MEMORANDUM

TO: City Council

FROM: Eric Holmes, City Manager
Chad Eiken, Community and Economic Development Director

DATE: September 28, 2020

SUBJECT: Proposed Revision to the Multi-Family Tax Exemption Program – First Phase

This memo summarizes the background and substantive elements of a proposal to revise the City's multi-family tax exemption (MFTE) program in two key areas. City staff developed the proposal after receiving feedback from City Council, conducting research on MFTE programs in other cities and engaging the City Center Redevelopment Authority (CCRA). The proposal retains and strengthens the linkage between the MFTE program and the City's efforts to expand access to affordable housing that City Council established in 2017 and provides additional flexibility to developers.

Executive Summary

The current set of proposed changes are the first of two phases of possible revisions to the MFTE program and include two key areas which are a high priority, based on recent input from City Council.

Key characteristics of the proposed Phase I of MFTE program refinement include:

- **Revision to affordable rent levels.** Affordable rent levels based on Vancouver median household income instead of Portland metropolitan area median family income.
- **Retention of the current 8, 10 or 12-year exemption terms.** An exemption term of 8, 10 or 12 years will continue to be available in exchange for an owner offering 20% of the units at rents affordable to households earning 100%, 80% or 60% of the revised median income.
- **Removal of the public benefit option.** The option for a developer to provide a public benefit in excess of other required improvements in exchange for an 8-year exemption is removed.
- **Addition of a fee-in-lieu of using an affordable housing option.** A new option is provided that allows a developer to pay a fee in-lieu of providing affordable housing in exchange for an 8-year exemption. The fee would support the city's Affordable Housing Fund (AHF) and the AHF's various affordable housing programs.

Phase II is intended to include:

1. consideration of an expansion of geographic boundaries of program to include Mill Plain Corridor, broaden Fourth Plain Corridor, and expand the Vancouver City Center Vision MFTE boundary; and

2. review the overall efficacy of the program, review and refine policy goals, and adjust the incentive by area as needed to accomplish policy goals.

A brief background of the MFTE program is provided below followed by more specific information on the proposed revisions. Staff will be presenting these options to City Council and will be requesting direction at a City Council workshop on September 28, 2020. After receiving direction from City Council staff will work with the CCRA on specific revisions to the MFTE program to bring back to City Council for final consideration and adoption.

Background

The State of Washington established the MFTE program in 1995 (Revised Code of Washington (RCW) Chapter 84.14) to help cities stimulate residential development in designated urban centers and to assist local governments in meeting density goals to help lower the infrastructure and operating costs associated with local government services. While the purpose of the law includes affordable housing, the program is not exclusively intended to be an affordable housing program. The 1995 MFTE program exempted the value of eligible housing improvements from property taxes for a period of 10 years and had no affordable housing requirement.

In 2007 the state revised the MFTE statute and reduced the 10-year exemption to 8 years and offered a 12-year exemption to projects that included at least 20% of their units as affordable housing at 115% of Area Median Income (AMI). Under the MFTE program land and non-residential improvements are not exempt.

In 2019 the Joint Legislative Audit and Review Committee (JLARC) issued a report assessing the impacts of the program state-wide. That report can be found here. Further resources can be found on the Municipal research Services Center site here.

The City of Vancouver adopted a multi-family tax exemption program in 1997 to stimulate the construction or rehabilitation of multifamily housing as part of the Esther Short Redevelopment Plan and create a more active and vibrant downtown. The MFTE program was a major part of the City's downtown redevelopment strategy and provided an incentive to attract more residents to the downtown area. Currently, the city offers the MFTE program in two designated residential target areas: The Vancouver City Center Vision Area (VCCV) and the Fourth Plain Corridor Subarea (added in 2007).

The Vancouver City Council enacted a modification to the city's MFTE program in January 2017. The city's 2017 modification made the following tax exemption options available to applicants:

- An 8-year exemption for market-rate projects offering public benefits negotiated through a development agreement process.
- An 8-year exemption for projects with 20% of units affordable to households earning up to 100% of area median income (AMI).
- A 10-year exemption for projects with 20% of units affordable to households earning up to 80% AMI.

- A 12-year exemption for projects with 20% of units affordable to households earning up to 60% AMI.

