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# Seattle Housing Affordability

## Policy Framework and Recommendations

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Prepared for:

Coalition for Housing Solutions

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ECONorthwest specializes in economics, planning, and finance. Established in 1974, ECONorthwest has over four decades of experience helping clients make sound decisions based on rigorous economic, planning and financial analysis.

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# Table of Contents

<b>Mayor Murray’s Housing Targets</b> .....	<b>2</b>
<b>Policy Brief Purpose</b> .....	<b>4</b>
<b>A Comprehensive Approach to Housing and Affordability</b> .....	<b>5</b>
<b>Strategy #1: Improve Affordability Through Market Rate Housing</b> .....	<b>7</b>
Action #1: Create an Abundance of Land and Zoning Capacity for Housing.....	8
Action #2: Reduce Barriers to the Entitlement and Permitting Processes for Housing Development .....	9
Action #3: Create Housing Choice Flexibility .....	11
Action #4: Create Limited Financial Supports for Market Rate Housing.....	11
<b>Strategy #2: Grow Housing Opportunities for Lower-Income Households</b> .....	<b>15</b>
Action #5: Refine and Expand Programs for New Affordable Housing Production .....	15
Action #6: Create New Programs for Housing Preservation .....	22
<b>Strategy #3: Increase the Resources for Affordable Housing Efforts</b> .....	<b>28</b>
Action #7: Increase Levels of Voter Supported Funding Measures .....	28
Action #8: Increase General Fund Support for Affordable Housing.....	28
<b>Appendix A</b> .....	<b>1</b>
How Filtering Delivers Affordability.....	1
Timing, Short-run and Long-run .....	4
Adding Supply in the Right Locations Offers More Affordability .....	7

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## Mayor Murray's Housing Targets

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In response to rising concerns about housing affordability in the City of Seattle, Mayor Ed Murray has convened a Housing Affordability & Livability Advisory Committee (HALA). He has charged this committee with evaluating strategies and delivering a set of recommendations to his office and Council by May 2015. To help inform the committee, ECONorthwest recently completed a policy brief in March 2015 on behalf of the Coalition for Housing Solutions that outlined a preliminary list of housing strategies for inclusion into the HALA process.

Since the completion of ECO's policy brief, Mayor Murray directed the HALA Committee to meet a new goal for the creation of both income-restricted affordable and market-rate units over the coming decade. He desires specific proposals that will allow the building and preservation of 50,000 housing units over in the next 10 years within the city. These additional units must also meet the following criteria:

- At least 30,000 of these units must be market rate.
- At least 20,000 of these units must be income-restricted affordable units for individuals and families making 80 percent of the area median income (AMI) and below. The 20,000 units represent a "no net loss" of affordable units, meaning that the city must either preserve or replace that many units.

The Mayor's target is ambitious and historical, and the City needs to find comprehensive solutions to meet this goal in the next 10 years – no one solution will solve these challenges. In order to meet these targets, the city leadership, residents, and businesses must move forward with a comprehensive set of innovative and forward-thinking measures. This policy brief provides actionable solutions that have the potential to produce the needed 50,000 units over the next ten years.

The brief lays out potential changes to zoning, housing flexibility, permitting and entitlement measures, and proposes limited financial incentives for market rate housing that could increase the number of market rate units above historical construction amounts. While it is difficult to quantify exactly how many units might be produced under these actions, it is clear that **finding ways to increase production above historical rates will not only meet the Mayor's target but will also provide more affordable housing to lower income households through price filtering**. Estimates in the brief suggest that 30% increases above historic rates could create about 3,500 units affordable to lower income households over 20 years. Finding ways to get even more housing built will only improve this situation.

Both market rate and subsidized production are viable and robust means of creating affordable housing at all income levels. It is imperative that the city recognize that much of the current affordability challenges have been decades in the making. Without a robust strategy for creating market rate housing, it will be difficult to find cost-effective solutions to subsidize housing production. Getting to the 20,000 affordable housing unit target will require a range of incentive and subsidy programs that are discussed in the brief. Many of these options leverage the

development of market rate housing and provide cost-effective solutions for affordable housing. In total, these measures suggest that the “no net loss” of 20,000 is within reach.

- Creation of a multifamily property tax exemption program for existing housing could preserve **21,000 income-restricted units**.
- Extension of the multifamily property tax exemption program for expiring units could preserve **2,580 income-restricted units**.
- Use of city-owned land represents for affordable housing represents the capacity for **4,390 income-restricted units**.
- Expansion of the multifamily property tax exemption program to areas where all multifamily housing is built could have created an additional **300 income-restricted units**.
- Refinements to the incentive zoning program that provided more flexibility and better price discrimination over the past 10 years could have created an additional **600-900 income-restricted units**.

Housing is critical to the city’s future success. It plays a central role in the economic vibrancy, environmental quality, and social wellness that all residents rely on and strive for. A robust housing strategy must be rooted in how private and supported markets deliver affordable housing. Without this central insight, the city may miss the “low hanging fruit” or pursue counter-productive strategies. The actions laid out in this brief provide a substantial first step in meeting the Mayor’s bold vision for housing in the city.

## Policy Brief Purpose

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In response to rising housing affordability concerns in the City of Seattle, Mayor Ed Murray has convened a Housing Affordability & Livability Advisory Committee (HALA) charged with evaluating potential housing strategies and delivering a set of recommendations to the Mayor and Council by May 2015. The following policy brief outlines a preliminary list of housing strategies for inclusion into the HALA process.

This policy brief presents a three-part strategy for addressing housing affordability in the City of Seattle. The strategy includes a description of actions designed to:

- 1) Support housing affordability over the long-run through the provision of market-rate housing supply,
- 2) Improve conditions for near-term development of affordable housing supply, and
- 3) Identify opportunities for securing financial resources that will directly support the affordable housing provision.

This policy brief provides basic information about each strategic approach and recommendations on strategy design intended to address the city's long-term goals for housing affordability.

For each action specified in the policy brief there is a discussion on the "impact on affordability". The impact discussion provides estimates on the how the policy and action could result in more housing affordable to lower income households. The brief anchors these analyses in Seattle housing market data. Instead of trying to predict future conditions in the housing market, the impact estimates consider the simple question: *"How much more affordable housing would the city have if these policies were in place?"* The affordability impact discussions provide range-of-magnitude estimates to spur thinking and suggest the size of the opportunity, knowing that the program details will matter greatly in the effectiveness of any single measure. The affordability discussions rely on historical data when available and assume conservative projections looking forward.

Using this framework, it is possible to see how new and refined policies might have produced more affordable housing. Further, it helps emphasize that the city must always be focused on housing policy and the implications on affordability, not just during times of rising housing prices.

