File #:	19-2047	**Name:**	
Type:	Resolution	**Status:**	Agenda Ready
File created:	4/30/2019	**In control:**	City Council Legislative Meeting
On agenda:	5/14/2019	**Final action:**	
Title:	Introduction and First Reading. Consideration. Passage on First Reading of an Ordinance to Amend Section 3-2-192 to Provide a Performance Based Partial Real Estate Tax Abatement to Induce Economic Development at 5001 Eisenhower Avenue.		
Sponsors:			
Indexes:			
Code sections:			
Attachments:	1. 19-2047_ cover, 2. 19-2047_Ordinance		

Date	Ver.	Action By	Action	Result

City of Alexandria, Virginia

MEMORANDUM

DATE: MAY 8, 2019

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: MARK B. JINKS, CITY MANAGER /s/

DOCKET TITLE:
Introduction and First Reading. Consideration. Passage on First Reading of an Ordinance to Amend Section 3-2-192 to Provide a Performance Based Partial Real Estate Tax Abatement to Induce Economic Development at 5001 Eisenhower Avenue.

ISSUE: Facilitating economic use of a long-vacant 16-acre office site at 5001 Eisenhower Avenue.

RECOMMENDATION: That City Council approve on First Reading and schedule for Public Hearing and Second Reading, and Adoption on May 18, 2019, an ordinance amending section 3-2-192 of the City Code to provide a performance based partial real estate tax abatement to induce economic development of 5001 Eisenhower Avenue.

SUMMARY: 5001 Eisenhower Avenue is a large, outdated office building, originally constructed in 1973 for the U.S. Army Material Command. Since that agency's move to
Ft. Belvoir in 2003, the building has sat vacant for 16 years, and has been the subject of numerous failed federal agency lease attempts and has been passed over for purchase by many real estate investors. The owners since 2004, Prudential Real Estate and its related successor, have not proven successful in the pursuit of federal tenants. As a result, the building has sat vacant, significantly raised Alexandria's total office vacancy rate, and has been an impediment to any significant Eisenhower West redevelopment activity.

A local major real estate investor and developer, Stonebridge, is now under contract to purchase the 5001 Eisenhower building, and has requested a partial real estate tax abatement to make the site conducive to office redevelopment and leasing. Stonebridge is the developer of the Oakville Triangle and the Wegmans-anchored Hoffman Town Center sites. The partial real estate tax abatement that Stonebridge is seeking would be similar to that agreed to by the City in the current owner's temporary win (which was then overturned in Federal claims court) of the lease competition for the Transportation Security Administration (TSA) headquarters, which was ultimately awarded to, and is now being constructed in, Fairfax County.

DISCUSSION: In the summer of 2018, PGIM Real Estate, formerly known as Prudential Real Estate Investors, retained Cushman & Wakefield to seek buyers for 5001 Eisenhower Avenue, and the 16 acres the approximately 600,000 square foot (SF) empty office building sits on. PGIM Real Estate (and prior affiliated entities) acquired the property in 2004 and began an extensive exterior renovation after the building was vacated by the Army Material Command as part of consolidation activities to Fort Belvoir in the late 1990's.

