

December 2, 2013

To: Councilmember Nick Licata, Chair, Housing, Human Services, Health, and Culture Comm.  
Councilmember Sally Bagshaw  
Councilmember Bruce Harrell

Cc: Councilmembers Tim Burgess, Sally Clark, Richard Conlin, Jean Godden, Mike O'Brien, and Tom Rasmussen

From: Rick Hooper

Subject: MFTE Program --- OH response to CM Licata's September 25 Decision Agenda

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At our meeting on Friday, November 15, you asked us to provide our assessment of each item addressed in your decision agenda presented at the September 25 Committee meeting. The following memo provides an assessment of each of the seven issues for which you recommended a proposed Committee direction.

There are additional issues that we would encourage the Committee to consider as part of its review the MFTE program. Some were raised in the 2012 program audit, and others have emerged as part of our independent evaluation of the program. We intend to present those issues in a future document.

### Issue 1: Program Goals

#### Your Proposed Committee Direction

*Revise MFTE Program goals to focus on one specific theme, or program objective [increase the supply of housing opportunities within the City for low income households], with 4 measurable goals with associated outcomes towards meeting that objective that will be tracked over time:*

- 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.**

#### OH Assessment

We agree with you that the nine current goals are too wide-ranging and not entirely measurable. That is consistent with the City Audit Report suggestion that we establish more focused goals for the program. We also agree with your suggested overall Program objective. Of the four recommended goals appearing in your decision memo, however, we are concerned that a goal to focus MFTE only on Urban Centers and Villages that are behind in meeting residential growth targets would be difficult to administer and place too much emphasis on point-in-time Comprehensive Plan growth targets rather than opportunities to increase supply and achieve below-market rents. (The question of residential targeted areas is discussed further below, under Issue 2.) We believe that addressing the overall program objective you proposed (increase the supply of housing opportunities within the City for low income households) requires continuing the Program's focus in all the City's Urban Center and Village areas and, potentially, designated transit communities (per Goal "b" appearing in the decision memo). Given these and other considerations, OH would amend the program goals as follows.

#### OH Recommendation for Program Goals

- a) Encourage the production of multifamily housing opportunities in urban centers and villages experiencing relatively slow development;
- b) Improve access to affordable multifamily housing opportunities for low-income households in urban centers and villages experiencing relatively robust development;
- c) Encourage both multifamily housing production and affordability along major transit corridors in these targeted areas.

These goals would continue the existing program's residential targeted areas, as discussed below under Issue 2.

#### Measurability

Measuring the affordability (per OH-recommended goal b, above) of MFTE units is easy to do, as MFTE rents and market-rate rents are easily known. Measuring MFTE's impact on development in general (per goal a) is harder to do, but we would suggest that looking at the portion of developments that use MFTE in neighborhoods that command lower rents (and therefore are relatively unattractive to real estate developers and investors) would help signal that MFTE played a role in stimulating development.

## Issue 2: Geographic Span

### Your 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.*

### OH Assessment

Pinning the program's geographic span to each neighborhood's ongoing progress towards a static goal means that the target areas will become outdated as we move closer to the end of the planning horizon. (As an example, following the September 25 decision agenda, one of the areas for cited to continue inclusion in the program – Admiral – hit 53% of its growth target and thus would drop off the list.) The picture would change once again when new 20-year growth targets are established next year under the 2014 Comprehensive Plan; at that point the MFTE geography would suddenly widen out all over again.

### OH Recommendation

Because the Comprehensive Plan identifies Urban Centers and Villages for the express purpose of concentrating growth in these areas and that the targets set for these areas are not intended as caps on new units, we believe that they are all appropriate candidates for MFTE eligibility.

## Issue 3: Occupancy Assumption for One Bedroom Units

### Your Proposed Committee Direction

*Reduce the occupancy assumption for one bedroom affordable units in MFTE projects from two persons to 1.5 persons.*

### OH Assessment

Reducing the assumed occupancy on one-bedroom units to 1.5 people will make MFTE assumptions consistent with those for all other housing programs, and we agree with this approach. As your memo suggests, this change, if applied to 2013 AMI limits, would reduce the maximum MFTE-restricted rents for one-bedrooms from \$1,201 to \$1,120 (after accounting for utilities). By widening the gap between market rents and the MFTE maximum, this would also reduce the program's benefit to developers. Under current market rent assumptions, we would estimate that the average building owner's estimated retained share of the tax exemption would fall from about 19% to about 14% percent, as follows:

DEVELOPMENT			SCENARIO 1 (status quo)		To developer	SCENARIO 2		To developer
Unit type (pro-rata share)			AMI Limit	Occupancy	19%	AMI Limit	Occupancy	14%
Studios	0.50		65%	1.0		65%	1.0	
1 BR	0.35		75%	2.0		75%	1.5	
2 BR/1 B	0.10		85%	3.0		85%	3.0	
3BR/2B	0.05		85%	3.0		85%	3.0	
<b>MFTE Affordable Units</b>								
			<u>Rent less</u>		<u>Foregone</u>	<u>Rent less</u>		<u>Foregone</u>
	<u>Set-asides</u>	<u>Units</u>	<u>utilities</u>	<u>Net rent</u>	<u>rent - MFTE</u>	<u>utilities</u>	<u>Net rent</u>	<u>rent - MFTE</u>
Studios	20%	10	\$886	\$106,320	(\$49,200)	\$886	\$106,320	(\$49,200)
1 BR	20%	7	\$1,201	\$100,884	(\$40,656)	\$1,120	\$94,054	(\$47,486)
2 BR/1 B	20%	2	\$1,519	\$36,456	(\$12,816)	\$1,519	\$36,456	(\$12,816)
3BR/2B	20%	1	\$1,519	\$18,228	(\$16,812)	\$1,519	\$18,228	(\$16,812)
		20		\$261,888	(\$119,484)		\$236,830	(\$126,314)
<b>MFTE Market-Rate Units</b>								
	<u>Set-asides</u>	<u>Units</u>	<u>Rent</u>	<u>Gross rent</u>		<u>Rent</u>	<u>Gross rent</u>	
Studios	n/a	40	\$1,296	\$622,080		\$1,296	\$622,080	
1 BR	n/a	28	\$1,685	\$566,160		\$1,685	\$566,160	
2 BR/1 B	n/a	8	\$2,053	\$197,088		\$2,053	\$197,088	
3BR/2B	n/a	4	\$2,920	\$140,160		\$2,920	\$140,160	
		80		\$1,525,488			\$1,525,488	

