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Seattle City Council

Date: September 25, 2013
To: Housing, Human Services, Health and Culture (HSHHC) Committee
From: Nick Licata
Subject: **Multifamily Tax Exemption Program (MFTE) – Decision Agenda**

On Wednesday, September 25, the HSHHC Committee will discuss the MFTE program. As part of that discussion, I will ask the Committee to consider direction on the program that I propose we incorporate into a forthcoming ordinance to be developed by Central Staff, potentially in collaboration with the Office of Housing (OH). The elements of this proposal originate from a Central Staff decision agenda prepared in May to guide the Committee's conversation. You received a copy of the decision agenda, but it was not discussed as planned because we deferred that discussion while OH and the King County Assessor's Office worked to determine the tax impacts of the MFTE program.

Issue 1: Program Goals

Included in the Seattle Municipal Code (SMC) are nine goals for the MFTE program. They are wide-ranging and not entirely measureable for their outcomes. The MFTE program audit completed by the Office of the City Auditor in 2012 suggested that establishing more focused goals for the MFTE program could make the program easier to evaluate over time. I propose an MFTE program with several measureable goals focused upon a single long term objective.

Proposed Committee Direction: Revise MFTE program goals to focus on one specific theme, or program objective, with 4 measureable goals with associated outcomes towards meeting that objective that will be tracked over time.

Proposed Program objective:

Increase the supply of housing opportunities within the City for low income households.

Proposed measurable goals towards meeting objective:

- a. Increase the supply of housing opportunities for low income households in Residential Target Areas (RTAs), defined as those **Urban Centers that are behind in meeting their 20-year residential growth targets**, based on Department of Planning and Development (DPD) statistics.
- b. Increase the supply of affordable housing in mixed-income multifamily housing along **major transit corridors** in those RTAs.
- c. **Preserve and protect affordable housing** with historic, cultural, architectural, engineering or geographic significance located within the City in those RTAs.
- d. Create **both affordable rental and homeownership housing for Seattle's workforce**.

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Issue 2: Geographic Span

MFTE program goals should be tightly integrated with the program's geographic span. The MFTE program currently operates in 39 RTAs. Currently, these areas are largely (though not perfectly) contiguous with the City's urban centers and villages. In addition to promoting the production of affordable units in higher-rent areas, the MFTE program is also used to encourage all housing development in neighborhoods with cooler real estate markets.

Proposed Committee Direction: Limit the geographic span of the MFTE program to include only urban centers and villages that have not met some share (e.g., 50%) of their adopted 20-year residential growth targets for 2024.

- Limiting MFTE eligibility to projects in urban centers and villages that have not yet met a specific share of their 2024 growth target could help to encourage development in cooler market areas and away from neighborhoods that have already exceeded their 20-year goals.
- Under this option, MFTE use would still stimulate affordable housing production in some hot markets that might not otherwise see much construction of new affordable housing. For example, South Lake Union, Ravenna, and the Admiral District are all desirable neighborhoods that have not yet met 50% of their 2024 growth targets.
- This option could lead developers that might otherwise invest in high growth areas to take on projects in lower income and/or transitional neighborhoods.
- Limiting MFTE eligibility to projects in areas with established growth targets could make the program's impacts on specific areas of the City easier to evaluate over the long term.

Issue 3: Occupancy Assumption for One Bedroom Units

The maximum monthly rent charged for an affordable one bedroom unit in an MFTE unit is derived from the assumption that such units are occupied by two-person households. However, in Seattle, the average occupancy of a one bedroom rental apartment is closer to 1.5. Other affordable housing programs administered by the City apply an average occupancy assumption of 1.5 persons for one bedroom units.

If the City were to maintain the 75% of area median income (AMI) limit that currently applies to one bedroom affordable units in MFTE projects but lower the assumed household size to 1.5, the maximum rent for such units would fall from \$1,201 to \$1,120, a difference of \$81 per month.

Proposed Committee Direction: Reduce the occupancy assumption for one bedroom affordable units in MFTE projects from two persons to 1.5 persons.

Issue 4: Affordability Levels and Unit Size Preference

The Council periodically amends the income limits that apply to renters of affordable units in MFTE projects. From the program’s inception in 1998 through 2002, the same AMI limits applied to all affordable units in MFTE projects regardless of unit size. From 2004 to 2008, the AMI limits that applied to affordable units in MFTE projects varied according to the percentage of units in a project that were set-aside as affordable. In 2008 changes were made to the MFTE program so that unit size was the variable determining the affordability of set-aside units.

Current MFTE affordability limits, including the maximum income that can be earned by tenants of affordable MFTE units and the maximum monthly rent that building owners may charge for such units, are summarized in Figure 2 below. Figure 2 also compares 2013 MFTE rent limits to 2012 Dupre & Scott-reported market rent averages for residential units located in newer multifamily buildings (i.e., the type of buildings that typically participate in the MFTE program).

Over the past few years, developers of more than 1,500 very small units averaging around 200 square feet (microhousing) have applied for MFTE tax exemptions. Due to their size, the rents charged for small studios units do not always exceed the maximum rent that can be charged under the MFTE project. Thus, the owners of MFTE projects that include small studios may be able to retain the full value of their tax exemptions without having to reduce the monthly rents they charge for many of their units. Also, on a per-square-foot basis, the rents charged for small studio units are often higher than those charged for much larger apartments.

