Seattle Incentive Zoning

Analysis of data relating to the historical production under Seattle's Incentive Zoning Program

February 4, 2014

Cornerstone Partnership
Keeping Homes Affordable & Communities Strong

On the Cover

Epicenter

Epicenter developed by Security Properties in Seattle's Fremont Neighborhood. Designed by Bumgardner Architects.

Introduction

This memo summarizes Cornerstone Partnership's analysis of data related to the historical production under Seattle's Incentive Zoning program. As the Seattle City Council prepares to evaluate and update the Incentive Zoning program, it seems essential to understand how the program has worked so far and what role it has played in the City's overall effort to respond to the growing need for affordable housing in Seattle. We have made no attempt here to provide qualitative judgments about the program's performance and, at this stage, we are not making recommendations for any changes. The purpose of this memo is simply to compile and establish baseline data about the level of activity under the program and to highlight key metrics that might help inform the upcoming policy discussion.

Key Findings

How has the IZ program contributed to meeting the affordable housing need?

- In some areas, developers have taken advantage of the bonus density offered through the IZ program at high rates but overall participation has been uneven.
- To date a total of only 56 units of housing affordable to households with incomes under 80% of the Median Family Income (MFI) have been produced by developers choosing or required to utilize the on site performance option.
- Instead most developers have elected to make a cash payment 'in lieu' of performance. These bonus contributions totaled $31.6 million through 2013.
- A total of $27.2 million in bonus contributions have been committed to affordable rental projects corresponding to 1,570 units. Of this total:
    - More than $23 million has been committed to a total of 20 new construction and acquisition/rehabilitation rental projects totaling 1,361 housing units. These units were primarily 1-bedroom or smaller units, with over 60% serving households under 30% or under 50% of MFI.
    - An additional $2 million was committed to several rehabilitation projects including 209 units, and $2 million more was committed to a project still in development.
- However because these bonus contributions were comingled with other local affordable housing resources, this total significantly overstates the real impact of the Incentive Zoning program Taking into account the other local resources invested in bonus-funded projects, Cornerstone Partnership estimates that the the $27.2 million committed to date for rental projects made it possible to create 616 units of affordable housing that would otherwise not have been built in Seattle.
- Another $2.18 million was committed for development of owner-occupied housing and downpayment assistance, benefitting 42 households with incomes between 60 and 80% of MFI.
- All together the program has created 714 affordable units since 2001 (56 onsite production units, 42 homeownership units, and cash in lieu payments equivalent to 616 rental units).

How does production with cash contributions compare to onsite production?

- We estimate that a cash contribution of $15.15 per square foot of extra floor area costs a developer roughly $53,350 per unit that would otherwise be required under the performance option.
- Thanks to leverage from the Low Income Housing Tax Credit and other sources, the Office of Housing has been able to produce additional affordable units at a local cost of approximately $44,000 per unit.
- This comparison suggests that, looking backwards, a program that did not allow a cash contribution option would have resulted in production of fewer affordable units.
- Units funded with cash contributions were also affordable to a lower income population – nearly all fee funded units served households earning less than 60% of Median income while the onsite performance units serve households earning up to 80% of Median Income.
- Looking forward, it seems likely that the city's ability to capture state and federal leverage will continue to decline and this change could mean that on site performance would produce more units than could be created with cash payments.

Where are the IZ Units located?

- Units funded with IZ bonus contributions do not tend to be highly concentrated in any one neighborhood. They are more likely to be located in neighborhoods closer to downtown and within close proximity to the properties that provided the bonus funds. It does not appear that greater reliance on the on site production option would result in a significant change in the geographic distribution of units.

Background

Data from 2001 to the present was analyzed to learn more about how the incentive zoning program is functioning. Cornerstone Partnership examined usage rates, bonus contributions, commitments, expenditures, and production. Because the Incentive Zoning program (and the market) has changed over time and because there are many rules, it can be difficult to draw overall conclusions, however there were some patterns.

What share of eligible projects choose to take advantage of the bonus program?

Participation rates have varied over time and neighborhood. Residential projects in the Highrise zone and commercial projects in downtown have tended to participate at a higher rate while other neighborhoods and building types have had varied participation.