The City has approved 30 MFTE program applications to date representing an estimated $550 million private investment. The table below provides a summary of the approved projects. As shown, the city has approved nearly 2,600 units including 653 affordable units. Of the 653 affordable units 424 are in projects that received Federal tax credit financing support and are required to limit monthly rents to amounts affordable to households earning 60% of the Portland median family income. Another 25 units are affordable due to other financing. The remaining 204 affordable units are in projects that only received a MFTE tax exemption.

Table 1. Summary of Projects and Units under the MFTE Program (2001-Present)

Multi-Family Tax Exemption Program Summary	Completed	In Construction	In Permitting	TOTAL
Approved Projects				
VCCV	17	6	4	**27**
Fourth Plain	2	1	0	**3**
Total Approved Projects	**19**	**7**	**4**	**30**
Total Units				
VCCV	1,266	663	420	**2,349**
Fourth Plain	212	36	0	**248**
Total Units	**1,478**	**699**	**420**	**2,597**
Affordable Units				
VCCV	308	43	82	**433**
Fourth Plain	212	8	0	**220**
Total Affordable Units	**520**	**51**	**82**	**653**
Affordable Units				
Federal Tax Credit Projects	424	0	0	**424**
Other Program Units			25	**25**
MFTE Only Projects	96	51	57	**204**
Total Affordable Units	**520**	**51**	**57**	**653**

Issue 1: Revisions to Affordable Rent Levels

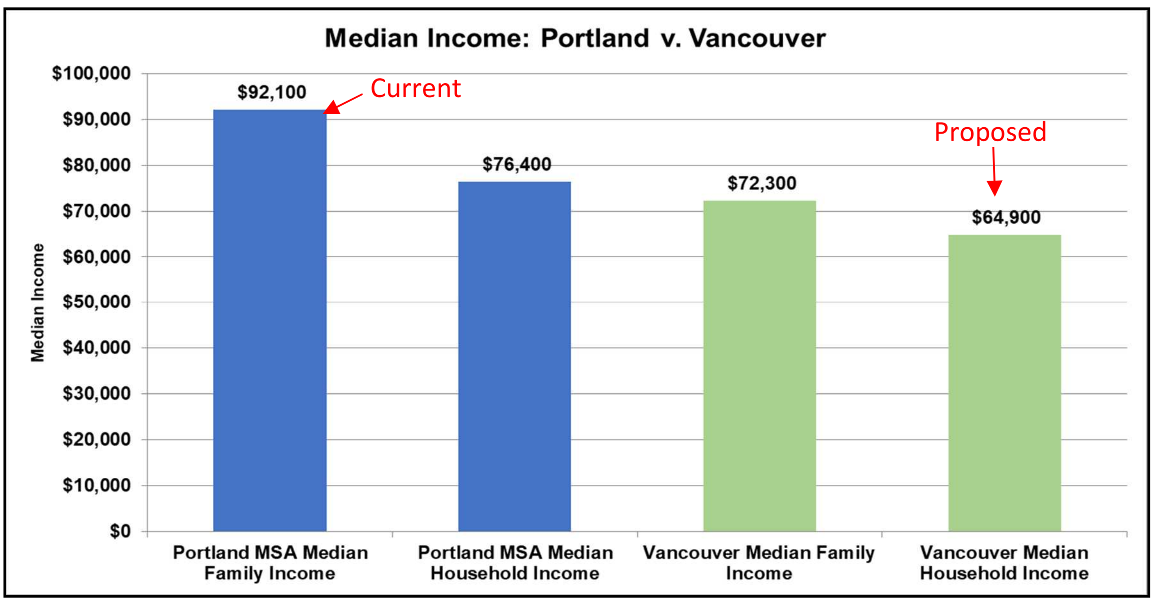
City Council, CCRA board members, city staff, and the public have all commented on the fact that the MFTE program's affordable rent levels are significantly higher than the average rent in Vancouver and Clark County. The city's MFTE program currently defines affordable rent in Vancouver using the Portland metropolitan statistical area (MSA) median family income which is the same source the federal Housing and Urban Development (HUD) program uses for Vancouver Community Development Block Grant (CDBG) programs. As discussed in this memo, City staff recommend using Vancouver's median household income as the basis for establishing affordable rent limits and applying a reduction factor to the Portland MSA Median Family Income index.