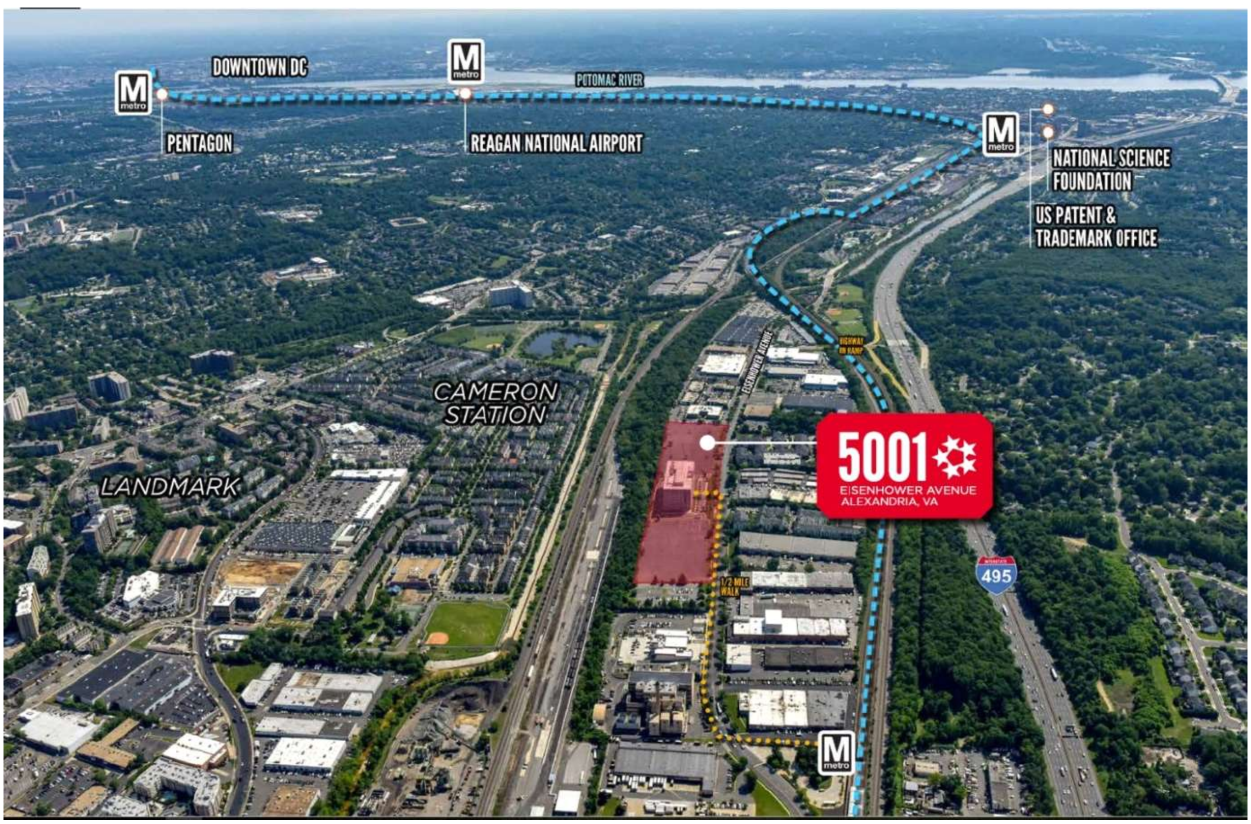
The owners and their representatives have spent the last decade actively pursuing federal tenants to lease the building, and potential new construction on site. The decision to sell the asset is a result of multiple failed pursuits, detailed below. The asset was placed under contract to Stonebridge earlier this year.

Located within the Eisenhower West Small Area Plan boundaries, the 5001 Eisenhower Avenue building and 11+ acres of undeveloped land, currently paved for surface parking, are imagined as a catalyst for continued investment in the west end of the City. Specifically, the plan calls for redevelopment of the entire site into a mixture of office, residential, and retail uses. The western portion of the existing 11-story building is within ½ mile of the Metrorail station and was taken down to the concrete slabs and columns in a $60 million renovation (in anticipation of winning the BRAC-133 major Department of Defense development and sale competition) that now meets the most rigorous GSA Level-IV Security Standards (i.e., major blast proof protections). The building addresses key federal government leasing criteria, including its physical construction, transportation, accessibility, and proximity to amenities.

The contract purchaser intends first to actively pursue upcoming federal agency procurements, including the expected consolidation of U.S. State Department offices. If that office leasing fails, then the backup position could be to convert the existing building and property to multi-family residential uses. On a parallel timeline to the tax abatement request, Stonebridge submitted an application to the Department of Planning & Zoning to subdivide and rezone the eastern portion of the site to accommodate residential townhouse development. The former was approved by the Planning Commission on May 7, 2019 and the latter will be docketed for consideration by the City Council at the May 18, 2019 public hearing meeting. This simultaneous action is key to making the acquisition work from a financial point of view.

The objective of the application for a subdivision (to create a separate parcel on what is now the eastern parking lot) and to rezone that new parcel to CRMU-H is not to add density but instead to allow residential development, such as townhouses.