The Department of Planning and Development analyzed the rate at which residential or commercial projects participated in the incentive zoning program.

Overall, usage rates varied dramatically by zone, land use (commercial or residential), and time of application, and it is not yet possible to draw many conclusions. There have been relatively few projects eligible for incentive zoning, making it hard to interpret patterns. Additionally, in some cases, even if developers had an option to achieve extra density without affordable housing requirements, projects would not have used it. For example, if a lot is too small, it is not feasible to have a taller building, even if the zoning code allows it. Once the economic consultant completes their work, it may be possible to draw more conclusions.

Table 1

Source: Department of Planning and Development 2014.

	Commercial	Residential	
Downtown DOC1 DOC2 DMC 340 DMC 240 DMC 125	 1 of 1 2 of 3 1 of 1 0 of 0 0 of 1	 0 of 0 0 of 1 1 of 2 2 of 4 n/a	Overall, downtown high rises tended to participate at a high rate.
South of Downtown	1 of 3		Limited development potential in this zone and the one development that participated was atypical of the zone.
S Lake Union (Application started before rezone)	5 of 7	0 of 6	Could use either earlier pre-rezone or post re-rezone rules.
S Lake Union (Application started after rezone)	1 of 7	0 of 0	
Dravus	1 of 2		
High Rise Residential Zone	N/A	4 of 5	
Midrise		8 of 19 historically 0 of 6 currently	Some variation in usage by neighborhood
Suffix	2 of 7		

How many units have been produced onsite?

Developers in Seattle's high-rise zones have an option to either produce affordable units on site or make a cash contribution in lieu of performance. In zones with height limits below 85 feet, onsite performance is the only option for developers wanting to use incentive zoning. Since the Downtown rezone in 2001, every developer has made a cash contribution to the City if allowed per the Land Use Code. Together, affordable units that have been or will be built on-site total only 56 units. These 56 units average 518 square feet in size and have 50-year rent and income restrictions limited to 80% of area median income, adjusted by household size[1].

1 Office of Housing, 2014, "Incentive Zoning Report" provided to Cornerstone Partnership. On 1/23/14

Table 2
Source: Office of Housing Data

Efficiency studios & micros (1)	Studio	1 BR	2 BR	3 BR	TOTAL
13	14	19	10	0	56

(1) Defined as any small residential unit without full kitchen.

How much has been collected in in-lieu payments?

Of the projects using incentive zoning that vested since July 2001, bonus contributions totaled approximately $31.6 million through 2013. Of total bonus contributions, 86% was contributed by developers of commercial projects and 14% was contributed by residential developers. Of the $31.6 million, $27.2 million had been invested in or committed to rental housing projects by the end of 2013. An additional $2.18 million had been committed for assistance for low-income homebuyers.

Table 3
Source: Office of Housing Data

	Payment Option Projects	Amount of Payments
Downtown Commercial	11	$21,106,065
South Lake Union Commercial	3	$6,098,694
Residential	3	$4,434,063
Total		$31,639,092

What has been produced with 'bonus' payments?

Rental Production[2]:
Between 2000 and 2013, Seattle invested $247 million in local housing funds into 117 affordable housing developments with over 6,000 new housing units[3]. The majority of this funding has come from Seattle's Housing Levy and a sizable share has also come from federal HOME and CDBG grants managed by the City. These projects were awarded $23 million in bonus contributions representing about 10% of the City's total investment[4]. Bonus contributions were awarded to a total of 20 new production projects which together will produce 1,361 units of housing. (A number of these projects are still under construction or in development.) On average each project received only $16,935 in Bonus funds per unit created.

However it would be highly misleading to conclude that the bonus funds "created" 1,361 units because these funds were comingled with other local, state and federal housing funds. In total, the typical project over this period cost $192,000 per unit and the total city investment was $40,265 per unit. More recently, between 2009 and 2013 the average tax credit project cost a total of $228,000 per unit including $50,106 per unit in funding from the City of Seattle.

