Background

Table 1 below summarizes the property interests held by each of the Applicants and current occupancy of each of the Properties.

Three of the Applicants operate under the umbrella of Building Pathways, a non-profit entity also known as the Charter School Incubator Initiative (Initiative). Since 2006, Building Pathways has worked towards its mission of renovating and operating educational facilities for newly-established DC public charter schools until the school has the institutional and financial capacity to operate and manage its facilities independently. In addition to serving more than two dozen public charter schools through its direct activities, Building Pathways established Shaed in 2014, 5601 East Capitol in 2015, and St. Paul in 2016 as stand-alone entities that have been renovated and are responsible for all aspects of operation of their respective facilities in exchange for rent payments from charter schools as lessees or sublessees¹. Charter school rent payments² are pegged to the facilities allowance that each occupying charter schools receives from the District, based on a per-pupil allotment. In addition, the fourth entity, Mamie D Lee, was established by Building Pathway’s parent company, Building Hope,³ to serve a purpose similar to that of the other three entities.

Table 1: Property Summary

Property SSL and Address	Property Ownership	Property Activity
Square 3552, Lot 816 200 Douglas Street, NE	Lessor: Shaed School, LLC (Shaed) Owner: DC Government	Shaed entered into a 20-year lease with the District on May 21, 2014. Shaed renovated the property and subleases it to Inspired Teaching Demonstration Public Charter School, which has operated in the building as of the 2014 school year.
Square 5283, Lot 153 5601 East Capitol Street, SE	Lessor: 5601 East Capitol, LLC (5601 East Capitol) Owner: DC Government	5601 East Capitol entered into a 20-year lease with the District on June 19, 2015. 5601 East Capitol renovated the property and subleases it to DC Scholars Public Charter School, which has operated in the building since 2015. 5601 East Capitol also currently subleases a

¹ The Initiative owns approximately 62 percent of Shaed, with Inspired Teaching Demonstration Public Charter School owning the remaining, non-majority interest. The Initiative is the sole member of St. Paul. The Initiative is the minority member of 5601 East Capitol with DC Scholars Public Charter School owning a 99 percent interest in the entity.

² Charter school rent payments make up nearly all of the revenues received by the three entities for which the OCFO received financial statements.

³ Building Hope - A Charter School Facilities Fund (Building Hope) founded the Charter School Incubator Initiative (now called Building Pathways) and was its sole member until 2011.

Property SSL and Address	Property Ownership	Property Activity
		portion of the building to the University of the District of Columbia and the Capital Area Food Bank.
Parcels 124/136 and 124/160 5101 Fort Totten Drive, NE and 100 Gallatin Street, NE	Lessor: Mamie D. Lee, LLC (Mamie D. Lee) Owner: DC Government and U.S. Government	On November 25, 2015, Mamie D. Lee entered into a lease with the District for 30 years, plus a 25-year extension period. Mamie D. Lee renovated the property and subleases it to two charter schools operating in the building, Bridges Public Charter School and Briya Public Charter School. Medical services offered by Mary’s Center for Maternal and Child Care, Inc. are also located in this building.
Square 3648, Lots 1068 and 1069 3015 4 th Street, NE	Owner: Saint Paul on Fourth Street, Inc. (St. Paul)	St. Paul purchased the property on June 21, 2016. St. Paul renovated the property and leases it to two charter schools, Washington Leadership Academy and Lee Montessori, which have occupied the building as of the start of the 2016 school year.

All four properties have applied for an administrative exemption from real property or possessory interest taxation⁴. Applications filed by Mamie D. Lee and St. Paul are currently under review; the two other properties, Shaed and 5601 East Capitol, have been denied exemptions and subsequently filed lawsuits contesting the denials⁵.

The LLCs with leasehold interests in publicly-owned properties – Shaed, 5601 East Capitol, and Mamie D. Lee – are potentially liable for possessory interest tax. The Real Property Tax Administration (RPTA) within the OCFO’s Office of Tax and Revenue has not yet formally assessed or taxed the possessory interests for these three properties. While these three properties will potentially be retroactively obligated to pay possessory interest tax from the time of lease commencement, the tax has not yet been levied against these properties.

