

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




Natwar M. Gandhi
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: **February 6, 2012**

SUBJECT: **“King Towers Residential Housing Real Property Tax Exemption**
 Clarification Act of 2011”

REFERENCE: **Bill Number 19-530**

Findings

The tax exemptions tax proposed by Bill 19-530 are necessary in order for the owner (King Housing, LLC) of King Towers Apartments (King Towers) to maintain the 129 affordable rental units located there. In the absence of the proposed exemptions, current projections show that cash flow is estimated to be insufficient to pay all operating costs and debt service on King Housing, LLC’s three loans.

The proposed bill would exempt King Housing, LLC from economic interest transfer tax and from real property tax owed for September and October 2010. The total abatement would equal approximately \$648,000, which includes approximately \$90,000 in penalties and interest.

Background

King Towers is a 129-unit building built in 1969. It is a low-income housing residential property, which is subject to a U.S. Department of Housing and Urban Development (HUD) Use Restriction Agreement through the year 2047. This agreement caps the rents that King Housing, LLC is able to charge and requires that all excess cash flow remains in the project, rather than being distributed to the owner.

A for-profit entity acquired the property in August 2010, in order to take advantage of federal Low-Income Housing Tax Credits and District of Columbia Housing Finance Agency bond financing. The new owner, King Towers, LLC, used the funds to renovate the property.

Prior to August 2010, the property was owned by a nonprofit entity and was financed using the HUD 221(d)(3) Below Market Interest Rate (BMIR) program. As a result, the property was exempt from real property taxes under Chapter 8 of the DC Code as well as PILOT payments under Chapter 10 of the DC Code. In addition, the property was exempt from deed recordation, deed transfer and economic interest transfer taxes.¹

Because the ownership of the property changed from a nonprofit entity to a for-profit entity and the renovation required the HUD 221(d)(3) BMIR mortgage to be refinanced, King Towers became subject to real property taxes and economic interest transfer taxes. In 2010, the Council granted a real property tax exemption to King Housing, LLC. The bill did not include an exemption from deed recordation, deed transfer or economic interest transfer taxes.²

The current legislation would exempt King Towers, LLC from real property taxes for the period between September 26, 2010 and October 15, 2010 (see footnote #2), as well as from economic interest transfer taxes that stem from the August 2010 acquisition of the property.

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. Terms of the Exemption or Abatement

The proposed legislation will provide a one-time abatement of tax liability previously assessed. Existing law exempts the Property from real property taxation so long as the property continues to be owned by King Housing, LLC, or by an entity controlled, directly or indirectly, by King Housing, LLC, or continues to be under applicable use restrictions during a federal Low-Income Housing Tax Credit compliance period or any other federal program governing income and use restrictions at the property, and is not used for commercial purposes. The proposed legislation is a clarification of existing law. It adds a real property tax exemption for the 19-day gap between the expiration of the emergency legislation and the enactment of the permanent legislation. In addition, it provides for an exemption from economic interest transfer tax.

¹ Economic interest transfer tax is a tax on the transfer of the controlling interest in an entity that owns real property. This tax is a type of recordation tax.

² On June 28, 2010, the Mayor signed into law Bill 18-854, the King Towers Residential Housing Real Property Tax Exemption Emergency Act of 2010. This act exempted the King Towers residential housing rental project located in Lot 49 on Square 281 from real property tax on an emergency basis. The emergency bill (Bill 18-854) expired on September 26, 2010 and the permanent bill (Bill 18-749) did not become law until October 15, 2010. As a result, King Towers, LLC was charged real property taxes for the 19-day period between September 26, 2010 and October 15, 2010.

2. Annual Proposed Value of the Exemption or Abatement

The OCFO estimates the proposed value of the one-time exemptions to be:

	FY2012
Amount of Economic Interest Transfer Tax to be Exempted	\$553,845
Penalties and Interest on Unpaid Economic Interest Transfer Tax*	\$89,698
Amount of Real Property Tax Paid (to be Refunded)	\$4,969
Total	\$648,512

**Assumes total penalties and interest charged through March 1, 2012*

Due to circumstances related to the use of federal Low Income Housing Tax Credit equity, the transfer of the Property was completed using an economic interest transfer rather than a sale of the deed. The tax rate for economic interest transfer tax is 2.9%, while the tax rate for deed recordation tax is 1.45%. If deed recordation tax had been assessed instead of economic interest tax, the amount of tax owed on the sale would have been approximately \$277,000 rather than approximately \$554,000. In addition, King Towers, LLC did not receive a tax bill until September 2011, after the Office of Tax and Revenue denied its application for an exemption, at which time approximately \$61,000 in penalties and interest was assessed.

Approximately \$5,000 in real property tax to be refunded is the total real property tax assessed because of the 19-day gap between the expiration of the emergency legislation and enactment of the permanent legislation.

3. Summary of the Proposed Community Benefits

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

4. Financial Analysis for Existing Buildings

Review and Analysis of the Financial Condition of the Recipient of the Proposed Exemption and Whether Recipient Could Be Reasonably Expected to Meet Its Fiscal Needs without the Proposed Exemption

King Housing, LLC provided the OCFO with financial statements, projected cash flows, and loan documents. Based on the OCFO's analysis of the information provided, King Housing, LLC does not have sufficient funds to make the required tax payments listed in section 2 above.

Tax Abatement Financial Analysis - B19-530 "King Towers Residential Housing Real Property Tax Exemption Clarification Act of 2011"

King Towers, LLC financed the project using the sources listed below:

SOURCES	
DC Housing Finance Agency Bonds	\$ 12,830,000
Short Term Bonds	\$ 2,780,000
King Housing Inc. Loan	\$ 11,350,000
National Foundation for Affordable Housing Solutions, Inc. Loan	\$ 1,444,841
Low Income Housing Tax Credit Equity	\$ 6,692,112
Deferred Developer Fee	\$ 549,090
Interim Income	\$ 577,442
Total Sources	\$ 36,223,485
USES	
Acquisition	\$ 19,158,000
Hard Construction Costs	\$ 6,497,220
Soft Construction Costs (including Developer Fee)	\$ 3,716,236
Financing Costs	\$ 1,903,823
Required Reserves	\$ 2,168,206
Payoff of Short Term Bonds	\$ 2,780,000
Total Uses	\$ 36,223,485

If King Housing, LLC was required to pay economic interest transfer taxes as well as real property taxes for the 19-day period, the OCFO estimates that it would be required to delay final payment of the \$549,090 deferred developer fee until the end of 2015. In addition, the OCFO estimates that King Housing, LLC would not be current on interest payments on the King Housing, Inc. loan and the National Foundation for Affordable Housing Solutions, Inc. loan until 2039 and 2040, respectively.³ Given the tight margins under which King Housing, LLC operates King Towers, a \$648,512 tax payment in 2012 would place significant stress on the future cash flow of the property.

³ Interest accrues on any unpaid interest on the King Housing, Inc. loan. Deferred interest payments on these loans will not cause a foreclosure on the property.