2 Rental production data from Office of Housing, 2014 "OH 2001-2013 projects_Sources_Bonus_sort_2.xlsx" provided to Cornerstone Partnership on 1/22/14
3 These projects include new construction and acquisition-rehab projects, and exclude minor rehab projects.
4 An additional $2.1 million was invested in rehab projects producing 402 units and $2.2 million was invested in homeownership projects producing 42 units.

Figure 1: Breakdown of local sources for Office of Housing Investment

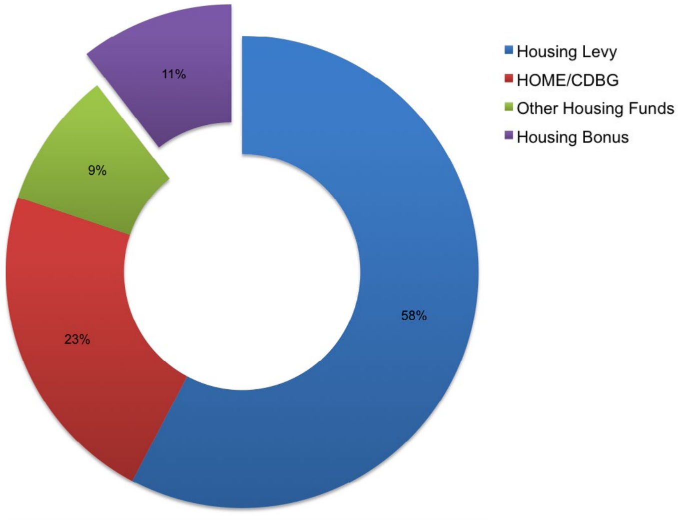
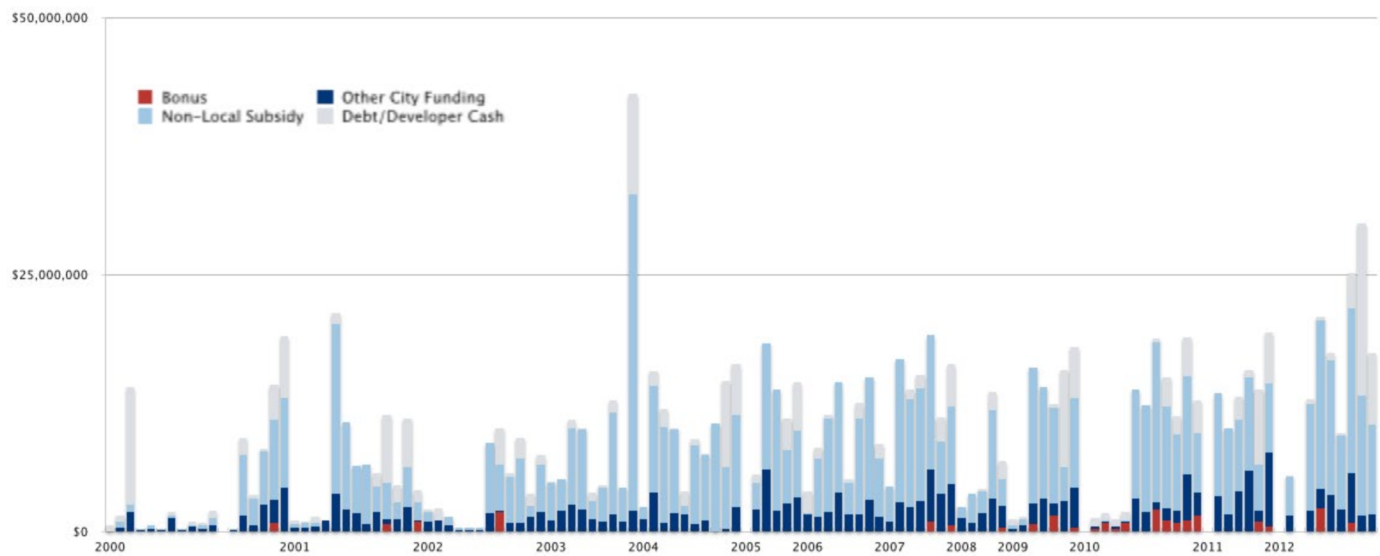


Figure 2: Actual Spending



In order to better evaluate the role that these bonus payments have been playing in Seattle's affordable housing program, Cornerstone Partnership constructed a hypothetical model that enabled us to estimate how many fewer units might have been produced in the absence of the bonus funds.