Adjusting the MFTE income level based on the Vancouver median household income will provide a more appropriate basis for establishing affordable rents used in the MFTE program. Shortcomings associated with using the Portland MSA's median family income as the base include:

- The U.S. Census Bureau's definition of a "family" includes a group of two people or more related by birth, marriage, or adoption and residing together. It excludes single individuals and non-family households (roommates) which are 35% of the households in Vancouver and 36% of the households in the MSA.
- Vancouver "Families" represent roughly 10% of the total Portland MSA families – meaning Vancouver's families and their incomes are woefully underrepresented in the estimate of Portland MSA median family income.
- Family income is higher than overall household income since it only includes households of two or more persons that are related.

The below table illustrates the difference between incomes in the Portland MSA and City of Vancouver using the median family income or median household income as the basis for the program.

Table 2. Comparison of Median Family Income and Median Household Income (Family of 4).



In addition, the MFTE program's use of median family income to determine affordability is in conflict with the MFTE program's definition of households which includes "…a single person, family or unrelated persons living together." HUD's median family income estimate is based on the U.S. Census Bureau's American Community Survey (ACS) median family income data. The ACS defines a family as "…a group of two people or more (one of whom is the householder) related by birth, marriage, or adoption and residing together." Family households are a subset of total households and exclude single person households or households with unrelated individuals.

The data and methodology for establishing the Vancouver median household income comes from the same source and uses the same method as the Portland MSA median family income. The data source for the 2020 estimate is the Census Bureau's American 2017 Community Survey (ACS) 1-year estimate inflated to 2020 using the Consumer Price Index and the same methodology used by HUD. The 2020 Vancouver median household income estimate can then be converted to income limits for various household sizes and then to affordable rent levels (at 30% of income) for each unit size using the same methodology used by HUD.

Vancouver's 2020 median household income estimate using HUD's methodology is $64,900 and is 29.5% lower than the $92,100 Portland MSA median family income. Despite the smaller sample size, the accuracy of the ACS estimate of Vancouver's median household income is well within the criteria used by HUD.

A table comparing the current MFTE program affordable rent level to the affordable rent level using Vancouver's median household income (adjustment in column 3) is provided below.

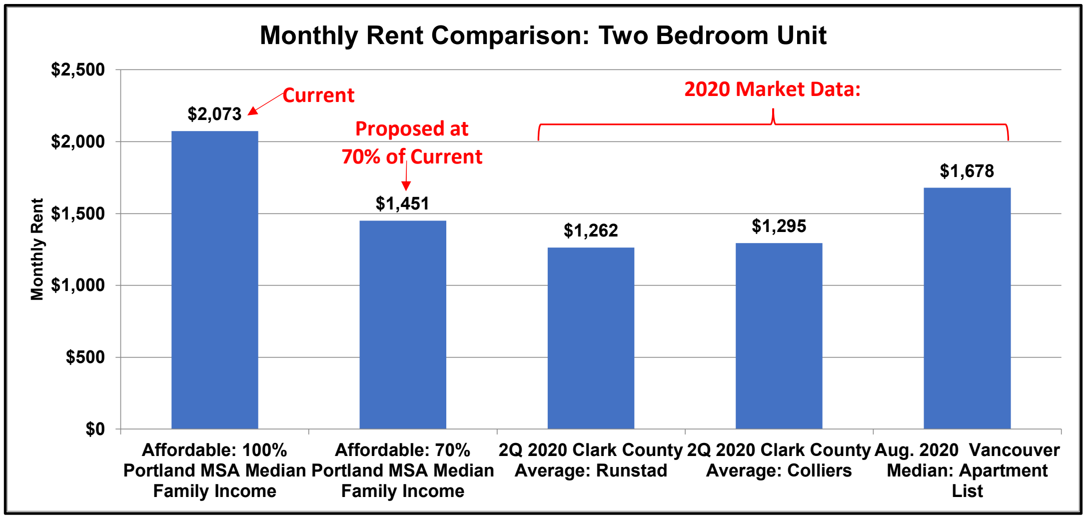
Table 3. Comparison of Rents Using Median Family Income vs. Median Household Income*