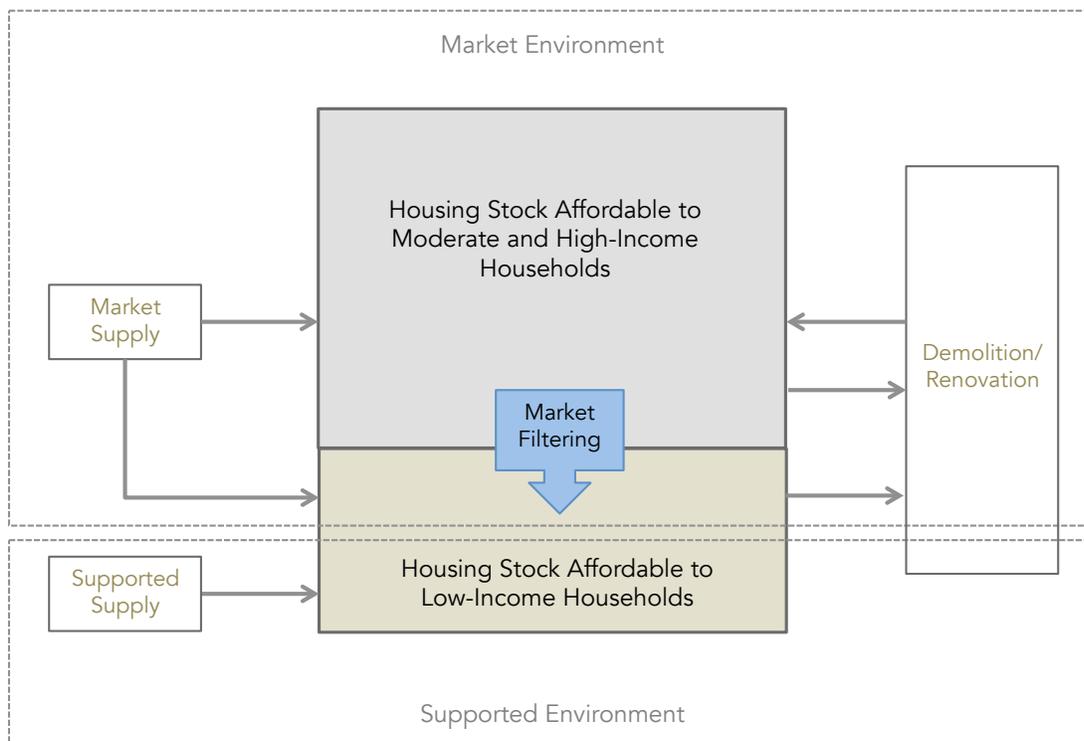
# A Comprehensive Approach to Housing and Affordability

Seattle needs a comprehensive housing strategy. A strong regional housing policy helps the region meet its economic, environmental, and social goals. This strategy should be rooted in an understanding of how subsidized *and* market rate housing contribute to the supply of housing available to households at all income ranges—particularly lower income households. Over time, a successful affordable housing policy will need to focus on growing the supply of housing relative to population and income growth with specific policies and incentives that:

- Increase the rate of growth in market rate housing production.
- Create robust and targeted supports for the delivery of subsidized affordable housing.
- Slow the rate of demolition and renovation of older, lower cost housing to market rate housing.

A general model of these dynamics represented in Figure 1 illustrates the stocks and flows of housing in the Seattle market. The stock of housing affordable to low-income households increases through the addition of new subsidized units, smaller market rate units, and older market rate units that become more affordable over time. This stock of housing decreases through demolition or renovation for market rate development.

**Figure 1: Key Aspects of a Comprehensive Housing Strategy**



Source: ECONorthwest

Most new market rate development is affordable to moderate and high income households. Through the market filtering process, these stocks become affordable to lower-income

households. There is also a supply of housing affordable to lower income households provided through various public regulatory and financial supports. **The overall growth in the supply of housing affordable to lower income households is then a function of rate of market-rate housing production plus the rate of supported housing production less the rate of demolition/renovation of lower cost housing.**

For reference, the US Census Bureau estimates that there are 288,439 occupied housing units in the city as of 2013. Based on analysis conducted by the Puget Sound Regional Council, there are approximately 23,401 subsidized units in the city in 2013 affordable to households making 80% or less of area median income. Over the past eight years, Seattle lost about 600 housing units a year to redevelopment (however, it added about 6,000 a year during that same time).

# Strategy #1: Improve Affordability Through Market Rate Housing

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## Problem Definition

Seattle has been at the epicenter of economic and technological change that has driven business productivity, personal income, and population growth in the city. Limited redevelopable land for denser housing is under intense competition from businesses and households leading to steep increases in house prices. Ultimately, the city has not been able to supply enough housing to meet this rising demand.

Housing has therefore been rationed by price with huge impacts for those with lower incomes seeking low-cost housing. **To the extent that the city can get any type of housing built, it will enhance the available stock of low-cost housing via price filtering**—a dynamic process in which housing built for higher income households slowly depreciates and filters down to lower income households (see Appendix A for a fuller description of filtering and its impact on affordability in Seattle).

An important feature of housing markets is the filtering of housing units from higher-income households to lower-income households with the passage of time. This dynamic process is the primary means through which markets provide affordable housing to lower-income households. Developers build housing for purchase and rent in the market, and as this stock of housing depreciates in value over time it becomes affordable to households with lower incomes. **Efforts that limit market rate housing production reduce the supply of low-cost housing and increase the level of subsidy needed to meet income-qualified housing production targets in the future.**<sup>1,2</sup>

A successful market rate affordable housing strategy will involve developing new rental housing stock, particularly in neighborhoods where land costs are lower and transit is easily accessible. To maintain and improve market rate affordability, the following general features of the housing market are needed going forward.

- Increasing the rate of supply for market rate production to maintain a continual supply of affordable stock in the future.
- Reducing costs for supplying the market with new rental units.
- Increasing new market rate housing supply outside of downtown area, as this supply, on average, will have lower costs.

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<sup>1</sup> Mayer, Christopher J. and C. Tsuril Somerville. 2000. "Land Use Regulation and New Construction." *Regional Science and Urban Economics*. 30:6, pp. 639-62.

<sup>2</sup> Malpezzi, Stephen and Richard K. Green. 1996. "What has happened to the bottom of the US housing market?" *Urban Studies*. 33;10 pp 1807-20.

- Increasing the supply of transit-accessible housing since a household’s total housing and transportation budget is what determines “affordability”.
- Preserving older market rate rental housing stock.

## **Action #1: Create an Abundance of Land and Zoning Capacity for Housing**

The following set of actions is meant to expand the markets for all types of housing by creating additional capacity for housing. Seattle has little room to grow its boundaries. **Finding additional opportunities for both horizontal and vertical capacity for housing will be a major determinant in how well the city can address housing affordability challenges in the long run.**

### **Potential Actions:**

#### ***Create more housing capacity in transit-accessible areas***

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Areas around transit offer the best opportunity for residents to economize on housing and transportation costs. The City has created more capacity in recent subarea plans and rezones; however, expanding the number of areas for rezones that include areas served by frequent and reliable transit service (10 minute walk shed) will create more opportunities for transit oriented development. The Seattle Planning Commission and other sustainability groups have advocated for such measures culminating in a comprehensive plan amendment in 2013.

#### ***Create more mid-rise housing zoned capacity***

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Mid-rise capacity offers a more cost-effective form of dense housing development. The use of wood frame construction delivers projects at lower average construction costs, thus allowing for lower average rents. Finding more capacity in neighborhoods outside of downtown where land costs are lower and transit is easily accessible should drive this action.

#### ***Create more low-rise housing zoned capacity***

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These areas offer a large-scale, near-term, and economically feasible opportunity to create market rate housing. These projects also tend to have more bedrooms and be in neighborhoods with better access to schools. Expanding this type of zoning capacity could be the city’s best opportunity to grow the supply of family-sized housing.

## Action #2: Reduce Barriers to the Entitlement and Permitting Processes for Housing Development

These actions would target opportunities to provide more expediency and certainty in the entitlement and permitting process.<sup>3</sup>

### Potential Actions:

#### *Use available SEPA tools to expedite housing production*

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The State Environmental Policy Act (SEPA) provides a set of tools to local agencies to support the expedited permitting of adopted land use regulations. The adoption of “planned actions” and infill exemptions could be used to streamline the development permitting process. These are tools that have been effectively used by other jurisdictions to support housing development.