It is clear that the majority of affordable housing units that received some bonus funding would have been developed with or without the bonus funding. The majority of affordable housing projects that received local investment also benefited from the Federal Low Income Housing Tax Credit (LIHTC). It is important to recognize that there are two different types of LIHTC. The so-called 9% credits provide a large share of the cost of eligible projects and as a result they are in very high demand and limited supply. The 4% credits provide relatively less subsidy and require relatively more investment from local sources and private debt, and as a result they are in less high demand. The 9% credits provide deeper subsidies that enable projects to create units that are more deeply affordable. The majority of Seattle's 9% units serve households below 30% of median income, while most of the 4% units are affordable at the 50% to 60% of MFI level. Each state is responsible for allocating access to LIHTC, and Washington's allocation plan essentially caps the amount of 9% credits that will be awarded for projects in King County each year. However, there is no comparable limit in Seattle's ability to access 4% credits. Seattle has access to enough locally controlled housing subsidy that it has successfully captured the maximum allocation of 9% LIHTC and also funded 2-3 4% projects each year. No amount of additional local funding would increase the city's allocation of 9% credits. But additional local funding increases Seattle's ability to secure 4% credits.

Therefore, while the bonus funds were in fact invested in both 9% and 4% units, had the bonus money not been available, it seems safe to assume that levy funds would have been redirected away from the 4% projects to fully fund the 9% projects. The result would have been fewer 4% units being funded.

To evaluate how many fewer units would have been built, we restructured the actual historical spending data AS IF the city had invested the bonus money only in 4% LIHTC projects[5]. On average, the City investment in 4% LIHTC projects was $44,178 per unit from 2000 to 2013, with a total of 1,998 units produced or in development[6]. At this rate, it is reasonable to estimate that the City's ability to invest $27.2 million in bonus funding made it possible to create approximately 616 units of affordable housing that would otherwise not have been built. Local investment in 4% projects in this period leveraged over $350 million in State, Federal and private financing including grants, debt and tax credit equity. If the City had $27.2 million less available to invest in 4% LIHTC projects, roughly $97 million of this money might not have been invested in Seattle.

However, Seattle's leverage rate is declining. An Office of Housing analysis[7] for LIHTC projects between 2009 and 2013 shows that Seattle funded 2 or 3 4% LIHTC projects per year creating an average of 153 additional units primarily affordable at the 50-60% of MFI level. Seattle invested an average of $8.8 Million each year for a local investment per unit of $57,431. These same 4% projects collectively received an annual average of $11.6 million in tax credit equity, $5.8 million in other public grants and $8.6 million in debt (mostly in the form of tax exempt bond financing). All together each $1 in funding from OH leveraged $3.57 in other non-OH financing. Put another way, OH has accounted for an average of 22% of the financing of tax credit projects in recent years, with other sources making up the remainder.

However, it seems highly possible that this leverage rate will decline in the coming years due to declining State and federal budgets. Without affordable housing grants from State and federal governments, Seattle's share of funding for future 4% LIHTC projects could rise to 36% of the total cost implying a leverage rate of only 1.78 to 1. At this leverage rate, Seattle would need to invest nearly $95,000 per new 4% unit created.

Homeownership Production:

In addition to the investment in affordable rental projects, $2,184,450 of bonus contributions were committed to Habitat for Humanity and Homestead Community Land Trust for housing development and/or downpayment assistance for low-income homebuyers. Forty-two households with incomes under 80% of MFI were assisted through these awards, with an average local investment of $52,000 per household[8].

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5 Nothing in this analysis suggests that the Office of Housing should be investing the bonus contributions only in 4% units. Because the bonus contributions may be the most flexible fund source available, it makes sense that it would be invested in a variety of projects but this pattern of investment, unfortunately, makes it difficult to track and isolate the impact of this one source. This hypothetical analysis makes it easier to see the true contribution of the bonus funds.