Unit Size (#BR)	Current Affordable Rent Using Portland MSA Median Family Income	Proposed Affordable Rent Using 70% Adjustment Factor	Reduction: Dollar Amount	Reduction: Percent
Studio	$1,613	$1,128	-$485	-30%
1	$1,728	$1,209	-$519	-30%
2	$2,073	$1,451	-$622	-30%
3	$2,384	$1,668	-$716	-30%
4	$2,672	$1,870	-$802	-30%

*100% of Area Median Income

As shown, the proposed affordable rent level for a two-bedroom apartment is $1,451 or $622 lower than the rent using the Portland MSA median family income. For context several surveys suggest the proposed affordable rent level is comparable to the current market rent. Data for the average rent in Clark County from the Washington Center for Real Estate Research 2Q Apartment Report and Colliers 2Q 2020 Multi-Family Market Report and data from Apartment List on the median rent in Vancouver suggest the market rent for a two bedroom apartment is between $1,262 and $1,678. The midpoint of this range is $1,470 or $19 (1.3%) higher than the proposed affordable rent using Vancouver median household income.

Table 4. Comparison of Median Income Indices to Actual Rents in Vancouver.



Current MFTE program rules allow an 8, 10 or 12-year exemption for providing 20% of units affordable to households earning 100%, 80% and 60% of Portland MSA median family income respectively. Under the proposed approach, an 8, 10 or 12-year exemption would be available for providing 20% of units affordable at rent levels of 100%, 80% and 60% of Vancouver median household income. A table summarizing the proposed rent levels for each unit size under the three affordable housing options is provided below. Note that the MFTE affordable rent levels would be adjusted annually on April 1 using the HUD methodology and the most recent ACS data on Vancouver median household income.

Table 5. Proposed Rent Levels (8-10-12 Year Exemption) Using Median Household Income.

	8 Year Exemption	10 Year Exemption	12 Year Exemption
Unit Size (#BR)	Affordable at 70% of Portland Median Family Income	Affordable at 55% of Portland Median Family Income	Affordable at 45% of Portland Median Family Income
Studio	$1,128	$886	$725
1	$1,209	$950	$777
2	$1,451	$1,140	$933
3	$1,668	$1,311	$1,072
4	$1,870	$1,469	$1,202

The change to Vancouver's MFTE Program to adjust the Median Family Income threshold by -30 percent (derived from the Vancouver Median Household Income) will result in rents under the 8, 10 and 12-year Affordable Housing Options that are more aligned with actual incomes and rents in Vancouver.

City Council is authorized to adopt adjustments to affordability and income eligibility criteria by RCW 84.14.030(2) as follows: *"The multiple-unit housing must meet guidelines as adopted by the governing authority that may include height, density, public benefit features, number and size of proposed development, parking, income limits for occupancy, limits on rents or sale prices, and other adopted requirements indicated necessary by the city or county."*

Issue 2: Removal of the Public Benefit Option

The city's MFTE program currently allows an applicant to receive an 8-year property tax exemption, without providing 20% of the units as affordable housing, so long as the developer provides other public benefits over and above those required by the city's approval of the project. The Vancouver Municipal Code (VMC) section for the MFTE provides general guidance on what a public benefit is including "…enhanced design, public art, additional parking or structured parking, enhanced landscaping, enhanced infrastructure (e.g. wider sidewalks, undergrounding utilities), homeownership component, energy efficiency…".

The VMC guidance provides examples of the types of public benefit but lacks specific criteria which has made the review and approval process a challenge for applicants, staff, and decision makers. For example, there is no direction on the minimum cost or value of the public improvements, the nexus between the value of the forgone affordable units, or the location and accessibility of the public improvements – all of which has caused confusion.

To-date the city has received four applications using the public benefit approach and city staff have negotiated with each applicant to determine the public benefit to be provided. Each negotiation has required significant staff and developer time. A final agreement regarding the negotiated public benefit is required by the VMC to be memorialized in a development agreement that is approved by City Council. The formal approval process adds cost to applicants and requires an additional investment of time by staff and City Council.