#### *Reduce barriers in the Design Review process for housing*

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The Design Review process can be complicated, long, and uncertain—all factors that drive development costs. Reforms that provide more certainty and less delay for housing will speed the delivery of projects. Specifically, allowing housing projects to go through administrative review, rather than design review could support faster development process while reducing costs.

#### *Reduce barriers to the Alley Vacation process for housing*

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The Alley Vacation process can be complicated, long, and uncertain—all factors that drive development costs. The process is unique in that a series of public benefit thresholds have to be met in order for the alley to be vacated. Improvements to the process that provide more certainty with respect to the public benefit “tests” would aid in reducing development cost and uncertainty. These rules could specifically apply to all or just housing projects.

### Impact on Affordability (Summary of Actions #1-2)

The following discussion covers actions that support the production of market rate housing. The list of potential actions above covers some, but not all actions that could be taken to support market rate production. **If actions undertaken can marginally increase the rate of market-rate production above current conditions, they will have delivered larger stocks of lower cost housing to Seattle households.**

With some basic information about the Seattle housing market it is feasible to implement a simple model of the filtering process as a dynamic system of stocks and flows. Such a model is by its nature very high-level and simplistic. The purpose of this kind of model is not to produce detailed predictions but rather to characterize the interaction between

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<sup>3</sup> John M. Quigley and Steven Raphael. 2004. "Is Housing Unaffordable? Why Isn't It More Affordable?" Journal of Economic Perspectives—Volume 18, Number 1—Winter 2004

parts of the system and gain an order of magnitude understanding of potential outcomes from alternative assumptions.

The simple model construction represents the stocks of multi-family housing (low price, moderate price, and high price), and flows into and out of those stocks over 20 years. The model follows the basic structure of the diagram shown in Figure 12. New housing production is assumed to closely match the last 10-year average and demolition rates are assumed to be on par with recent annual averages.

As a simplification, housing price inflation is held constant with income growth. So, increasing the supply of moderate cost market rate housing will place downward pressure on prices while overall growth in household demand will place upward pressure on prices. Housing unit filtering rates are assumed to be consistent with the academic literature.

**Under baseline conditions (around 3-4,000 units/year), the filtering down of moderately priced market rate housing supplies as much as 1,300 units of lower cost “affordable” housing each year in Seattle.**<sup>4</sup> It is important to remember that this estimate includes more than just housing units that are reduced in price but also reflects housing unit turnover from higher income households to lower income households. This is not the same as the net change in any specific level of affordable housing, however, which would reflect filtering, new construction and demolition.

**When an additional 1,000 units of moderate cost market rate housing are added to the model each year above the 10-year average, the filtering rate increases to over 1,600 units per year.** Under this simplistic model test, at the end of a 20-year simulation, there is an additional 3,500 units of “affordable”, non-subsidized multi-family housing than would otherwise be the case under baseline conditions.

The timing, location, and cost of supplying housing to the market will play a major role in determining how well filtering supports affordability goals. **In the Seattle market, housing unit prices decrease \$15, on average, with each year that they age.** As a result, strategies that extend the life of housing services provided by the existing stock of market rate housing play an important role in maintaining housing affordability. **And for each mile further from the central business district (CBD) that housing is located the average rental rate (for 1 bedroom units) declines by \$90 per month** (see Appendix A for a fuller description of these analyses).

Increasing the amount and timing of market rate housing production is a viable housing affordability strategy. But filtering operates over the longer-term and will not

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<sup>4</sup> In this simplified analysis, “affordable” units are consistent with units considered affordable to households (depending on households size) at approximately 80% of area median income.

sufficiently address near-term affordable housing needs. **However, failure to deliver market rate housing at adequate levels will make future affordable housing problems worse, as the current affordable housing “crisis” is directly attributable to a lack of supply of older and lower cost housing that has been decades in the making.** This has been the case in other coastal, high housing cost cities in the US, such as San Francisco.

### **Action #3: Create Housing Choice Flexibility**

These actions would target opportunities for flexibility in habitation standards and/or the building code. Government habitation and building standards have largely regulated substandard housing out of existence. Lower income households have safer, higher-quality housing that is more expensive. There are opportunities to reduce some regulation while still providing safe, quality housing at a lower cost to consumers.

#### **Potential Actions:**

##### ***Expand opportunities for ADUs and microhousing***

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A range of flexible housing types can provide affordable housing opportunities for lower-income households. Micro-units and ADUs have the potential to address changing household compositions and provide a new source of affordable housing to a wider range of households. The city has taken steps to formalize rules for both micro-units and ADUs; however, continued efforts that can appropriately expand their use offer the ability of more housing choice and affordability.

#### **Impact on Affordability**

About 3,100 permitted sleeping rooms in micro-units have been permitted over the past several years per February 2014 Director’s Report from the Seattle Department of Planning and Development (in 2013, it was estimated that there were 2,100 micro-units in the city). Average unit rental prices are significantly less compared to comparable studio units. Units typically rent for between \$500-\$700/month and often include utilities, some furnishings and internet with lease terms usually 3-6 months then month-to-month.

### **Action #4: Create Limited Financial Supports for Market Rate Housing**

This action would focus incentive tools to stimulate and support market rate housing in areas where new, dense market rate housing is not being built.

## Potential Actions:

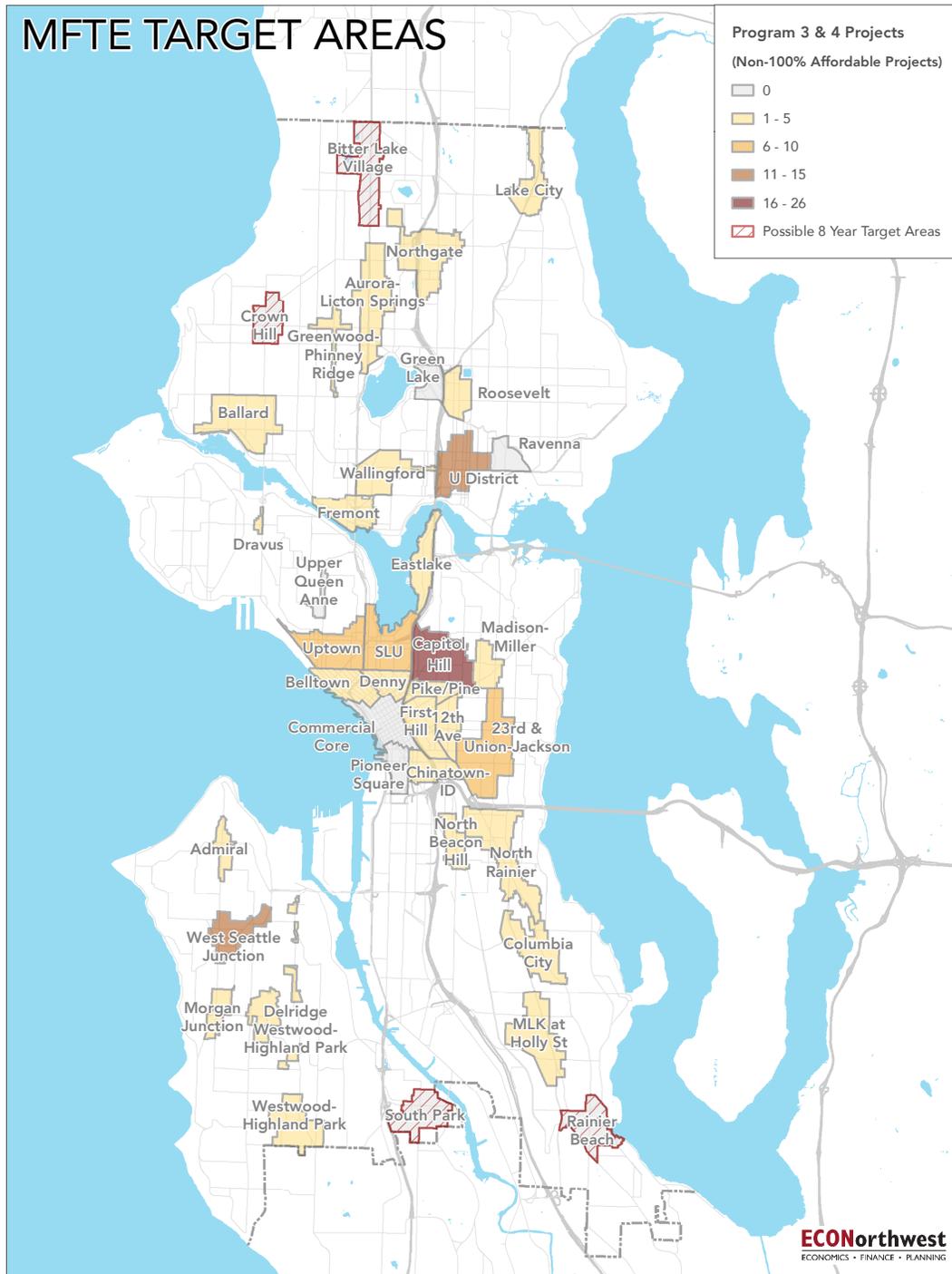
### ***Create an 8-year MFTE Program for market rate housing***