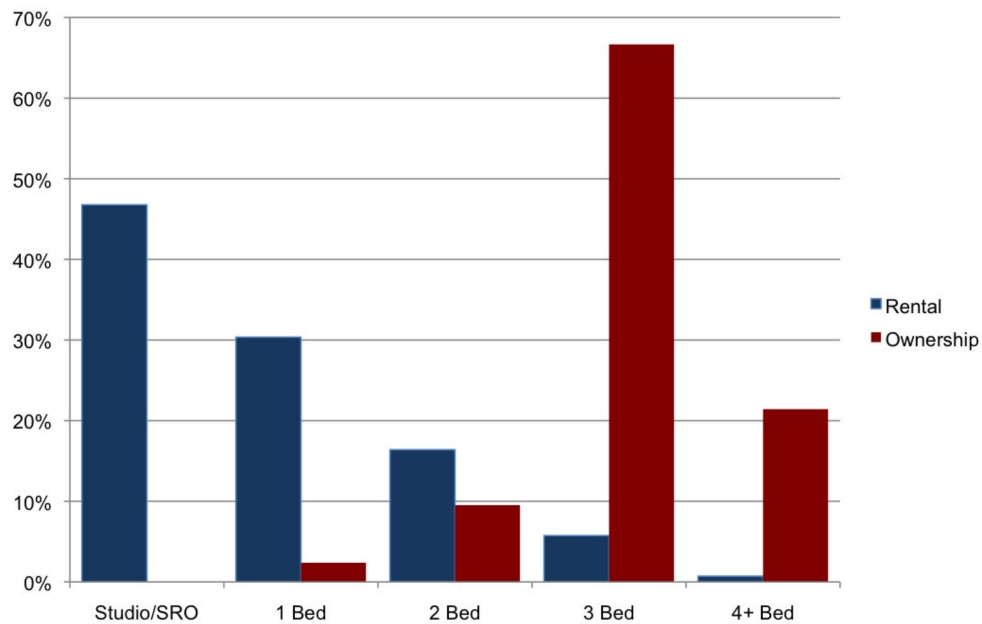
6 For projects between 2009 and 2012 the average city investment was $57,0587.

7 Office of Housing 2013 (c)

8 Office of Housing Data from "Location, affordability & size of IZ ownership housing.xlsx" provided to Cornerstone Partnership on November 22, 2013.

While the rental units that were created with bonus contributions were largely studios and one-bedroom units, the homes purchased were nearly all 3- and 4-bedroom homes.

Figure 3: Number of Bedrooms in Rental and Ownership Units
Source: Office of Housing Data



How does production with cash contributions compare to onsite production?

The complexity of Seattle's various incentive zoning requirements makes it difficult to know how many units would have been produced if developers that made cash contributions 'in lieu' of onsite production had instead selected the onsite performance option. For the three downtown highrise projects using incentive zoning since it was implemented in 2006, developers contributed $4.4 million for affordable housing. The incentive zoning program enabled these projects to build a total of 289,918 gross square feet of bonus residential floor area[9].

In order to estimate how much affordable housing would have been created if these developers had selected the onsite option, we used the performance set-aside formula for affordable housing in Chapter 23.58A (14% of bonus residential floor area). We assumed that units would average 518 nrsf, since that is the average size of the units promised to date by developers through onsite performance[10].