BACKGROUND: Over the last decade, the 5001 Eisenhower Avenue building and site has ultimately lost out on four large federal government requirements. For the first two, no City incentive or inducement were contemplated. For the third (Transportation Security Administration), a partial real estate tax abatement incentive was included as part of the Best and Final Offers (BAFOs) by the property owner. The site won that procurement, but it was eventually overturned by a Federal claims court on a technicality. In the fourth, no incentive was included. Details of those pursuits follow:



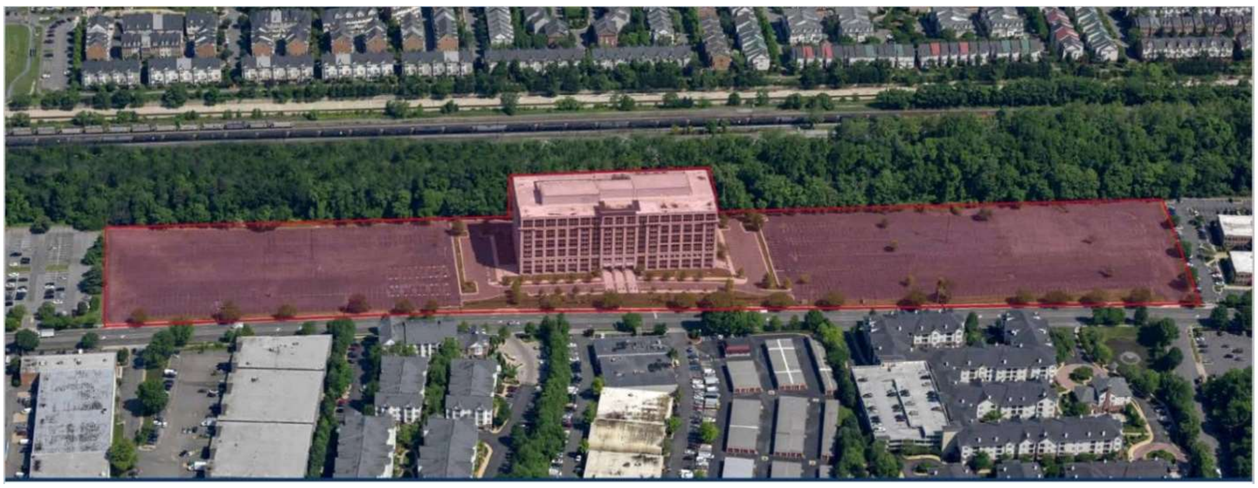
2005 Base Realignment and Closure (BRAC) Requirements

As a result of the national 2005 BRAC, millions of square feet of office space in Arlington and Alexandria leased by the Department of Defense (DoD) were vacated and moved onto bases and installations in Northern Virginia and throughout the United States. During the consolidation process, the DoD identified groups of commands that needed to remain in the National Capital Region, and thus conducted separate procurements.

The Victory Center (now 5001 Eisenhower Avenue) competed for two of these procurements. The first, known as **BRAC 133 proposed consolidation by DoD**, was a collection of 6,400 employees working for the Washington Headquarters Service (WHS) and related commands in the DoD. Victory Center and Alexandria's Mark Center were the two finalist locations for the 1.75 million square foot office requirement- Mark Center was ultimately selected in September 2008 and the DoD contracted for construction of the major office building at that site largely because the Victory Center pricing was much higher.

The second, known as **Tricare or the Medical Command Headquarters**, was for more than 700,000 square feet housing 3,000 workers. The DoD initially looked at 17 potential sites, narrowing it down to three, to include the Victory Center, before ultimately choosing a site in Fairfax County in July of 2010.

<u>Transportation Security Administration (TSA)</u>



In 2015, after an intense regional competition (where lease cost and the City's proposed partial real tax abatement were major determining factors) the Federal government awarded a lease for the relocation of the TSA headquarters at the Victory Center site (5001 Eisenhower Avenue) in Alexandria. The proposed relocation utilized most of the existing building and then constructed a new building and parking garage for the federal tenant.

In order to win the deal, during the final stages of that competitive pursuit, the ownership of the Victory Center approached the City with a request for a partial real estate tax abatement, similar in structure to the one the City provided to win the National Science Foundation (NSF) procurement a few years earlier. The need for the partial real estate abatement was driven largely by the fact that during the lease negotiations, the federal government changed its requirements and drove up the lease costs to the point that Prudential could not make a competitive bid without the City's participation via a partial real estate tax abatement. As a result, Prudential requested and received up to a potential $1.6 million fixed annual partial real estate tax abatement over a 15-year period. The nominal value of the abatement was about $25 million. The partial real estate tax abatement could have been earned if performance requirements of TSA occupancy of the building were met. That abatement was never put in place as the TSA bid ultimately was not successful. Details about the structure of the proposed abatement are included below in the Eisenhower West Redevelopment District section of this memo.