RPTA has assessed real property taxes on the property owned by St. Paul. As of November 30, 2018, the owner owes real property taxes due for the second half of Tax Year 2018, plus penalties and interest accrued, but has paid its prior real property tax obligations⁶.

⁴ Under D.C. Official Code § 47-1009 and related provisions.

⁵ The status of litigation is as follows:

- Shaed applied for a possessory interest tax exemption on May 23, 2014; the application was denied on March 15, 2016 because Shaed did not meet the then-applicable statutory requirements for exemption. A lawsuit contesting the denial (Docket No. 2016 CVT 105) was filed on September 13, 2016.
- 5601 East Capitol applied for an administrative exemption from possessory interest tax on September 2, 2015; the application was denied on October 5, 2016 because the LLC did not meet the then-applicable statutory requirements for exemption. The LLC filed a lawsuit (Docket No. 2017 CVT 15) contesting the exemption denial on March 28, 2017.
- Based on subsequent amendments to the possessory interest tax statute and contingent on changes to their organizing documents, these applicants may be able to reapply for exemption and potentially qualify for a prospective (but not retroactive) exemption from the possessory interest tax.

⁶ Taxes due for Tax Year 2018 total \$211,838 annually, consisting of installments of \$105,919 for each half tax year. St. Paul made a real property tax payment earlier in 2018 which is not reflected in the 2015-2017 financial statements reviewed.

The pending exemption applications provisionally exempted the Applicants from recordation taxes due at the time that deed instruments were recorded, and these taxes would be due if any of the entities are ultimately determined not to be entitled to real property or possessory interest tax exemptions.

Tax Abatement Financial Analysis

The Exemptions and Abatements Information Requirements Act of 2011⁷ requires the analysis provided by the OCFO to contain the following information.

Terms of the Exemption

The introduced legislation calls for the Properties to receive exemptions from real property tax and possessory interest tax, as well as from transfer tax and deed recordation taxes. The bill applies the tax exemptions to the Properties retroactively to the date each was purchased or leased by the Applicants. The bill provides for an indefinite exemption from real property and possessory interest tax for each of the Properties, provided that: 1) each of the Applicants continues to retain its respective property interest and 2) its respective property continues to be used by one or more District of Columbia Public Charter Schools or other entities described in the bill.

The bill exempts the properties included in the bill from transfer and deed recordation taxes for any transfer, assignment, or other disposition. This exemption would include the initial sale or lease of any of the Properties to the respective Applicants, any recorded deed of trust or other security instrument, or an assignment or sublease of any of the Applicants’ real property interest.

Value of the Exemption

As shown in Table 2, the value of the exempted taxes is approximately \$5.5 million in the current financial plan period, including \$3.4 million in tax liabilities incurred in years prior to the current fiscal year⁸. By 2034⁹, the cumulative value of the exemptions is estimated to be \$10.9 million.

Table 2: Estimated Value of Exempted Taxes

	Prior to FY 2019	FY 2019	FY 2020	FY 2021	FY 2022	Total to 2022	2023 - 2034	Total to 2034
Exempted Real Property Tax and Possessory Interest Tax	\$1,451,908	\$547,815	\$526,738	\$513,003	\$495,031	\$3,534,494	\$5,475,385	\$9,009,879
Exempted Transfer and Deed Recordation Tax	\$1,933,524	0	0	0	0	\$1,933,524	0	\$1,933,524

⁷ Exemptions and Abatements Information Requirements Act of 2011, effective September 14, 2011 (D.C. Law 19-21; D.C. Official Code § 47-4701 et seq.).

⁸ The value of the possessory interest tax exemption on Shaed, 5601 East Capitol, and Mamie D. Lee uses estimates by RPTA prepared specifically for this analysis.

⁹ 2034 is the year the 20-year leases for Shaed and 5601 East Capitol end.

Purpose of the Exemption

The purpose of the proposed exemption is to lessen the operations expense of each of the Properties for the benefit of the D.C. Public Charter Schools that operate within the facilities.

Summary of the Proposed Community Benefits

A summary of proposed community benefits, provided by Building Pathways, is attached to this analysis. Note that Building Pathways does not have an ownership interest in Mamie D. Lee, and the entity that manages Mamie D. Lee did not provide a summary of proposed community benefits.