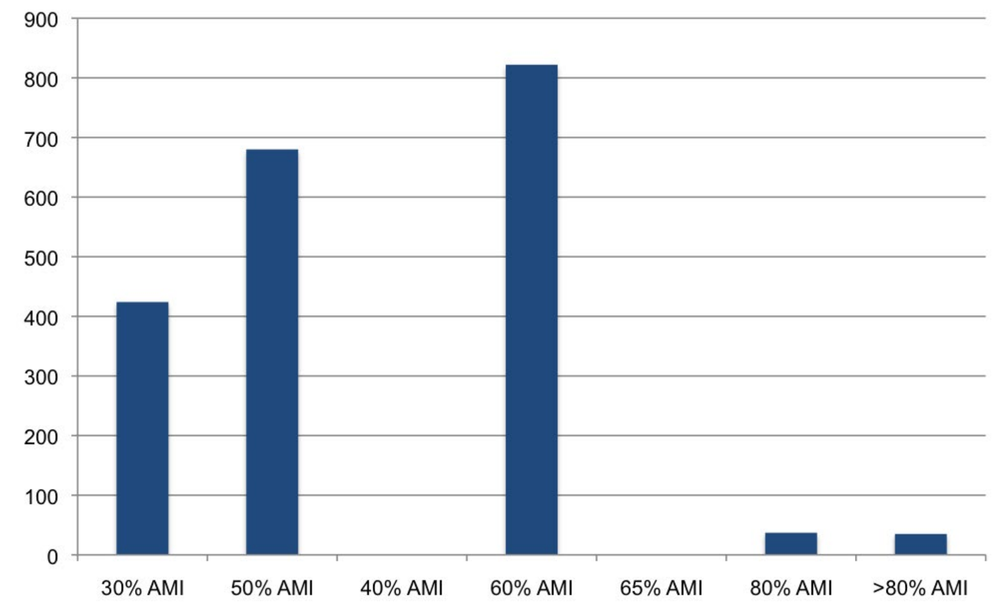
With those assumptions, 289,918 bonus feet would have created a requirement for about 78 units affordable to households earning 80% of the Area Median Family Income.

Rather than build these 78 onsite units, developers elected the payment option generally at the rate of $15.15 per square foot of bonus residential floor area which totaled $4.4 million. This works out to a bonus contribution of approximately $56,055 per unit that would have been created.

9 Office of Housing, 2014, "Incentive Zoning Report" provided to Cornerstone Partnership. On 1/23/14.
10 Office of Housing, 2014, "Incentive Zoning Report" provided to Cornerstone Partnership. On 1/23/14.

As we described above, the city was able to generate additional 4% LIHTC units at a cost of about $44,000 per unit and at that rate these bonus contributions would have 100 units – 22 more than would have been produced onsite. Not only did leverage allow the city to create more units through the payment option, but these units were typically affordable at 50-60% of MFI rather than the 80% that would be required for onsite units. It is also likely that the units produced with the bonus funds were significantly larger than the 518 square foot average for onsite units.

Figure 4: Income Levels served by 4% LIHTC Projects
Source: Office of Housing Data



Looking forward however, it seems likely that the city's ability to leverage state and federal funding will continue to decline. If, in the future the City is unable to rely on State and Federal grant sources, local investment per new 4% LIHTC unit could rise to $95,000[11]. This would reverse the economics such that onsite performance produced more total units than would be produced by bonus contributions – however these units would still be somewhat less affordable than the units created with bonus contributions.

Table 4: Comparison

	On Site Performance	Payment (historical Leverage)	Payment (projected Leverage)
Bonus Square Feet Awarded	289,918	289,918	289,918
Payment ($15.15 per gsf of bonus residential floor area)		$4,392,258	$4,392,258
Units	78 at 80% MFI	100 at 60% of MFI (4% LIHTC)	46 at 60% of MFI (4% LIHTC)

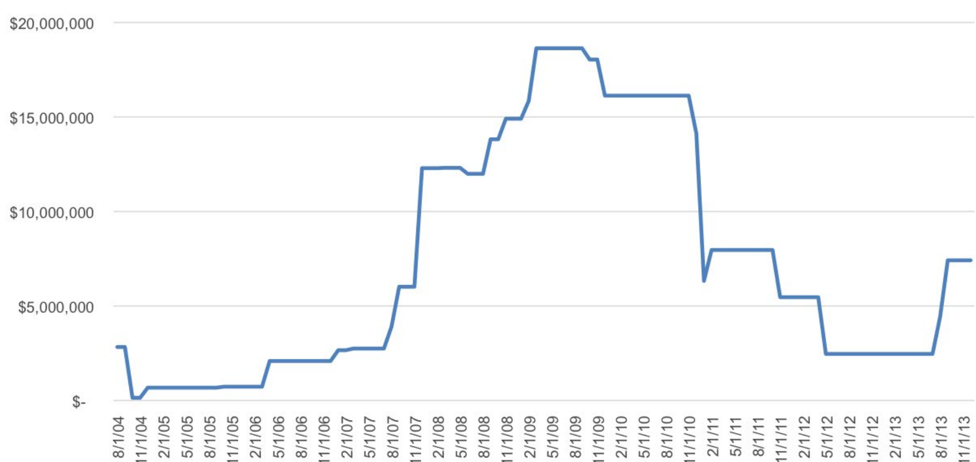
11 Office of Housing, 2013, "Modeling TC Production with Bonus Funds_revised.xls" provided to Cornerstone Partnership on 12/14/13.