In early 2016, the GSA issued a notice to the property owners/developers who were finalists in the TSA headquarters competition, believed to be two sites in Alexandria, two sites in Arlington and one site in Fairfax County. The notice included an amendment that clarified language in the prior Request for Lease Proposals (RLP) and extended the schedule for completion from 2017 to 2020.

At that point, the Council considered whether or not to provide the same partial real estate tax abatement to the second Alexandria site, JBG-Hoffman Block 2. AEDP and City staff supported the provision of exactly the same real estate tax abatement for the JBG site as that provided at the Victory Center site.

Ultimately, Council supported the provision for a partial real estate tax abatement for both Alexandria sites continuing to pursue the revised TSA procurement, noting that Victory Center remained the City's first priority, but allowing for the JBG-Hoffman site to compete if Victory Center were eliminated. Neither Alexandria site was chosen- in August 2017 the General Services Administration (GSA) announced the award of the TSA headquarters lease to the Boston Properties' site in Springfield.

Drug Enforcement Administration (DEA)
The most recent procurement for which 5001 Eisenhower Avenue competed was for the relocation of the Drug Enforcement Administration (DEA) headquarters from Pentagon City in Arlington. Because of the TSA delay (noted above) this procurement took place during the same time frame, with many of the same properties competing.

The DEA requirement was the smallest of the four pursued, 575,000 SF, and would have occupied the existing building on site. As a result, the Victory Center site did not formally request a tax abatement for the DEA headquarters project even though the City indicated an interest in providing if needed- but given the project economics, the tax abatement offer became moot. As an existing building, and by choosing not to construct parking as part of their response, the increased real estate value would have been much lower than in previous procurements, and hence, the level of abatement would have been much lower than that previously provided to that ownership entity for the TSA requirement.

In March 2018, with all signs pointing towards GSA choosing a different site, the Victory Center ownership filed a bid protest challenging the government's plans to keep the DEA in Pentagon City. A judge eventually denied that challenge and the GSA signed a lease for the DEA headquarters at the stay-in-place option in Arlington in September 2018. Arlington County worked with the property owner there to provide a financial incentive of $11.5 million.

EISENHOWER WEST REDEVELOPMENT DISTRICT: The City has officially adopted two separate partial tax abatement districts; one for the National Science Foundation and one at 5001 Eisenhower Avenue for the TSA headquarters. In both, real estate taxes on the office building(s) and other improvements are partially abated over 15-years, aligned with the term of the office lease. Taxes on the land and any existing building(s) continue to be levied by the City.

The real estate tax abatements were established creating the "*National Science Foundation Redevelopment District*" and the "*Eisenhower West Victory Center Redevelopment District*," which were defined to include only the parcels where the catalyst projects are located. All other adjacent existing real estate, including the value of other buildings that may be constructed to house contractor tail, or to fulfill other spin-off needs, are fully taxable unless the City were to amend its tax policies in the future. Under Virginia law, in a partial real estate tax abatement only the value of new improvements is subject to partial tax abatement, while the value of any existing structures and land remain fully taxable.

While this district is still an active ordinance, the benefits of abatement will never be realized as the terms will never be met, as TSA did not occupy the building.

PROPOSED REVISED PARTIAL REAL ESTATE TAX ABATEMENT: In order to provide an abatement for a new federal agency or other office tenant, the existing ordinance needs to be amended. The following outlines the contents to be included in the proposed replacement ordinance.

Given that any federal lease competition is going to be priced based on a lease rate that is required to be no higher than the GSA Northern Virginia cap, and given the recent large jump in construction prices (currently averaging about 6% per year), developing a realistic financial plan for 5001 Eisenhower has been challenging. Other real estate investors have considered acquiring 5001 Eisenhower and have declined to purchase because of the financial challenges and risks.

As has been the case for the consideration of other partial real estate tax abatements in the City, the City has employed an independent outside firm to review the developer's pro forma in great detail. The purpose of that review is to determine if the developer's assumptions (construction costs, rental income) are reasonable, and if a partial real estate tax exemption is needed to provide a rate of return that is consistent with market expectations. The City's practice is to only provide a partial real estate tax abatement if the project would not likely proceed **"but for"** the City's financial support.