The latest statistics on MFTE participation rates show that the impact of the modeled decline in financial benefit to developers is not just theoretical. In 2011, 42 percent of newly permitted multifamily projects applied for MFTE (11 out of 26). In 2012, the share of new projects participating in MFTE increased to 57 percent (24 out of 42). But in 2013, the share of new projects participating in MFTE dropped to 29 percent (18 out of 62). Moreover, several developers have withdrawn or inquired about withdrawing their already-approved applications, as property owners judge the tax exemption insufficient to compensate for the loss of rent revenue.

#### OH Recommendation

Any actions to widen the gap between market rents and MFTE rent limits will likely accelerate the trend away from participation in the program; nevertheless, we do agree with you that the occupancy assumptions for one-bedroom units should be lowered to 1.5 persons.

#### **Issue 4A: Affordability Levels**

##### Your Proposed Committee Direction

*Lower the income thresholds for 2 bedroom units to 80% AMI...*

##### OH Assessment

By layering a reduction in current affordability level for 2-bedrooms on top of the reduction in the occupancy assumption for 1-bedrooms, the incentive for developers to participate drops further to an estimated 12 percent of the tax savings.

OH Recommendation

Given that a widening gap between market and existing MFTE rents is already stifling participation in the program, we believe that lowering the rent level for 2-bedroom units is not advisable.

**Issue 4B: Unit Size Preference:**

Your Proposed Committee Direction

*...and create new thresholds, where none current exist, for microhousing at 50% AMI and 3 bedroom units at 85% AMI.*

OH Assessment: 3 Bedrooms

Creating a new affordability category at 85%AMI for 3 bedrooms would likely have little impact on participation. Currently rent for 3-bedrooms is already capped at 85% (as the 85%AMI threshold currently applies to any unit of 2 bedrooms or more, including 3 bedrooms). The gap between the 85%AMI rent (\$1519, after utility deduction) and market rents for 3 bedrooms is far too wide to make MFTE participation desirable for units of this size.

OH Recommendation

If Council wishes for to restructure MFTE to incentivize production of 3 bedrooms, it would be necessary to create a new category with an affordability limit greater than the current limit of 85%AMI.

OH Assessment: Efficiency Studios and Microhousing

A 50% AMI income threshold for microhousing, if implemented in 2013, would restrict incomes of micro units to \$30,350 and rents to \$759, which is not substantially lower than market-rate rents for aPodment-style microunits.

OH Recommendation

Because microhousing (defined as multiple sleeping rooms surrounding a common kitchen) is already a profitable form of development and relatively low-cost option for tenants who might otherwise rent a studio apartment, OH recommends a simple prohibition on MFTE for congregate residences or any other dwelling type that involves sleeping rooms or other unit types that fall short of a self-contained apartment with cooking facilities. Such units are already effectively prohibited under an OH Director's Rule that requires developers to present a consistent count of dwelling units to DPD for purposes of permitting and OH for purposes of MFTE. A Code change would ensure that this type of unit was not precluded from MFTE on a technicality, but as a matter of Council intent.

However, for very small efficiency studios (of, say, 350 square feet or less) that qualify as standard "dwelling units" (i.e., including a qualifying kitchen), OH does

recommend creation of an affordability threshold below the current 65%AMI that applies to standard studios. Subject to further modeling, we believe that income and rents for very small efficiency studios should be capped at 50%AMI (for 2013, \$658 per month after utility deduction).

**Issue 5: Percent of Units Affordable:**

Your Proposed Committee Direction

*Require 25% of the residential units in MFTE projects to be set aside as affordable.*

OH Assessment

By layering an increase in the unit set-aside on top of the reduction in the occupancy assumption for 1-bedrooms as well as a reduction in the affordability level for 2-bedrooms, there would be no further incentive for developers to participate in the MFTE program, as the revenue lost by requiring 25% of the units to be affordable would exceed any savings on property taxes and thus produce a loss (estimated at 8% of the potential savings) for developers. The following table shows the incremental effect of each policy change.

	Status Quo	Reduce 1BR occupancy	And cut 2BR AMI	And increase set-aside to 25%
Benefit to Developer	19%	14%	12%	-8% (a loss to the developer)

OH Recommendation

OH recommends against increasing the setaside. We anticipate that this action, unless accompanied by an increase in the MFTE units' affordability level, would end any participation in this voluntary program, effectively reducing the program's production of below-market units to zero.

**Issue 6: Income Requalification**

Your 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.*

OH Assessment

OH concurs with this direction.

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

We leave this issue for Councilmembers to consider.