Financial Analysis and Advisory Opinion

The financial analysis for each of the Applicants is provided separately.

St. Paul

Audited financial statements demonstrate that this corporate entity has been operating at a loss for the two full calendar years it has been in operation. The entity cannot currently afford to pay its real property tax obligation in 2019 and beyond, nor does it have the resources to pay its prior year real property tax and recordation tax if these obligations are not exempted. According to Building Pathways, the property needs to be “right sized” and operated at full capacity in order to generate more revenue and operate more sustainably. In order for the charter school minority member to eventually take full control of the entity, as intended, it will have to pay off Building Pathways’ cash infusions to the entity that have allowed it to continue to pay its operating expenses and debt service.

Shaed

Audited financial statements indicate that this LLC has had net revenue in the past three calendar years, after paying debt service and annual operating expenses, that should be sufficient in the current and future tax years to pay its estimated possessory interest tax¹⁰. However, Shaed’s current cash and cash equivalents are not sufficient to pay the estimated possessory interest tax and the recordation taxes that would be retroactively imposed on the property if these taxes are not exempted.

5601 East Capitol

Unaudited financial statements indicate that this LLC has had net revenue in its past three fiscal years (the most recent ending June 30, 2018), after paying debt service and annual operating expenses, that should be sufficient in current and future tax years to pay its estimated possessory interest tax¹¹. The LLC also has sufficient cash to pay the estimated possessory interest tax and recordation taxes that would be retroactively imposed on the property if these taxes are not exempted.

Mamie D. Lee

No financial information was provided by Building Hope, the entity that manages this LLC. Absent sufficient information regarding the financial condition of the LLC, the OCFO has no evidence that the proposed exemption is financially necessary.

¹⁰ Shaed operates at a loss when depreciation, a non-cash expense, is added to its Profit and Loss Statement.

¹¹ 5601 East Capitol operates at a loss when depreciation, a non-cash expense, is added to its Profit and Loss Statement.

Conclusion

The financial condition of each of the Applicants is different, and the financial necessity of the proposed exemption therefore is varied. A full exemption is a financial necessity for St. Paul, given its current operations. An exemption of back taxes is financially necessary for the sustainable operation of Shaed. The financial information presented indicates that an exemption is not necessary for 5601 East Capitol and Mamie D. Lee to be financially sustainable.

Attachment: Applicant Provided Statement of Community Benefits

St. Paul on Fourth Street, Inc.– The community benefit for the site is that it serves as the premises for Lee Montessori and Washington Leadership Academy, both are public charter schools authorized by the Public Charter School Board. The space leased to these schools is at a below market rates to public charter schools. A portion of the premises is leased at below market rates for nonprofit, education-focused organizations. The schools are both highly rated, Tier 1 charter schools and collectively serve five hundred (500) public school students. The building is owned by the Charter School Incubator Initiative.

Shaed LLC - The community benefit for the site is that it serves as the premises for Inspired Teaching Public Charter School, a public charter schools authorized by the Public Charter School Board. The space leased to these schools at a below market rates to public charter school through a sublease from the LLC directly to Inspired Teaching for the remainder of the ground lease with the city. The entire square footage of the building is subleased to Inspired Teaching and it serves four hundred forty six (446) public school students. The LLC Board is comprised of staff from the Charter School Incubator Initiative and Inspired Teaching and the Charter School Incubator Initiative has the long-term ground lease from the District of Columbia.

5601 East Capitol Street, LLC - The community benefit for the site is that it serves as the premises for the University of the District of Columbia a higher-education institution in D.C. and D.C. Scholars Public Charter School, a public charter school authorized by the Public Charter School Board. The space leased to these schools at a below market rates to public charter school through a sublease from 5601 East Capitol Street, LLC to both entities. The entire square footage of the building serves five hundred forty five (545) public charter school students and additional students and programs from UDC. The Capitol Area Food Bank also occupies a small portion (1,747 square feet) of the leased Premises as a non-profit food bank serving District of Columbia residents of Ward 7. The Charter School Incubator Initiative has a percentage interest in the long-term ground lease from the District of Columbia along with the other members of the LLC, D.C. Scholars.