

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

A handwritten signature in black ink that reads "Jeffrey S. DeWitt".

DATE: **October 24, 2017**

SUBJECT: **"Scottish Rite Temple Vacant Property on Lot 108 Real Property Tax Abatement Act of 2017"**

REFERENCE: **Bill 22-361**

Findings

The 25-year real property tax abatement proposed by Bill 22-361 is not necessary for The Supreme Council (Mother Council of the World) of the Inspectors General Knights Commanders of the House of the Temple of Solomon of the Thirty-third degree of the Ancient and Accepted Scottish Rite of Free Masonry of the Southern Jurisdiction of the United States of America, Inc, (the "Supreme Council") to renovate their headquarters at 1733 16th St, N.W., referred to as the "Temple."¹ Information submitted to the Office of the Chief Financial Officer ("OCFO") by the Supreme Council² indicates alternative means to finance the project are available.

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

¹ Known for taxation and assessment purposes as Lot 108 in Square 192.

² For the purposes of this report, references to the "Supreme Council" shall include the fraternal organization which owns the Temple, as well as two related organizations: (1) the House of the Temple Historic Preservation Foundation, Inc. which manages and operates the Temple, and is the entity charged with renovating the Temple; and (2) The Scottish Rite Foundation, Southern Jurisdiction, USA, Inc., which manages the charitable functions of the fraternal organization. According to the annual financial statements provided to the OCFO, the related organizations "are managed by persons who also actively manage the Supreme Council."

Background

The Supreme Council is a private fraternal organization with approximately 150,000 members in 31 states. Their headquarters, the “Temple,” was constructed in 1915, and is listed in the D.C. Inventory of Historic Places. The Temple is open to the public for tours, and includes a library, archives, and multiple museums.³



The Temple is a 98,000 square foot facility on approximately 2 acres of land, with a surface parking lot. The Temple is located at 1733 16th St, NW, approximately 0.6 miles from both the Dupont Circle and the U Street metro stations.

The Supreme Council has identified a \$65.8 million renovation project for the Temple that includes extensive investment in windows, bronze curtain walls and grilles, skylights and roof monitors, exterior stone, the lower roof, significant improvements to structural, mechanical, electrical, and plumbing systems, and new accessibility components (including two elevators and accessible restrooms on the lower three floors).

According to the Supreme Council, they are unable to fund the Temple renovation project without capturing the development value from their surface parking lot behind the Temple. The Supreme Council has identified Perseus Development (“Perseus”) to lease the land which is currently a parking lot, and develop an apartment building.

The property (Square 192, Lot 108) was fully exempted from real property tax beginning in fiscal year 2015 under D.C. Official Code § 47-1094, and the exemption applies so long as the property “is not used for commercial purposes.” The proposed apartment project by Perseus is a commercial purpose, and the property would be subject to a real property tax liability under current law. The Supreme Council has stated that the apartment project is not profitable enough to qualify for a construction loan, and is therefore undevelopable.

According to the Supreme Council, the proposed 25-year property tax abatement would (a) increase the profitability of the apartment project such that it would be eligible for financing and could be developed, which would then (b) generate land lease payments from Perseus to the Supreme Council, which in turn would allow (c) the Supreme Council to fund their Temple renovation project.

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:

³ According to the Supreme Council’s website: “Exhibits include the Americanism Museum, the Albert Pike Museum, Masonic Philanthropies Museum, and a museum dedicated to Illustrious Brother Burl Ives, 33°.”

(A) Terms of the Abatement

The proposed legislation extends the Supreme Council’s existing property tax exemption to the commercial development planned by Perseus on the Temple’s existing surface parking lot. The abatement would expire after 25 years.

(B) The Value of the Abatement

Table 1: Value of Abated Taxes⁴

	FY2018	FY2019	FY2020	FY2021	4 Year Total	25 Year Total
Abated Real Property Taxes	\$72,000	\$143,000	\$143,000	\$277,000	\$635,000	\$22,278,000

(C) The Purpose of the Abatement

The proposed purpose of the abatement is to create a funding stream for the Temple which can support a Temple renovation project. According to the Supreme Council, the proposed property tax abatement would (a) increase the profitability of the apartment project such that it could be developed, which would then (b) generate land lease payments from Perseus to the Supreme Council, which in turn would allow (c) the Supreme Council to fund their Temple renovation project.