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The MFTE program is a powerful incentive program that provides a property tax exemption for dense, infill housing. The City currently uses a twelve-year program with affordability requirements. The current law also allows for an eight-year program. The city take advantage of this program to support and catalyze market rate development in areas currently struggling to produce market rate housing under the current MFTE target area scheme and have access to transit. Market rate housing in these projects would likely be more “affordable” than comparable units elsewhere because of prevailing rents in the area, the value of the incentive, and lower land costs in these areas. The program could be structured to sunset after a set amount of units are built and then revert back to the 12-year program with affordability requirements.

Assuming the program used the existing MFTE target area schemes and the following filters were applied: 1) no current MFTE projects are in place; and, 2) no more than one multifamily project has been built since 2010; the target areas for an 8 year program would be Rainier Beach, South Park, Bitter Lake, and Crown Hill as shown in Figure 2.

Figure 2: Potential Locations for an Eight-Year MFTE Program



Source: King County, City of Seattle

Source: ECONorthwest, City of Seattle, King County Assessor

## Impact on Affordability

**Assuming the sunset provision was limited to the first 200 units produced (i.e. approximately two mid-rise wood frame construction apartments), approximately 800 units of market-rate affordable units couple be produced in these areas.** The amount of local direct subsidy of these units could be very low. Based on analysis from the City's Office of Housing on the 2013 MFTE program review, the tax-expenditure per unit would likely be in the \$10,000 per unit range over the eight years (cumulatively in the \$8 million range for those 800 units) – a very low amount of city subsidy per unit and no other form of federal leverage is needed.

While there is a cost to subsidizing this production, the City is likely a net fiscal winner since these projects generate one-time tax revenues from sales and B&O taxes plus on-going taxes from property taxes (once the exemption ends) and sales and utility taxes from residents. The City benefits from economies of scale where the marginal cost of serving new residents is lower relative to the marginal new revenues these projects bring in. **A more comprehensive assessment of the MFTE program would likely conclude that the program is a net fiscal winner for the city.**

## Strategy #2: Grow Housing Opportunities for Lower-Income Households

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### Problem Definition

People with low and moderate incomes need to be able to find suitable housing in Seattle with good access to transportation and job centers. These affordability challenges are caused more by the far-reaching effects of poverty and low income than by high housing costs alone. Expansion of city, region, state, and national affordable housing programs will allow a wider array of incomes to benefit from the city's housing efforts.

### Action #5: Refine and Expand Programs for New Affordable Housing Production

Creating more income-qualified housing will require subsidy programs that underwrite rents at less than market feasibility and cost-recovery rates. Refining existing programs offers a low cost and effective solution towards growing these resources.

#### Potential Actions:

##### *Refine the incentive-zoning program*

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The incentive zoning programs allows development to exceed the “by-right” zoning into “incentive” zoning in exchange for the provision of specified public benefits. Revisions to the program could result in more participation and affordable housing production. The following specific refinements should be considered:

- The program should remain voluntary and should provide developers with a range of options to fulfill their public benefit requirements. This includes onsite and offsite performance, land dedication, and fees in-lieu.
- Affordable housing provided through the performance option should serve people with incomes between 60% and 80% of area median income (AMI) since these households are not typically served through publicly subsidized affordable housing programs.
- The City should consider varying the income targets for different unit sizes. In the case of very small units with market rents affordable to households with incomes equal to or less than 80% of AMI, it would be appropriate to establish a lower AMI target.
- The fee in-lieu option should be available in all incentive zoning areas.
- The City should continue to have the flexibility to use affordable housing payment proceeds from residential and non-residential developers to serve the full spectrum of lower incomes from 0% to 80% of AMI.
- Residential developers should be allowed to use incentive zoning and the multifamily tax exemption (MFTE) program in the same project.

- **The City should establish better price discrimination in the fee setting that makes participation in the program more desirable.** Issues to consider would be more robust incentives beyond bonus floor area, varying performance set-asides and per-square-foot payment levels on the basis of economic analysis throughout different parts of the city.

Such variations should take into account:

- Use (e.g. residential vs. non-residential development),
  - Construction type (e.g. steel and concrete high-rises vs. wood-frame buildings),
  - Tenure (rental vs. ownership), and
  - Real estate market conditions by location or zoning classification.
- The performance set-aside and payment levels required for residential and non-residential developers who participate in incentive zoning should be reviewed and revised periodically in light of changing market conditions. This process should be implemented by administrative action after being reviewed by a non-political technical advisory committee.

### Impact on Affordability

Based on a thorough review of the incentive zoning program in 2014 by the Cornerstone Group and David Rosen & Associates (DRA), the current incentive program has been a productive part of the city's affordable housing efforts mainly through the collection of fees that was levered into new housing production. 56 units of housing affordable to households with incomes below 80% median family incomes have been produced and fee in-lieu contributions of \$31.6 million through 2013 have been generated. \$27.2 million of this has been committed to projects corresponding to 1,570 affordable units. For both incentive zoning and housing levy fund, additional affordable units have been produced at a local subsidy cost of \$44,000 per unit.

However, these reports also demonstrated two critical findings: 1) that bonus density is typically an insufficient incentive for building into the incentive zone, and 2) there are opportunities for better program participation via price discrimination (e.g. some eligible projects may have participated at a lower cost of participation). As constructed, the current program effectively limits what types of projects can participate in the program.

Based on analysis from Seattle's Department of Planning and Development from the end of 2013, since 2007 not all projects built, permitted, or in early design guidance have chosen to use the incentive:

- In Downtown zones: 4 of 6 commercial projects and 3 of 7 residential projects have used the incentive program.
- In South Downtown zones: only 1 of 3 projects have used the incentive program.

- In South Lake Union zones: 6 of 14 commercial projects and 0 of 6 residential projects have used the incentive program.
- In Highrise zones: 4 of 5 residential projects have used the incentive program.