How long does it take to spend the cash contributions?

Another consideration when evaluating the tradeoffs between bonus contributions and onsite production is the fact that units built with bonus contributions typically don't become available until several years after the projects using the extra floor area are occupied. The Office of Housing provided Cornerstone Partnership with data on the timing of receipt of bonus contributions and the dates of commitment and expenditure of bonus funds between 2004 and 2013.

Developers of projects vested to housing bonus code provisions in effect since July 2001 through 2013 contributed $31.6 million and by the end of 2013 the Office of Housing had invested $27.2 million of these funds into 25 affordable housing developments[12]. The table below shows that bonus contributions were being paid in at a relatively high rate in 2007 and 2008 but the market downturn led to minimal incentive zoning activity between 2010 and 2012. However during these 'down' years, the program invested bonus funds received from projects developed before the downturn into new affordable projects that were built during the recession.

Figure 5: Uncommitted Funds
Source: Office of Housing Data, Cornerstone Partnership Analysis



We evaluated the length of time before an equivalent amount of funding was committed and expended and found that typically, the first commitment of a given bonus contribution was made after 33 months (2.75 years) and paid out 47 months (3.9 years) after the contribution was received[13]. Initially the Office of Housing was somewhat constrained regarding the location of projects that could receive bonus funds. Specifically, bonus funds generated downtown were required to be expended downtown. In June of 2009, that restriction was removed by ordinance and the funds generated from downtown development are now allowed to be invested in projects downtown, in urban centers adjacent to downtown, and in transit corridors that provide downtown service. Funds have been committed more rapidly since.

12 Office of Housing, 2013, "Intake Commitment & Expenditure of Bonus $ - Dates_new.xlsx" provided to Cornerstone Partnership on 12/12/13.

13 While the Office of Housing does not keep bonus contributions from different projects separate, in order to evaluate the typical length of time between receipt and commitment or expenditure of funds, Cornerstone constructed a model that assumed that money were spent in the order that it was received (i.e. funds from a given project were not spent until all money from prior projects had been fully spent).

Where are IZ Units located?