At the other end of the spectrum, there are no established levels for three or more bedroom units within MFTE program’s tiered affordability. Currently, the income and rent limits for two bedroom units are also applied to larger units when they are included in MFTE projects. Consequently, building large, family-size apartments does not appeal to most developers using MFTE.

Figure 2: Estimated Rent Impacts of the Current MFTE Program

Unit Size	AMI	Maximum Annual Income	MFTE Maximum Monthly Rent*	Reference: Market**	Rent Savings to Tenant	Rent Foregone by Owner***
Studio	65%	\$39,455	\$886	\$1,249	\$363	29%
1BR	75%	\$52,050	\$1,201	\$1,574	\$373	24%
2BR	85%	\$66,385	\$1,519	\$1,848	\$329	18%

*MFTE rents shown are for 2013. They are reduced to reflect a utility allowance of \$100 for studio and one bedroom units and \$140 for two bedroom units.

**Market rents based on Sept 2012 Dupre & Scott average rents for multifamily rental buildings constructed since 2008 in eight indicator areas.

***Represents the difference between revenue possible from MFTE-restricted rents vs. average market rents.

Proposed Committee Direction: Lower the income thresholds for 2 bedroom units to 80% AMI and create new thresholds, where none current exist, for microhousing at 50% AMI and 3 bedroom units; at 85% AMI.

- Since the income thresholds for affordable MFTE units were last amended in early 2011, the program has remained very popular among Seattle’s multifamily development community. There no evidence to suggest that the income thresholds for affordable MFTE units should be increased at this time.
- The local residential construction industry has begun to rebound from the recession and the rental real estate market has grown increasingly strong. The income thresholds that currently apply to affordable units in MFTE projects were established in early 2011 and may not be the most appropriate in the context of today’s economy.
- There may be some room to lower the affordability limits without substantially diminishing developer interest in the program.
- Creating an income threshold of 50% AMI for affordable microhousing units in MFTE projects would create opportunity for lower income renters to benefit from the program.
- If an income threshold of 85% AMI is designated for affordable units with three or more bedrooms, it is possible that more such units may be developed in MFTE projects.

Issue 5: Percent of Units Affordable

To qualify under the MFTE program, as established by State law, at least 20% of the housing units in a multifamily project must be classified as affordable (RCW 84.14.020). However, local governments have discretion to require a greater set-aside of affordable units.

Proposed Committee Direction: Require 25% of the residential units in MFTE projects to be set aside as affordable.

- A majority of the City’s MFTE projects are comprised of 50 or more residential units. Thus, increasing the required share of affordable units from 20% to 25% could have a real impact on the number of affordable units produced on a per-project basis.

Issue 6: Income Requalification

In its 2012 review of the MFTE program, the City Auditor raised the questions of whether 1) tenants should be required to periodically re-qualify for their units, and 2) building owners should be obligated to designate alternate affordable units within their MFTE projects when tenants’ incomes grow to exceed the maximum thresholds established for the program. Without an income review or requalification system in place, any abuses of the program that are occurring will be harder to detect or address.

Proposed Committee Direction: Require tenants of income-restricted units in MFTE projects to periodically re-qualify for their units once every two years. When a tenant is found to no longer income-qualify for their unit, require the building owner to designate an alternate affordable unit on-site.

- Analysis completed by OH staff suggests the average length of tenancy for households residing in affordable rental units in MFTE projects is about 14 months, so the number of tenants that may need to requalify should be small. Still, establishing a process for requalifying tenants of affordable MFTE units, and training building owners and managers to carry out that process, will require some staff resources.
- Selection of this option would expedite the creation of a process that could help to address and rectify any abuses of the MFTE program that may be occurring.

Issue 7: Proposed Amendment to Extend MFTE Eligibility to a Multifamily Project that is Currently Ineligible

Chuck Wolfe, an attorney representing the developer of a multifamily residential building currently under construction in Southeast Seattle, has asked that the Committee consider amending the SMC to allow his client’s project to participate in the MFTE program. Mr. Wolfe’s client received their first building permit for their project sometime between July 22, 2007, and August 6, 2008. From August 2008 until April 2011, the SMC permitted developers of projects that received their first building permit between July 22, 2007, and August 6, 2008, to apply for a tax exemption via the MFTE program at any time prior to the completion of their project. In 2011, the SMC was amended to remove the reference to the time period between July 22, 2007, and August 6, 2008, and to require MFTE applications be submitted to OH no later than the date that a project’s first building permit is issued. Mr. Wolfe’s client had to put their project on hold for a few years during the recession and did not submit an application for a tax exemption before the SMC was amended in 2011. As a result, although their initial building permit was lawfully extended during the time their project was on hold, their project is not currently eligible for a tax exemption through the MFTE program.

Mr. Wolfe and his client would like to see the SMC amended in order to allow developers who received their first building permits for a multifamily residential project between July 22, 2007, and August 6, 2008, and who lawfully extended such permits, to apply for a tax exemption through the MFTE program at any time prior to the completion of their project. OH does not believe Mr. Wolfe’s suggested amendment would impact any projects other than his client’s.

Proposed Committee Direction: Amend the SMC to allow developers who received their first building permits for a multifamily residential project between July 22, 2007, and August 6, 2008, and who lawfully extended such permits, to apply for a tax exemption through the MFTE program at any time prior to the completion of their project.

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Proposed Next Steps

Following the September 25th Committee meeting, OH and Central staff will begin assembling a Council Bill that will propose policy changes to the City’s MFTE program. Once complete, that draft Council Bill can be discussed at the December 11 HSHC Committee for review at its December meeting.