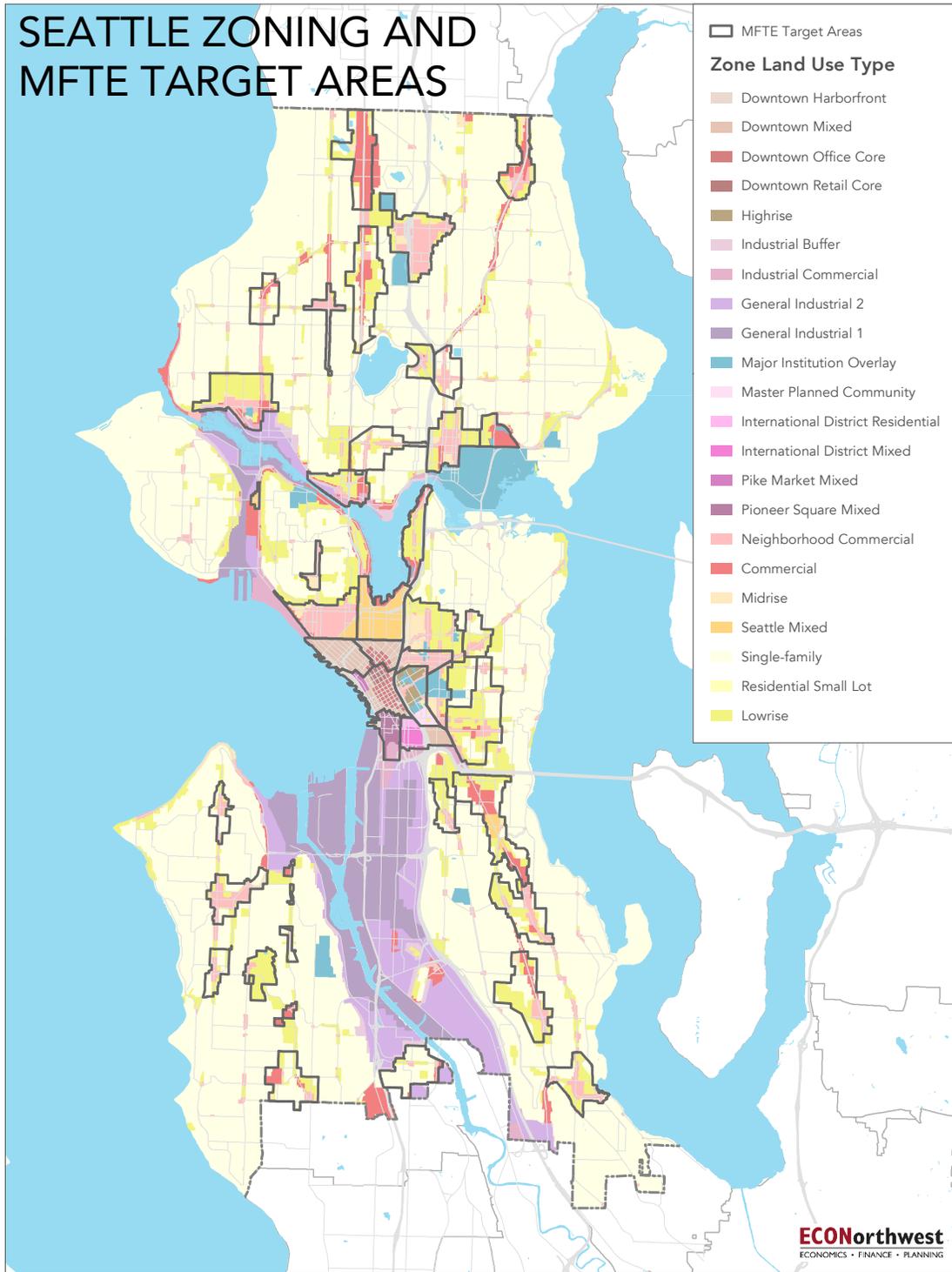
These participation results generally support the findings suggested in the DRA analysis around the challenges of the value of the incentive, program performance pricing, and changing market conditions. A simple analysis of these 23 projects that were eligible and did not participate shows that they represent in the range of 2 to 3 million square feet in incentive square feet that was not used in exchange for public benefits. **It remains a distinct possibility that some of these projects might have participated with better incentive price discrimination that accounted for issues cited above. For illustrative purposes, the potential foregone value (assuming 40% discount from current fees in-lieu) is roughly \$26 to \$40 million of additional fee in-lieu revenues that could have been dedicated toward affordable housing activities.** The Cornerstone Group found that incentive zoning and housing levy fund dollars had been leveraged with other resources at a rate of \$44,000 per unit. Assuming available leverage, the opportunity cost of not having better price discrimination is in the range of 600-900 affordable units.

### ***Expand the geographic reach the 12-year MFTE Program***

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The MFTE program is a powerful incentive program that provides a property tax exemption for a period of twelve years in exchange for the provision of income-qualified housing. Changes that impact the program's use will increase the amount of affordable units available. Currently, the MFTE program is administered in 39 target areas. However, these areas do not include all the zoning areas where multifamily is allowed, as shown in Figure 3. Expanding the target areas to include these zones will allow for more projects to participate and the delivery of more affordable housing. Further, allowing existing multifamily projects to use the program would open up an even larger supply of housing where income restricted housing could be offered.

Figure 3: Multifamily Zoning and MFTE Target Areas



Source: King County, City of Seattle

Source: City of Seattle, King County Assessor

## Impact on Affordability

In total, the MFTE program has produced 4,477 affordable units since its inception. The current iteration of the 12-year MFTE program (Programs 3 and 4; 2008-2013) through 2013 had approved 131 projects to use the program. This is approximately 73% of all projects built within these areas over the same time. However, if the program had included all areas where multifamily housing was built during that same time, an additional 34 projects would have been eligible. If a similar participation rate of in-target area projects were applied to these projects, there would have been an additional 18 MFTE projects totaling 1,546 additional units eligible to participate. Applying the 20% affordability requirement would have produced **an additional total of 317 affordable units over the 2008 to 2013 time period.**

The MFTE program is one of the more cost-effective means the City has in supporting the development of affordable housing. The amount of local direct subsidy of these units is relatively very small (compared to \$44,000 per unit of local subsidy from levy and incentive zoning funds derived through the Cornerstone analysis). **Based on analysis from the City's Office of Housing on the 2013 MFTE program review, the cumulative tax-expenditure per unit is roughly \$12,000 per unit (e.g. foregone revenue) over the 12 years.** Outside of being a very low amount of city subsidy per unit, the city needs no outside jurisdictional approval to implement the program, and no other form of federal funding leverage is needed to support these units.

While there is a direct cost (in the form of foregone revenue) to subsidizing this production, the City is likely a net fiscal winner since these projects generate one-time tax revenues from sales taxes and B&O taxes; plus on-going tax revenue from property taxes (once the exemption ends) and sales and utility taxes from residents. The City benefits from economies of scale where the marginal cost of serving new residents is lower than the marginal new revenues these projects bring in. **A more comprehensive assessment of the MFTE program would likely conclude that the program is a net fiscal winner for the city.**

## ***Use public lands for affordable housing production***

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The city and other public agencies own vacant and/or redevelopable land capable of supporting infill housing. A policy and program to move these lands into the production of affordable housing could generate large amounts of affordable housing. A structure like a citywide Public Development Authority could be created to hold public lands; manage and access subsidy funds; and, develop, hold, and sell residential buildings for affordable housing purposes.

