

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: **September 17, 2020**

SUBJECT: **“800 Kenilworth Avenue Northeast Redevelopment Project Real
Property Limited Tax Abatement Act of 2020”**

REFERENCE: **Bill 23-754**

Findings

The proposed bill generally would extend the existing real property tax abatement to the 800 Kenilworth Avenue, N.E. redevelopment project known as Lotus Square Apartments (the Property) for an additional 41 or 40 years, to tax year 2061 or 2060.¹

Based on the financial information provided by the applicant and projections of future operating revenues and expenses, an abatement of all tax liability for 41 or 40 years is not financially necessary. A partial tax abatement, for a limited duration, is necessary for the Property to meet its fiscal needs. A real property tax abatement of up to \$940,000 in total for 12 years, through fiscal year 2032, capped annually at \$149,000 maximum, is warranted, if the District would like to support this project

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

¹ One provision of the bill would amend the existing abatement, replacing the current 10-year abatement with a 51-year abatement, resulting in a 41-year extension, and another provision would add a new subsection (b) to the statute providing a 40-year abatement beginning with the bill’s effective date if enacted, likely resulting in a 40-year extension. It is not clear which provision would take precedence, but this issue may be clarified during the markup of the bill.

Background

The Property is currently receiving a full real property tax abatement, which began with tax year 2011 (commencing October 1, 2010) and which will end with tax year 2020 (ending September 30, 2020).²

The Property is a 173-unit affordable housing development that was placed in service in 2006. It is located in the Mayfair neighborhood of Ward 7 and is known for tax and assessment purposes as Lot 8 in Square 5058.

The maximum rents are restricted to 60 percent of the Washington, D.C. area’s Median Family Income (MFI) for a 30-year period. The building was financed in part with an allocation of Low-Income Housing Tax Credits. Kenilworth Avenue Apartments, LLC, a for-profit entity, owns the Property and operates the rental housing project.

Financial Analysis

District of Columbia Official Code § 47–4701 requires the analysis provided by the Office of the Chief Financial Officer (OCFO) to contain certain information. The required information is included below.

Terms of the Exemption or Abatement

The bill would extend the abatement of the Property’s real property tax liability for 41 or 40 tax years beyond the end of the Property’s existing 10-year abatement of its full tax liability,³ which became effective with tax year 2011 (commencing October 1, 2010). The bill would add a new subsection (b) to the statute providing that the Property shall be deed-restricted in perpetuity to tenants with incomes that do not exceed 80 percent of the MFI.

Annual Proposed Value of the Exemption or Abatement

The table below provides the estimated value of the abatement.

Estimated Value of the Proposed Tax Abatement							
	FY 2021	FY 2022	FY 2023	FY 2024	Total FY21-24	Total FY25-60	Total Value
Real Property Tax Abatement	\$183,075	\$189,300	\$194,411	\$201,604	\$768,389	\$13,418,744	\$14,187,133

Summary of the Proposed Community Benefits

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

² This abatement is provided by D.C. Official Code § 47-4643, which states that “[t]he real property described as Lot 8, Square 5058, and any improvements thereon, shall be exempt from the tax imposed by Chapter 8 of this title for 10 years.”

³ D.C. Official Code § 47-4643.

Financial Analysis

The Office of Finance and Treasury (OFT) within the OCFO reviewed Kenilworth Avenue Apartments, LLC’s audited financial statements for 2017, 2018, and 2019.⁴ These financial statements contain revenue, expense, and cash flow information for the Property. In all three years, the Property had positive net operating income (“NOI”).⁵ After deducting from NOI the required principal and interest payments related to the Property’s mortgage and other required payments,⁶ the remaining available income to pay property taxes was approximately \$13,000 in 2019.

By projecting the Property’s future NOI, assuming modest growth in revenue and a similar percentage of revenues expended on operating expenses as in the three previous years,⁷ the estimated amount of available income in tax year 2021 to pay real property taxes (taking into account debt service and other required payments) is approximately \$35,000, or 19 percent of the estimated real property tax liability in that year. Paying the estimated full tax liability would leave a deficit of approximately \$149,000 in tax year 2021. Assuming NOI increases annually at a similar rate, by tax year 2033, projected NOI is sufficient to pay all projected real property tax liability (taking into consideration the required debt service obligation and other required payments). These projections do not consider the potential for reductions of operating costs or any refinancing of existing debt, however such measures would likely also increase the net income available to fully pay property tax obligations and debt service payments.⁸

Conclusion

An abatement of all tax liability for an additional 40 or more years is not financially necessary. A partial tax abatement, for a limited duration, is necessary for the Property to meet its fiscal needs. Based on the financial statements provided by the applicant and OFT projections of future operating revenues and expenses, a real property tax abatement of up to \$149,000 per year, to a maximum of \$940,000 through fiscal year 2032, is warranted if the District would like to support this project.

⁴ For a fiscal year ending December 31.

⁵ Net operating income is calculated as the Property’s revenue less the Property’s operating expenses. NOI measures an income-generating property’s net revenue before debt service or payments to equity investors.

⁶ In addition to debt service, there are a required reserve replacement escrow of \$66,600 per year and a required investor payment of approximately \$6,700 per year.

⁷ The projection assumes 1.5 percent annual growth over 2019 revenue, starting in 2022, and annual operating expenses equal to 57 percent of annual revenue. These benchmarks are based on the average recent revenue growth (one percent in 2018 and two percent in 2019) and the median ratio of operating expenses to revenue in 2017, 2018, and 2019. No revenue growth is projected in 2020 or 2021 due to the public health emergency.

⁸ There is a mandatory refinancing in 2025. The projection assumes that debt service remains unchanged.

Attachment: Summary of Community Benefits Provided by the Applicant

Level of MFI. Lotus Square Apartments is a 173-unit affordable housing development that was placed in service in 2006. The development received \$1.5 million in annual Low-Income Housing Tax Credits from the Department of Housing and Community Development and executed a 30-year affordability covenant with the District restricting maximum rents to 60% of Median Family Income (MFI). The proposed real estate tax abatement restricts the maximum MFI limitation to 80% in perpetuity which ensures the preservation of 173 units of affordable and workforce housing in the District’s Mayfair section regardless of potential future demographic changes.

Number of Jobs Created. The property currently employs 5 people through the property management company two of which are residents of the District.