The subjective nature of the public benefit and the lack of guidance on the appropriate value or cost have made negotiations with applicants a challenge for staff and leads to an opaque policy discussion for the City Council when projects come before them for consideration. To address these challenges, staff worked with the CCRA to consider a few options:

Table 6: Possible Options to Revising Public Benefit

Options	Considerations
Option 1: Retain the public benefit requirement but define it more clearly in terms of: • Value (public amenity should approximate $2,000 per unit in value • Proximity to the project site (preference for amenity that is on the project site or within several blocks); and • Type of public improvement (park or trail improvements, public art installation, or transportation improvement beyond typical requirements of development);	• Would add clarity to the definition of public benefit, assuring more consistency between projects. • Maintains flexibility in administration for the public benefit concept based on individual project characteristics. • Retains some ambiguity inherent in the public benefit concept; requires project-by-project negotiation.
Option 2: Eliminate the public benefit option in favor of a fee-in-lieu of the required public benefit to be paid at $2,000 for each unit in the project, at the option of the developer, which could: • Be committed fully to an affordable housing fund, or • Split the fee-in-lieu between affordable housing (directed to the AHF) and a to-be-created public amenity fund (with program administration also to be determined).	• Provides clarity for city and applicant through a quantifiable payment to the City in lieu of taxes; Assures absolute consistency between projects under program administration. • Draws a logical nexus between market rate housing development and support of funding for additional affordable housing. • Splitting the fee between a to-be-created public benefit program and the AHF could "water down" positive impact on affordable housing. • Affordable housing funds derived through a fee in lieu program could be used to support development of income-based housing that would remain affordable for a longer period (up to 20 years) than that allowed under the MFTE program (max 12 years).
Option 3: Eliminate the affordable housing options (100%-80%-60% AMI) and apply the fee-in-lieu ($2,000 per unit) to all MFTE projects • Any project would qualify for the abatement if up-front fee is paid • Fee would be directed to the AHF to increase supply of very low income housing (at or below 50% AMI)	• Streamlines the approval process (no development agreement required). • Eliminates the need for the city to monitor rents and incomes of renters in approved affordable units (new projects only). • Could have an unintended effect of decreasing the number of new projects with moderate income units.

The City Center Redevelopment Authority, which is charged in their bylaws with periodically reviewing the effectiveness of the MFTE Program, recommends that the city's MFTE program provide an option for an applicant to pay a fee in-lieu of providing affordable housing or a public benefit (Option 2 above). The fee-in-lieu option might be appealing to applicants who do not want the administrative burden that comes with offering affordable units. The exemption term associated with the fee-in-lieu option would be limited to eight years.

Under a fee-in-lieu option the applicant would pay a fee of $2,000 per multi-family unit to the city in exchange for the exemption from certain taxes under the program. The staff recommendation is to have the fee go into the city's existing Affordable Housing Fund (AHF). The AHF is funded by a six-year voter approved property tax levy and supports several programs to expand the availability of affordable housing for the most vulnerable households within the city which earn 50 percent or less of the area median income. AHF programs include grants to build and preserve affordable housing in Vancouver, rental assistance and services to help households avoid an eviction or access a rental unit and temporary shelter for people experiencing homelessness. AHF grants require units to be retained as affordable for a full 20 years instead of the 8, 10 or 12 years under the current MFTE program.

Basis for Determining Recommended Fee per Unit

The $2,000 per unit fee amount is based on a June 2019 analysis that looked at:

- Fees on new development related to affordable housing charged by other cities.
- The impact on developer/owner rental income of requiring affordable housing.
- The value of the tax exemption to the developer/owner over the exemption period.