(D) A Summary of the Proposed Community Benefits

The Attachment, provided by the Supreme Council, describes the community benefits.

(E) Financial Analysis and Advisory Opinion

The proposed abatement is not necessary for the Supreme Council to fund the Temple renovation project. The OCFO analysis, detailed below, indicates there are a number of alternate financing structures that the Temple could utilize to fund the proposed renovations at the Scottish Rite Temple.

Financing the Temple Renovation Project

The Supreme Council anticipates borrowing funds to finance the \$65.8 million renovation project⁵, with debt service payments totaling \$115.8 million over 30 years. The Supreme Council has forecasted approximately \$107.2 million from various funding sources over that same period, leaving a total funding shortfall of approximately \$8.6 million over 30 years, as shown in Table 2 below.

⁴ The OCFO was provided with three different sets of construction dates. Table 1 above assumes the construction dates provided directly by Perseus are the most current, with construction beginning in July of 2019 and ending in April of 2021. The abatement value is based on the land value and construction costs provided by the Supreme Council.

⁵ \$65.8 million represents the costs remaining to be performed out of total project costs of \$82.3 million (as of a February 2015 estimate).

Table 2: Temple Renovation Project Funding Shortfall

Revenue Source	Total (\$millions)
Current Investment Balance	\$7.7
Pledged Estate Gifts ⁶	\$30.5
Direct Mail Solicitations ⁶	\$21.0
Related Organization Contributions ⁷	\$18.0
Other Contributions ⁶	\$30.0
Total	\$107.2
- Less 30 Years of Debt Service	(\$115.8)
Total Funding Shortfall	(\$8.6)

The OCFO has analyzed the Supreme Council’s financial statements and notes there are unrestricted investments totaling \$28.8 million⁸ that are not pledged to this project which could fund the \$8.6 million total funding shortfall. According to the Supreme Council, those funds are necessary to maintain operations at current levels.

In order to fund that \$8.6 million total shortfall and provide a long-term source of income to cover debt service costs and maintain the property, the Supreme Council sought to develop its parking lot into a 105-unit apartment building through a 75-year land lease agreement with Perseus⁹. The land lease agreement requires annual payments from Perseus to the Supreme Council totaling \$35 million over the 30 years debt service period (the lease terms provide for payments of \$969,272 per year, with 10 percent rate increases every five years, and reduced rent during construction). The lease also requires Perseus to construct 40 parking places for exclusive Temple use. According to the Supreme Council, neighborhood parking is saturated, and the members and employees of the Temple rely on free on-site parking. Finally, the lease also requires Perseus to pay the Supreme Council three percent of the proceeds of the first two refinances and sale of the project¹⁰.

Financing the Apartment Project

Under current market conditions and terms of the land lease, the proposed apartment project is not projected to be profitable enough to qualify for financing. Typically, commercial lenders require a 6 percent return on cost ratio to provide funding (return on cost is the ratio of annual net income divided by project cost). The OCFO agrees that under the current terms of the land lease, the project does not meet the 6 percent return on cost threshold.

⁶ Pledged Estate Gifts, Direct Mail Solicitations, and Other Contributions are forecasts provided by the Supreme Council and are likely to fluctuate based on economic conditions as well as the size and demographic makeup of the membership.

⁷ See footnote 2 for a discussion of the related organizations.

⁸ This includes \$19.1 million in investments held by the fraternal organization plus \$12.9 million held by the charitable foundation. According to the Supreme Council, 90 percent of those investments are unrestricted. The Supreme Council further commented that a transfer of more than 50 percent of investments to a legally separate entity would be a cause for concern for the Internal Revenue Service.

⁹ According to the documents provided to the OCFO, Perseus is the second developer to consider an apartment project at this site after a prior developer abandoned their effort after unsuccessfully pursuing additional density.

¹⁰ The potential revenue to the Supreme Council from such payments is not included a source in Table 2 because it is contingent upon events outside the Supreme Council’s control and may not occur. The apartment project proforma provided by the Supreme Council shows net sales proceeds in Year 10 of approximately \$45.9 million, of which 3 percent, or \$1.4 million, would be payable to the Supreme Council.