### **Impact on Affordability**

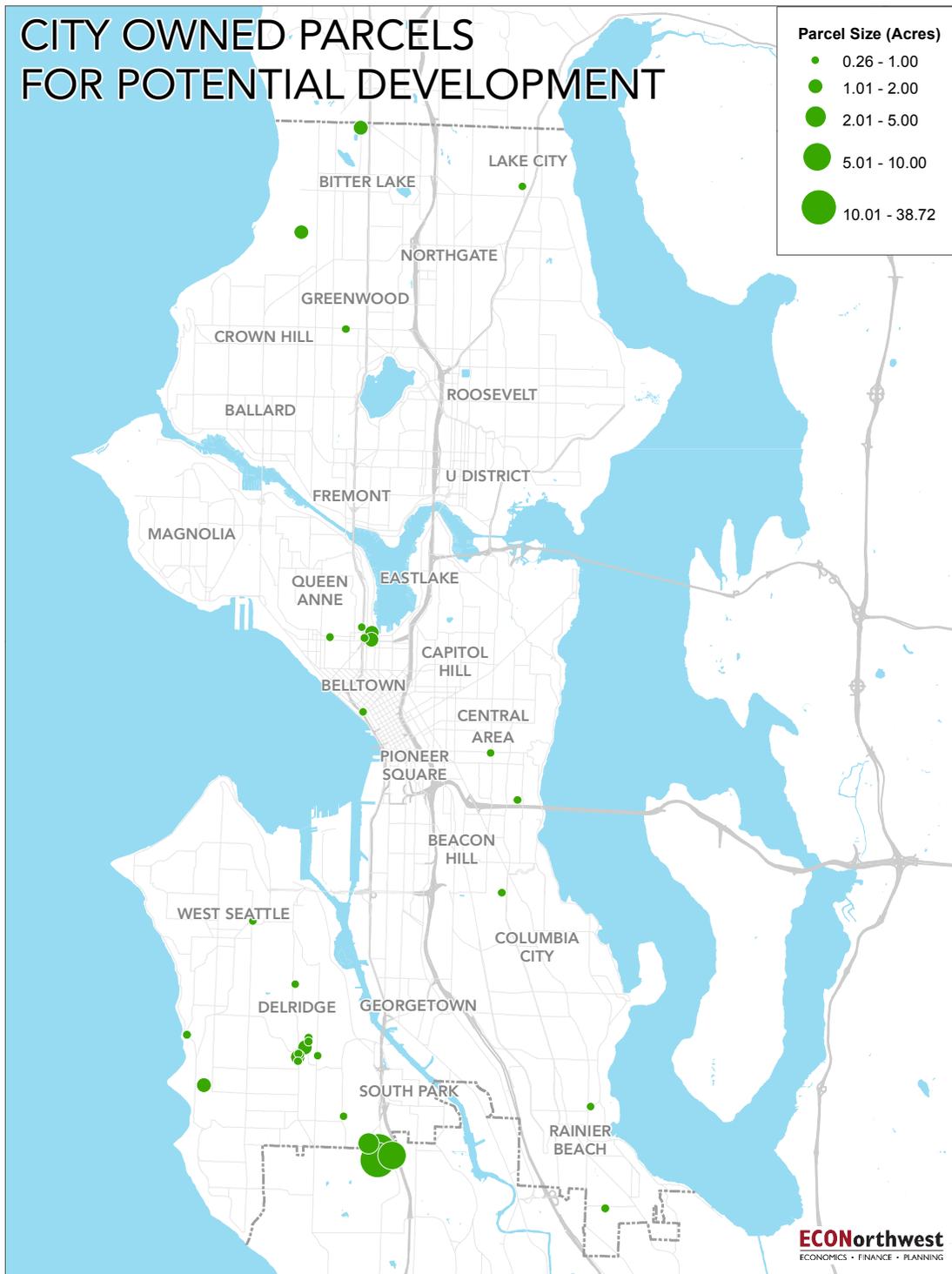
Using the city data on the location and use of current city-owned parcels, it is possible to estimate the number of units that this land might generate. Assuming the availability of local funds and federal and state leverage, it is possible that all or most of these units could be delivered at varying levels of affordability (under 80% AMI). **Thirty-two parcels were identified covering 60 acres. This land would be capable of producing 4,390 units** as shown in Figure 4 and Figure 5.

**Figure 4: Potential Affordable Unit Capacity on City-Owned Land**

<b>Zone Type</b>	<b>Parcels</b>	<b>Acres</b>	<b>Estimated Unit Capacity</b>
Commercial	6	41.0	3,085
Seattle Mixed	3	3.3	765
Downtown	1	0.9	235
Lowrise	5	2.4	115
Neighborhood Commercial	2	0.9	110
Single Family	15	11.0	80
<b>Total</b>	<b>32</b>	<b>59.5</b>	<b>4,390</b>

Source: ECONorthwest, City of Seattle, King County Assessor

Figure 5: Potential Locations of Affordable Units on City-Owned Land



Source: ECONorthwest, City of Seattle, King County Assessor

## Action #6: Create New Programs for Housing Preservation

Lower cost housing is delivered via market forces (filtering) and subsidized production. However, depreciation and program rules, respectively, may force units completely out of the market. Programs that provide subsidies or incentives may provide mechanisms to retain these units in the pool of low-cost units available to lower income households.

### Potential Actions:

#### *Create a MFTE Program for existing multifamily buildings*

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Allowing existing multifamily projects to use the MFTE program would open up an even larger supply of housing where income restricted housing could be produced. While it would take a change to state law, allowing existing multifamily units to participate in the program could allow for the dedication of units at varying levels of affordability below what is currently offered in the program by taking advantage of the filtering process and targeting low cost housing.

The initial purpose of the exemption program was to encourage multifamily housing to meet a range of economic, environmental, and social planning goals.<sup>5</sup> It was therefore limited to new construction housing developments. Changes in the law to include affordable housing opportunities dampened the value as a pure incentive program for new development by requiring the dedication of affordable units. However, greater levels of affordable housing units could be created in these buildings if the law decoupled the new construction requirement as a condition for the tax exemption incentive thereby allowing all multifamily units to participate. Levels of rent affordability could be structured based on the prevailing building rents, age of the structure, type of unit, term of the exemption, or location in the city.

