Multifamily Tax Exemption: Major Policy Issues

Review Topics for Seattle City Council's Housing, Human Services, Health and Culture Committee
March 27, 2013

At the Committee meeting on Wednesday March 27, the Office of Housing plans to review five policy issues with Committee members. Previously we have discussed administrative issues raised by last fall's audit (February 13) and lower-level policy issues (February 27). Now we are ready to introduce and discuss the policy issues that affect the program's direction.

Issue 1: Review Program Goals

The Seattle Municipal Code currently establishes nine goals for the MFTE program (see box). Based in part on the City Auditor's 2012 program review, City Council will decide whether to modify the goals to ensure that they are measurable and attainable. In particular, the Auditor questioned goals related to stimulating development.

As part of the broader review of the MFTE Program, the Committee's recommendations on the appropriateness of these goals and their relative priority would be most helpful.

From SMC 5.73.010
The purposes of this chapter are [emphasis added]:

1. To encourage **more Multifamily Housing** opportunities within the City;
2. To **stimulate new construction** and the **rehabilitation of existing** vacant and underutilized buildings for Multifamily Housing;
3. To increase the supply of Multifamily Housing opportunities within the City for **low and moderate income households**;
4. To increase the **supply of Multifamily Housing opportunities in Urban Centers that are behind in meeting their 20-year residential growth targets**, based on Department of Planning and Development (DPD) statistics;
5. To **promote community development, affordable housing, and neighborhood revitalization** in Residential Targeted Areas;
6. To **preserve and protect buildings, objects, sites, and neighborhoods** with historic, cultural, architectural, engineering or geographic significance located within the City;
7. To encourage the **creation of both rental and homeownership housing for Seattle's workers** who have difficulty finding affordable housing within the City;
8. To **encourage the creation of mixed-income housing** that is affordable to households with a range of incomes in Residential Targeted Areas; and
9. To encourage the development of **Multifamily Housing along major transit corridors**.

Issue 2: Geographic Span

Questions about program goals are tightly integrated with questions about the program's geographic span. State law requires that the program be targeted to areas that City Council determines to lack "sufficient available, desirable, and convenient … housing, including affordable housing."

MFTE currently operates in all of the City's 39 "residential targeted areas"; these are largely (though not perfectly) contiguous with the City's urban centers and villages.

While the MFTE program generally promotes greater affordability than otherwise possible in higher-rent areas, it is also used to promote development in cooler real estate market areas. Is it appropriate to use MFTE for both purposes? What data points could help support this decision?

Issue 3: Affordability Levels

Current MFTE affordability limits (affecting both maximum income and rent) vary by household size. For example, income for 1 person occupying a studio apartment must not exceed $39,455. Two people occupying a 2BR could earn up to $58,990; three people in a 2BR could earn up to $66,385.

The snapshot shown on the following table compares 2013 MFTE rent limits to Dupre & Scott-reported averages for newer construction as of Fall, 2012. The picture can change quite dramatically over time, and even more dramatically from a building commanding high rents to another commanding lower rents.

Estimated MFTE Rent Impacts, 2013

		RENT			
Unit Size	AMI	MFTE Maximum Monthly Rent*	Reference: Market**	Rent Savings to Tenant ($)	Rent Foregone by Owner***
0BR	65%	886	1,249	363	29%
1BR	75%	1,201	1,574	373	24%
2BR	85%	1,519	1,848	329	18%

*MFTE rents shown are for 2013. They are reduced to reflect a utility allowance of $100 for a studio and 1BR and $140 for a 2BR.
**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.

Models for Retained Tax Savings

Office of Housing staff have recently completed initial financial modeling at different AMI levels to help guide deliberations about appropriate affordability levels. The model focuses on averages; the actual impact of a given AMI threshold can vary widely by location and among individual properties.

In the past, MFTE affordability levels have been benchmarked by comparing forgone rent revenue to tax savings. The target was set at roughly 50%: for every dollar of tax exemption, a landlord would forgo 50 cents of revenue through reduced rents for at least 20% of the units. That target was intended to balance the need to provide an incentive for developer participation with a need to achieve reduced rents for up to 20% of units in a project . Because market rents have outpaced growth in HUD AMI levels, current modeling suggests that, given status quo affordability levels (65/75/85), an average owner's retained tax savings are now estimated at 37%, down from the 52% of several years ago.

Questions

MFTE income and rent limits have floated around over the years, ranging from just 60% of AMI, regardless of unit size, back in 2004 to 90% of AMI for a 2BR in 2008. Current AMI thresholds became effective in 2011, and we now face some questions, including:

- Should they be changed?
- Should we maintain a graduated set of income levels, depending on unit size?
- Should we consider differential rates depending on residential targeted area?

Issue 4: Percent of Units Affordable

Under State law, 20% represents the minimum number of set-aside units for the 12-year MFTE program. Local governments have discretion to require a greater set-aside. Depending on how these changing assumptions factor into the model, should we consider a greater set-aside than the current 20% of units?

Issue 5: Unit Size Preferences

Developers of over 1,000 very small studios, averaging around 200 square feet, have accessed the MFTE program. Due to the studios' small size, rents naturally hover around $600 to $700 per month, which is consistent with about 50% of area median income. While rents are substantially lower than a traditional studio on a per-tenant basis, rents are substantially higher on a per-square-foot basis, and some have questioned the tax exemption program's influence in either spurring the projects' development or enabling affordability levels that would not otherwise occur. Should very small studios be distinguished from traditional studio apartments for purposes of either eligibility for the program or affordability levels?

At the other end of the spectrum, the MFTE program's tiered affordability levels (lower for a studio, higher for larger units) presently provides developers a modest incentive to include larger-size units in their buildings. Should the program continue to provide higher income and rent thresholds for larger units?   Are there other options for encouraging units with a greater number of bedrooms?