However, the OCFO finds that alternative land lease terms could allow the apartment project to achieve a 6 percent return on cost and still fund the Temple renovation project.¹¹ Example A in Table 3 provides for a 6 percent return on cost, assuming the land payment is reduced to \$605,000, which would generate \$21.8 million over 30 years to fund the Supreme Council’s \$8.6 million Temple renovation project shortfall.

Example B in Table 3 similarly provides a 6 percent return on cost by reducing the land payment, but only to \$845,000. Example B assumes the Supreme Council no longer requires the 40 parking places within the apartment project’s underground garage and waives land payments until the apartment building is occupied. This scenario would generate \$31 million to fund the Supreme Council’s \$8.6 million Temple renovation project shortfall.

Table 3: Return on Cost¹² for the 105 Unit¹³ Apartment Project

Apartment Building Costs	Submitted by Applicant		Examples Without Abatement	
	Without Abatement	With Abatement	Example A: Reduced Land Payment	Example B: Maximize Land Payment
Gross Income	\$5,650,932	\$5,650,932	\$5,650,932	\$5,650,932
Operating Expenses and Vacancy	(1,301,636)	(1,301,636)	(1,301,636)	(1,301,636)
Property Tax Estimate from Perseus	(500,000)	-	(500,000)	(500,000)
Lease Payment to Supreme Council	(969,272)	(969,272)	(605,000)	(845,000)
Annual Net Income	\$2,880,024	\$3,380,024	\$3,244,296	\$3,004,296
Lease Payments During Construction ¹⁴	1,453,908	1,453,908	907,500	-
Parking for the Supreme Council	3,075,000	3,075,000	3,075,000	-
Apartment Building Costs	50,075,867	50,075,867	50,075,867	50,075,867
Total Costs	\$54,604,775	\$54,604,775	\$54,058,367	\$50,075,867
Return on Cost	5.27%	6.19%	6.00%	6.00%
30 Year Total Lease Payments to the Supreme Council	\$35.0 million	\$35.0 million	\$21.8 million	\$31.0 million

¹¹ According to the Supreme Council, selling the land directly to a developer does not improve the return on cost because the lease payment is less than 6 percent of the land value.

¹² Documents submitted to the OCFO showed three different apartment project costs. The first was a 2015 cost estimate of \$47.7 million which resulted in a 6.17 percent return on cost without a property tax abatement. That estimate was then updated and is the basis of Table 3, with project costs of \$54.6 million resulting in a return on cost of 5.27 percent without a property tax abatement. A third project cost was shown in a June 6, 2017 report by Delta Associates provided by the Supreme Council which calculated the economic impact of the apartment project. That report showed project costs of \$45.8 million which, by OCFO calculations, would result in a 6.3 percent return on cost without a property tax abatement. The Supreme Council stated the figures from the Delta Associates report were not correct.

¹³ According to the documents provided by the Supreme Council and discussions with their representative, the apartment project could be up to 150 units, subject to review by the Historical Preservation Review Board. When asked by the OCFO how much the return on cost would increase with additional units, the Supreme Council stated that 150 units was a mistake in the original documentation and not possible under existing zoning restrictions.

¹⁴ The lease partially abates land payments during construction. According to documents provided by the Supreme Council, the total payments during construction equal 1.5 times the annual payment.

Conclusion

The proposed abatement is not necessary for the Supreme Council to fund the Temple renovation project because the Supreme Council could change the land lease terms to allow the apartment project to achieve a 6 percent return on cost and also fund the Temple renovation project’s \$8.6 million total funding shortfall. Alternatively, or in combination with changes to the land lease terms, the Supreme Council could redirect up to \$28.8 million in unrestricted investments to the Temple renovation project total shortfall of \$8.6 million.

Attachment
Community Benefits

With the requested tax abatement and the successful development of the proposed residential facility, the Supreme Council will not only be able to continue its present level of “community benefits”, but will also be able to enhance some existing community benefits and create additional community benefits.