### Impact on Affordability

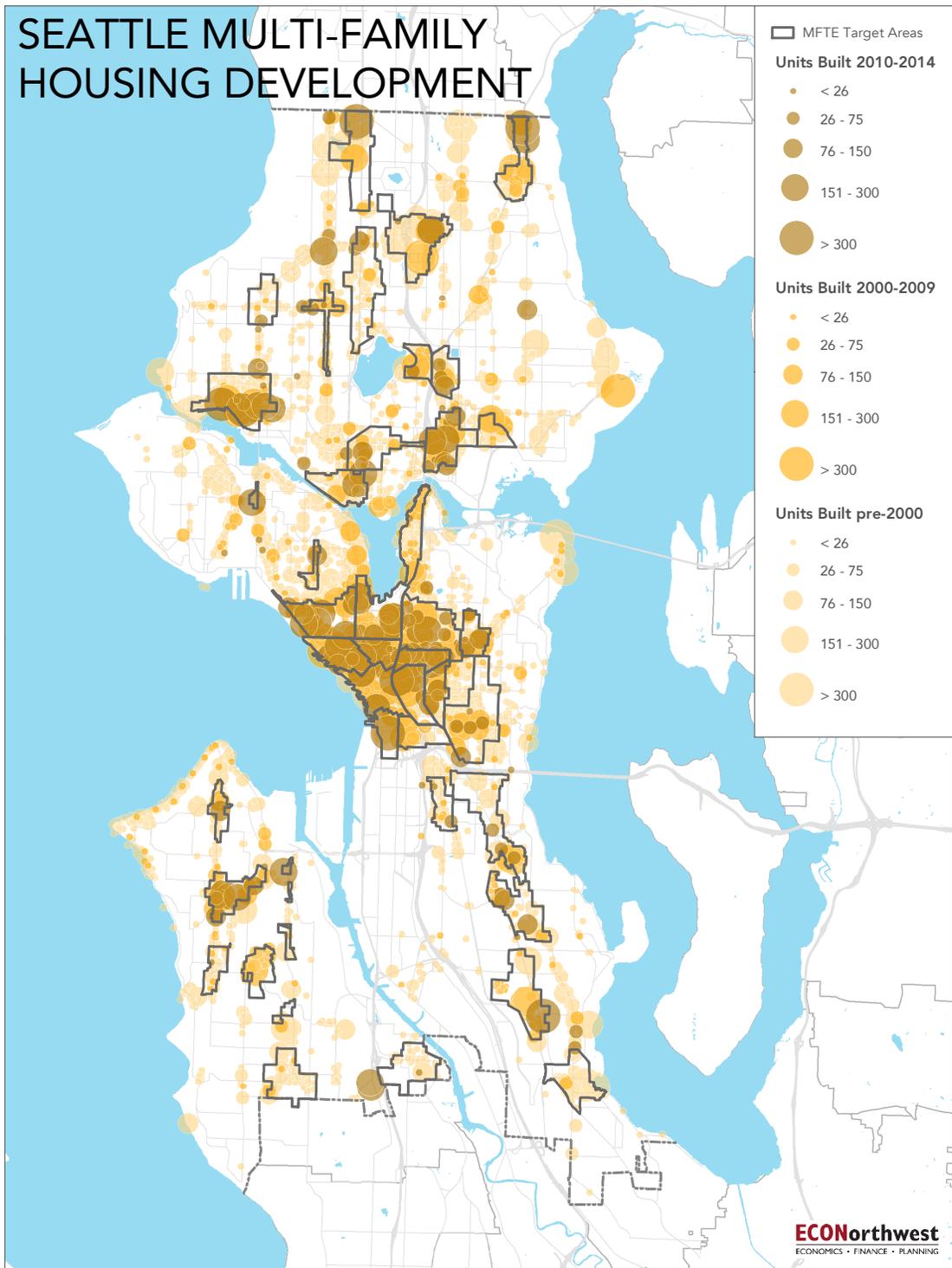
As shown below in Figure 6, there is a large supply of pre-MFTE era multifamily housing throughout the city. There are approximately 140,000 multifamily housing units across 7,100 buildings that could be eligible to participate in such a MFTE program. For a range of magnitude estimates on affordability production, it is possible to apply the existing 73% participation rate found in the current program with the assumption of a 20% set-aside for affordable units. **Under these assumptions, some 21,000 units could be created in these buildings at varying levels of affordability.** Based on the filtering analysis in this policy brief, deeper levels of affordability could be achieved beyond the 60% AMI currently achieved (in studios) depending on age of the structure, prevailing building market rents, term of the exemption, and location of the building.

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<sup>5</sup> RCW 84.14.007

A property tax exemption program on existing multifamily structures would not impact property tax collections of the city (e.g. current expense levy and levy lid lifts). **Unlike the existing MFTE program, the direct property tax subsidy per unit would be \$0.** However, such a program would shift the tax burden amongst taxpayers much like the existing program does. Even though these properties would receive a reduction in their property taxes paid, taxing districts (including the city) would still be able to collect their full legal levy limit. Due to the Initiative 747, taxing districts can only raise their levy (the amount they can collect) by 1% a year plus the new construction add-on value. A uniform tax rate is calculated by dividing the levy amount by the amount of assessed value in the district. Any reduction in the total taxable assessed value in a district through tax exemptions effectively means that non-exempt taxpayers must pay a higher tax rate.

Figure 6: Existing Multifamily Units and MFTE Target Areas



Source: City of Seattle, King County Assessor

## ***Create programs that preserve existing low cost housing***

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A substantial stock of multi-family rental housing was developed approximately 50 years ago in Seattle. Over the next decades some of this older stock of housing will depreciate in value to the point where it will be susceptible to redevelopment or renovation. Given the relationship between age of stock and rental price this process represents erosion in housing affordability. Strategies that extend the life of housing provided by the existing stock of market rate housing can play an important role in maintaining housing affordability.

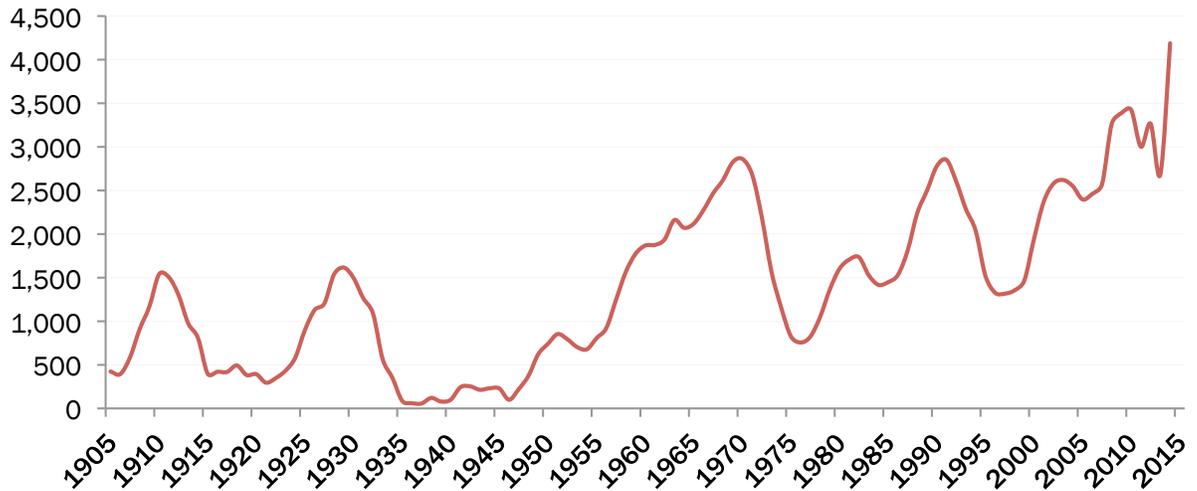
This program would acquire low cost market rate housing at risk of being redeveloped and rehabilitate the structure while maintaining income-qualified restrictions. There are various models that the city could pursue including the use of incentives like MFTE and the sale of development rights; access to grants and low interest loans; and, other public-private partnerships that might acquire or preserve units.

### **Impact on Affordability**

Finding programs that slow the rate of demolition/renovation of low cost, older housing by providing subsidies and financial incentives for housing preservation will be key to maintaining a strong stock of affordable housing. **There is large stock of housing developed during the 1960s and 1970s – some 40,000 units – that is reaching the end of its useful lifetime** (Figure 7). Some of this stock has already been renovated and has left the supply of lower cost housing.

Programs that can acquire and/or rehabilitate this housing have the ability to preserve affordability. Typically, in nominal terms a unit's value is never higher than when it is first developed. **On average housing unit prices decrease \$15 with each year that they are older than a new product. So if a 50-year-old apartment building is redeveloped, new 1-bedroom rental units can be expected to rent for an additional \$700 per month more, on average, than those that were replaced.** Well-designed preservation programs can help preserve the affordability of those units for a longer duration.