In the case of 5001 Eisenhower, under the scenario of a $150 million investment (investment amounts can vary substantially depending on the specifications of the occupying tenant), the City's consultant determined that no partial real estate tax abatement was needed as the developer could earn a market rate of return without the abatement. However, at a $175 million level of investment, a partial real estate tax abatement of $2.25 per square foot was needed to provide a market rate of return. This equates to an abatement of up to $1.1 million per year or up to $16.5 million over a 15-year period.

In the case of the construction of new buildings (as compared to the existing 5001 building), it is much more difficult to develop a financially feasible project as the GSA rent can go no higher than its Northern Virginia rent cap, but the new building construction could cost up to $500 per square foot to construct ($135 million in total) which is more than the GSA rent cap can support. In this case, about a $4 per net rentable square foot partial real estate tax abatement can be justified. This equates to a partial real estate tax abatement of up to $1.0 million per year or $15 million over a 15-year period.

When put together, these two project elements could have a total investment exceeding $310 million, making the outside limit of the partial real estate tax abatement up to a $2.1 million per year or a maximum of up to $31.5 million for 15 years. It should be noted that any partial real estate tax abatement would be based on the amount of the assessment increase due to the investment, so if there was less investment there would be proportionately less abatement. Each assessment and abatement year is calculated as a stand-alone time period so there is no roll-over of unused abatement to a subsequent year. Also, with the dollar amount of the tax abatement capped, if the City's real estate tax rate increases then the abatement does not increase. As performance requirements, there needs to be at least $175.0 million in documented investment in the existing 5001 Eisenhower Avenue building before any abatement is provided. For any new commercial buildings constructed on site, the abatement scales up with the amount of new construction, so if only 100,000 square feet of new construction is undertaken, then only about one-third of the abatement amount would apply. The partial real estate tax abatement would not apply to residential construction costs (i.e., the proposed townhouses, if multifamily buildings were constructed, or if 5001 Eisenhower Avenue was redeveloped as a residential structure).
The proposed terms and conditions are:

1. Existing TSA partial real estate tax abatement ordinance (3-2-192) as template for revised ordinance as authorized under State Code section 58.1-3221.

2. 15-year period of partial real estate tax abatement to be provided subject to conditions outlined in this term sheet are met. Abated amount is deducted from normal tax billing and the property owner is billed the new amount due.

3. Requires at least $175.0 million to be expended in the existing 5001 building to be eligible for partial real estate tax abatement. (defined as land acquisition costs plus hard construction costs as well as usual and customary soft costs).

4. Partial real estate tax abatement up to amount listed in #7 below starts the January 1 after at least 200,000 square feet of space is leased and occupied by a tenant.

5. Partial real estate tax abatement does not apply to residential parcel(s).

6. Partial real estate tax abatement for the existing building could be up to a maximum of $1.1 million per year for 15 years (= $16.5 million). For any annex buildings and related structures (such as a parking garage) the abatement could be up to a maximum of $1.0 million per year for 15 years (=$15.0 million). This totals $31.5 million for 15 years.

7. Partial real estate tax abatement could be less based on future not-yet-known real estate assessments to be determined on the value of the improvements using usual and customary real estate assessment methodologies employed to assess commercial office buildings in the City. Abatement does not include land nor existing building value prior to improvements being made.

8. Certification that at least $175.0 million in land acquisition costs and improvements have been made constructing and outfitting the 5001 building is required to be provided to the City.

9. Costs of construction of buildings and infrastructure not related to the office building use not eligible to be counted in the $175.0 million. Residential construction costs including within the 5001 building are not eligible to be counted.

10. Partial real estate abatement becomes a vested covenant that runs with the land.

11. "In the event the property is sold to the federal government" language currently in the City's TSA partial tax exemption ordinance would remain but would not be applicable if tax abatement does not occur.

12. City retains right to increase or decrease real estate tax rate in the future

13. The abatement ordinance is not evergreen as it would expire at the end of 2045.

ATTACHMENT: Proposed Ordinance

STAFF:
Stephanie Landrum, President and CEO, AEDP
Ryan Touhill, Chief of Staff, AEDP