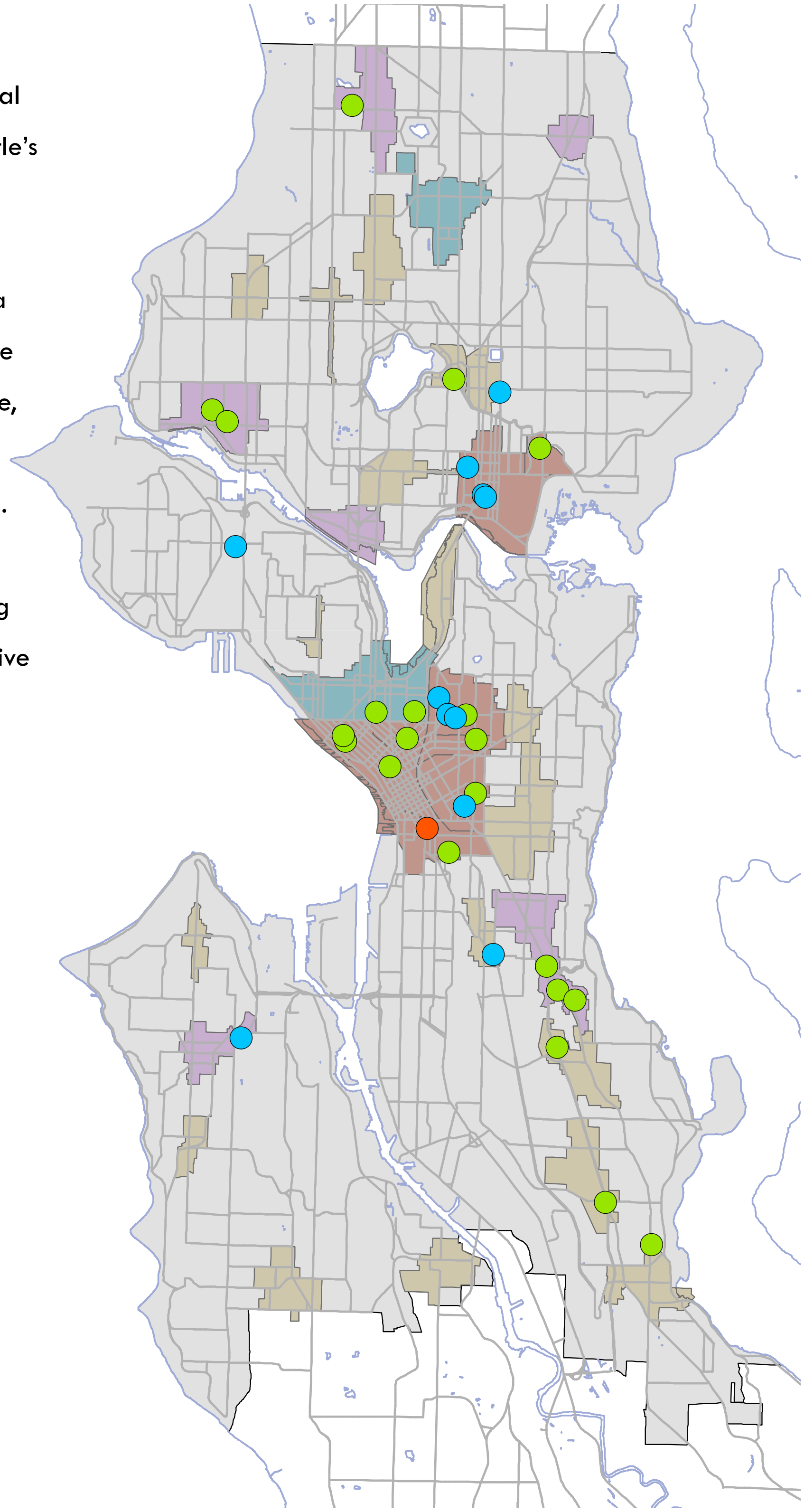
There is a tradeoff between producing as many housing units as possible and ensuring that the program contributes to economic integration of higher cost neighborhoods. If maximizing the number of units was the only goal, investing bonus contributions from projects in high cost locations in less expensive locations could be a successful strategy. In some other cities reliance on collection of In Lieu payments has resulted in development of affordable units in lower income communities far from the high opportunity neighborhoods where new market rate housing is being built.

However, in Seattle, in spite of the high reliance on bonus payments this does not appear to be happening. Both the onsite production affordable units and Bonus-funded affordable rental housing is largely concentrated in the central neighborhoods, near job and transit centers, including in many of the higher cost areas around downtown. Units funded with IZ bonus contributions do not tend to be highly concentrated in any one neighborhood. They are more likely to be located in neighborhoods closer to downtown and within close proximity to the properties that provided the bonus funds. It does not appear that a greater reliance on the on site production option would result in a significant change in the geographic distribution of units or that on-site performance units would located in neighborhoods of higher economic opportunity.

Figure 6: Affordable Housing Production Through the City's Incentive Zoning Since 2001

The Residential and Non-Residential Bonus element of the City of Seattle's incentive zoning program enables developers to provide affordable housing units in exchange for extra floor area. Developers can provide the affordable housing units on-site, off-site, or through fee-in-lieu payments to the Office of Housing.

This map shows affordable housing produced through the City's incentive zoning since 2001.



Types of Development in Incentive Zoning Program

- Fee-in-Lieu
- Off-Site Performance
- On-Site Performance

Urban Villages

- Hub Urban Village
- Residential Urban Village
- Urban Center
- Urban Center Village

City of Seattle
Office of Housing

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