On November 8, 1964 the House of the Temple was among the first group of buildings to receive an individual listing in the D.C. Inventory of Historic Sites. Over the years, the Supreme Council has ensured that one of the District’s and the Nation’s most historical and architectural landmark buildings remains open to the Nation’s and the World’s public. At its own expense, the Supreme Council annually hires twenty (20) tour guides to conduct free daily tours of the Temple. And, through its three (3) affiliated charities¹ (housed in the Temple), the Supreme Council continues its mission of supporting local social, charitable and community services and educational programs. In 1886, the first public library was housed in the Temple at a different location. When the existing Temple was opened in 1915, the library was moved into it and is still open to the public. It is used daily for research and to simply relax and read. The library houses a 175,000 volume historic and rare book library. For several years, the librarian hosted a Saturday morning children’s program that many nearby families and others attended. The Supreme Council had to discontinue this program because of safety concerns for the children. Upon completion of our restoration, rehabilitation and building code compliance project, the Supreme Council plans are to restart this wonderful and popular local community program.

In its support of an educated citizenry, in just the past two (2) years, the Supreme Council has provided over \$47,000 in scholarship funds to District residents. In 1927, a one million (\$1,000,000.00) endowment was given to George Washington University to establish a national scholarship program. In the last two (2) years, this scholarship program has granted over three hundred thousand dollars (\$300,000.00) in scholarship funds. District residents are also eligible to participate in this scholarship program. The Supreme Council hires District residents (students) attending our local universities to participate and work in its intern program at the Temple. As noted, the Supreme Council hires twenty (20) interns from the various local universities each year as Temple tour guides and employs an average of five (5) District resident students each year.

The Supreme Council also supports charitable and service organizations and community activities that are local or have strong commitments to the local community. For example, in the last two (2) years, the Scottish Rite Foundation of Washington, DC has contributed over \$400,000 to the Scottish Rite Center for Childhood Language Disorders at 2800 16th Street, NW. Approximately, Six- hundred (600) District children have been served by the Center’s programs. For twenty (20) years, the Supreme Council allowed its residential neighbors and other District residents to use a portion of its vacant property as a community garden. The Supreme Council also paid the costs of maintaining the garden and paid property taxes on the garden property until the City Council exempted the Temple’s vacant property in 2012. On the weekends, or holidays, the Supreme Council’s parking lot is sometimes used free of cost or for a nominal fee by various neighbors such as the 15th Street Church, the Universalist National Memorial Church and Congregation Bet

¹ Scottish Rite Foundation, Southern Jurisdiction, USA, Inc., House of the Temple Historic Preservation Foundation, Inc. and Scottish Rite Research Society.

Mishpachah. For several years, the Susan G. Komen Breast Cancer Foundation, Inc. used the parking area free of charge for lunch and as a rest break station for its marchers and daily a local exercise group has used the lawn and front stairs free of charge.

By using a ground lease to develop its vacant property to house a residential facility, the Supreme Council and Perseus will create new community benefits (both temporary and permanent) and enhance some existing community benefits. It will also help to fill the shortage of affordable residential living space for the community. This increase in housing stock will also convert vacant tax exempt land into income-producing property and, following the tax abatement period, joining the tax rolls and producing property taxes to help pay the District government's operating expenses. When the restoration, rehabilitation and building code compliance project is completed, the Supreme Council will be able to offer the community more opportunities to use certain parts of the Temple and Perseus will be able to offer the community some of the amenities found in the proposed residential building. Of course, we will not know the full range of amenities until the proposed project makes its way through the regulatory process.

By coming into compliance with the modern building code, the Temple will be accessible to more community members and visitors to the District and more people-friendly to all, helping the District strengthen its strongest private sector industry – tourism. Moreover, during construction, the proposed residential facility will generate an estimated \$12.5 million in annual economic activity and support 281 temporary jobs for District residents with total earnings of \$9.4 million. During the construction period, the proposed project is also expected to generate \$843,000 in annual income and sales tax revenue for the District. On an ongoing basis, the proposed project will support 82 permanent jobs for District residents with annual earnings of \$2.4 million and is expected to generate \$216,000 in annual tax revenue for the District. Even with the twenty-five year tax abatement, “[o]ver the 50-year period from year 26 to year 75, [the improved vacant site] will produce a total of \$82.7 million in property tax revenue. At a discount rate of 5.0%, the net present value of this revenue stream would be \$7.7 million”. Of course, the property tax revenue stream will steadily continue beyond the seventy five (75) year ground lease period.