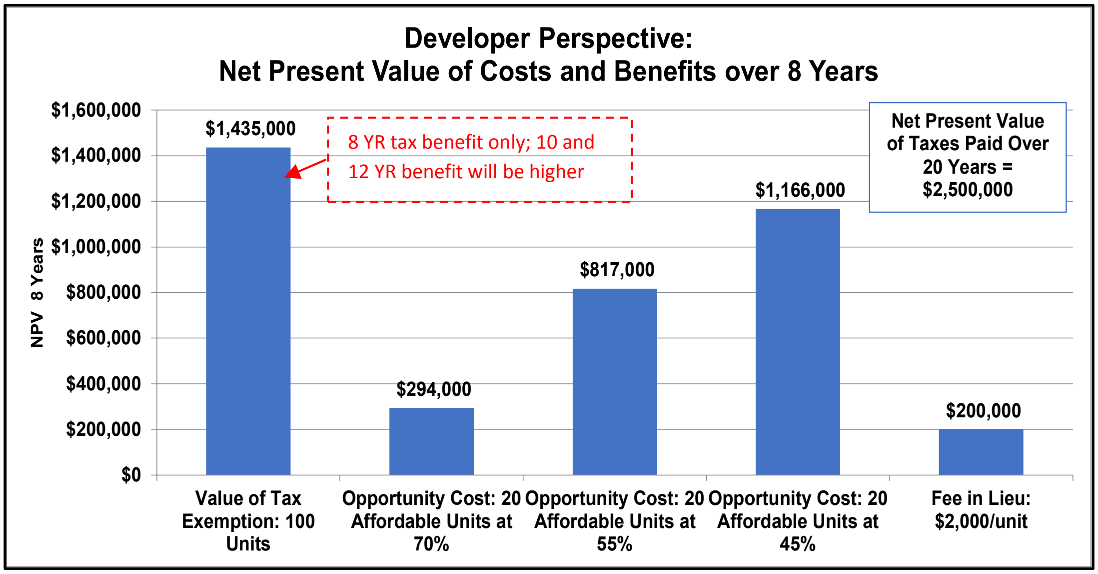
The 2019 affordable housing fee analysis found that fees in some cities ranged up to $20 per square foot or $20,000 for a 1,000 square foot unit. The CCRA recommended a fee of $10,000 per affordable unit (assuming affordable units are 20% of total units) or a fee of $2,000 per unit for all units. For context, the city's AHF provides grants of up to $50,000 per affordable unit for a 20-year affordable housing commitment. The equivalent value for an 8-year commitment to affordability would be $20,000. In addition, the estimated net present value benefit of an 8-year tax exemption to the owner was estimated at just over $50,000 per affordable unit or $10,000 per unit for all units.

The CCRA identified $10,000 per affordable unit as the appropriate fee citing the MFTE program's main goal of encouraging residential housing in targeted areas, the higher cost of developing projects in the two target areas and the other benefits the city receives from the creation of more housing and long term generation of tax revenue in the targeted urban areas.

A fee in lieu requirement in lieu of providing affordable units, in conjunction with elimination of the current "public benefit" requirement, would create a supplemental source of funding for affordable housing which has been identified as a high priority by City Council. The fee in lieu would streamline the review process by eliminating lengthy negotiations over the adequacy of proposed public amenities as well as the need for a development agreement. Further, the fee in lieu would provide greater consistency among market rate MFTE projects.

The below table compares the net present value of the tax benefit for a 100-unit, market rate project (8 years) with the opportunity cost of providing affordable rents to 20% of the project under the 60%, 80% and 100% of AMI options (note that the tax benefit is greater for the 60% and 80% options since the exemption period is 10 and 12 years, respectively). The fee-in-lieu of providing affordable units is also shown for comparison purposes. In the below example, the proposed fee-in-lieu is slightly less than the opportunity cost of affordable units under the 8-year, 100% of AMI option.

Table 7. Value of Tax Exemption vs. Opportunity Costs and Fee-in-Lieu



City Center Redevelopment Authority Input

The CCRA reviewed the currently proposed revisions to the MFTE program at a special meeting on September 21, 2020. The consensus of the CCRA was:

- Support for the proposed 30% reduction in the Portland MSA Median Family Income to better reflect Vancouver income and rents.
- Support for continuing to offer 8, 10 and 12-year exemptions as incentives for additional housing in the target areas as well as incentives for more affordable housing.
- Support for offering a fee in lieu option and a fee of $2,000 per unit seems reasonable and should not adversely affect the role of the incentive; however, they noted that developers should weigh in on this proposal to provide a more complete picture of how this might impact new housing.
- Support for using any MFTE fee in lieu payment to support affordable housing.

Development Stakeholder Outreach

As of the writing of this memo, a meeting with local developers who have utilized the MFTE Program had been scheduled but had not yet occurred. Staff will provide an update on feedback received from the ad hoc Developer Stakeholder group at the Council Workshop.