**Figure 7: Housing Units by Year Built (5-Year Moving Average)**



Source: King County Assessor, ECONorthwest

### ***Create an extension of the MFTE program for housing preservation***

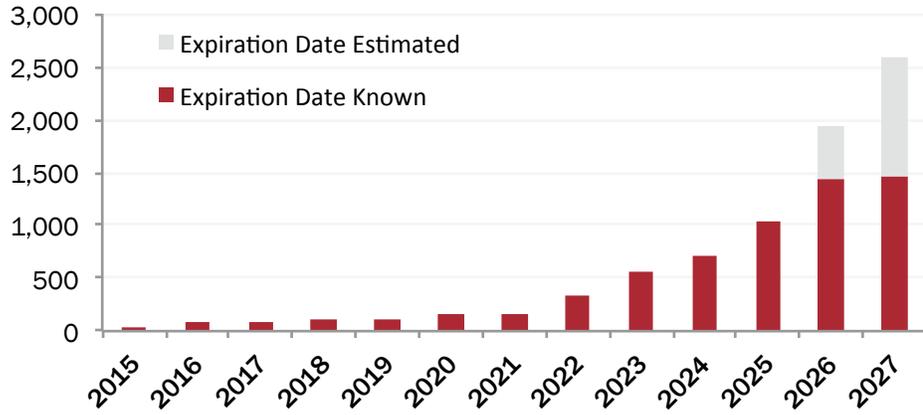
This policy would allow development projects to re-apply for the MFTE program using the property tax exemption to further support income qualified housing. This program would need changes in state law and could work as part of a broader program for existing buildings. Over the next decade, thousands of units will be rolling off the MFTE program. An MFTE preservation program could be structured to extend the exemption program to preserve the affordability of units. Based on the previous analysis on the rates of housing filtering, it is likely that a second term of MFTE could secure deeper levels of affordability in those buildings.

### **Impact on Affordability**

**Over the next 12 years, nearly 2,580 MFTE units will expire from the program as shown in Figure 8.** The right structure of a MFTE preservation program could preserve these units, and offer them at deeper levels of affordability. Based on the filtering analysis above, studio units (which make up the majority of units) that rent at the 60% AMI should be available at deeper levels of affordability.

Figure 8: Cumulative MFTE Units Expiring

### Estimated Cumulative MFTE Units Expiring in Non-100% Affordable Projects



Source: City of Seattle, ECONorthwest

## Strategy #3: Increase the Resources for Affordable Housing Efforts

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**Problem Statement:** In addition to the low-cost solutions suggested in Strategies #1 and 2, there will likely still be a need for additional revenue to fund subsidized housing. This strategy will also require development of new business models and partnerships to ensure that the resources are spent wisely—guaranteeing the greatest housing affordability return-on-investment. New revenue streams should be developed that complement and support strategies outlined earlier.

### Action #7: Increase Levels of Voter Supported Funding Measures

Washington tax law allows the city exceed its statutory limit on property tax levies through measures supported by a majority of voters. Seattle is one of a limited number of city's to support additional self-imposed property taxes for affordable housing.

#### Potential Actions:

##### *Increase the Seattle Housing Levy*

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Since 1981, residents of the City of Seattle have voted to impose an additional property tax for the purpose of creating affordable housing in the City. Increases in the levy will raise more revenue to support greater levels of supported housing production and preservation efforts.

#### Impact on Funding

In 2009, 63% voters approved a seven-year, \$145 million levy lid lift to provide affordable housing opportunities to low-income Seattle residents. The City's current levy rate is \$3.048 per \$1000 of assessed value. It is nearing its statutory maximum of \$3.60 per \$1000 of assessed value (includes a \$0.225 for firefighter pensions use currently in use). Therefore, there is about \$0.33 in effective levy rate capacity plus the amount of the existing levy. If the City sought to grow the amount of the housing levy, it would be constrained by this maximum amount.

**Theoretically, another seven-year levy lid lift tapping all of this remaining capacity could generate in the range of \$250-300 million in additional funding above the existing \$145 million over a seven-year time frame.** While there are concerns as to what level voters might approve and other levy commitments, there does appear to be capacity to increase the next housing levy to a greater degree and past experience shows that voters continue to place affordable housing as a priority.

### Action #8: Increase General Fund Support for Affordable Housing

Affordable housing is a major issue for Seattle residents, yet few general fund dollars are dedicated to housing programs. Furthermore, new construction generates fiscal benefits to the

city's general fund from increased property taxes and sales and B&O taxes on construction activity. These revenues tend to be higher than the marginal cost of service of new residential growth.

### ***Create a general fund supported Housing Affordability Fund***

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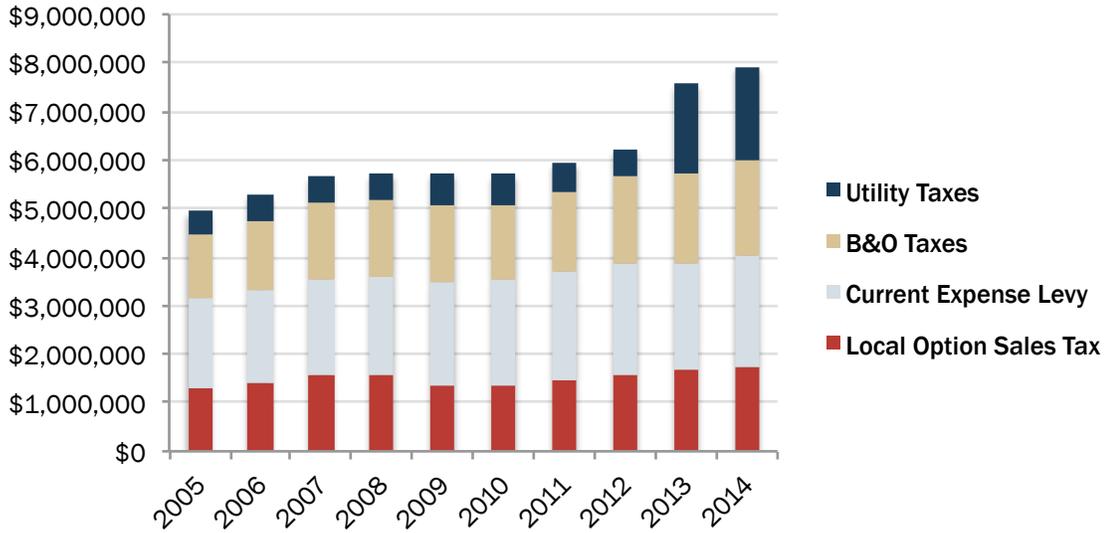
Dedicating some portion of general fund revenues to a "Housing Affordability Fund" could create additional resources for affordable housing uses identified in this policy brief as well as the city's existing programs. Two potential funding programs are contrasted below:

- **1% for Affordable Housing.** This funding policy would dedicate 1% of general fund tax revenues to affordable housing programs reflecting the city's policy commitment to providing affordable housing for constituents. This policy would direct 1% of current expense property tax revenues (excludes voted levy lid lifts and bonds already dedicated to other purposes), local option sales tax revenues (excludes public safety sales tax revenues dedicated to police services), business and occupation taxes, and utility taxes.
- **Construction-Driven Tax Revenues for Affordable Housing.** This funding policy would dedicate the "one-time" nature of general fund taxes derived from construction activity in the City to affordable housing programs (or other "growth" related expenditures). This policy would direct local option sales taxes stemming from the taxable retail sales on construction activity, the business and occupation taxes that construction firms would pay on this same activity, and the new construction add-on value to the current expense property tax levy.

### **Impact on Funding**

**Had it been in place over the last 10 years, a "1% for Affordable Housing" policy would have generated \$60,658,078.** Annual funds would have ranged from \$5 to \$8 million a year (Figure 9).

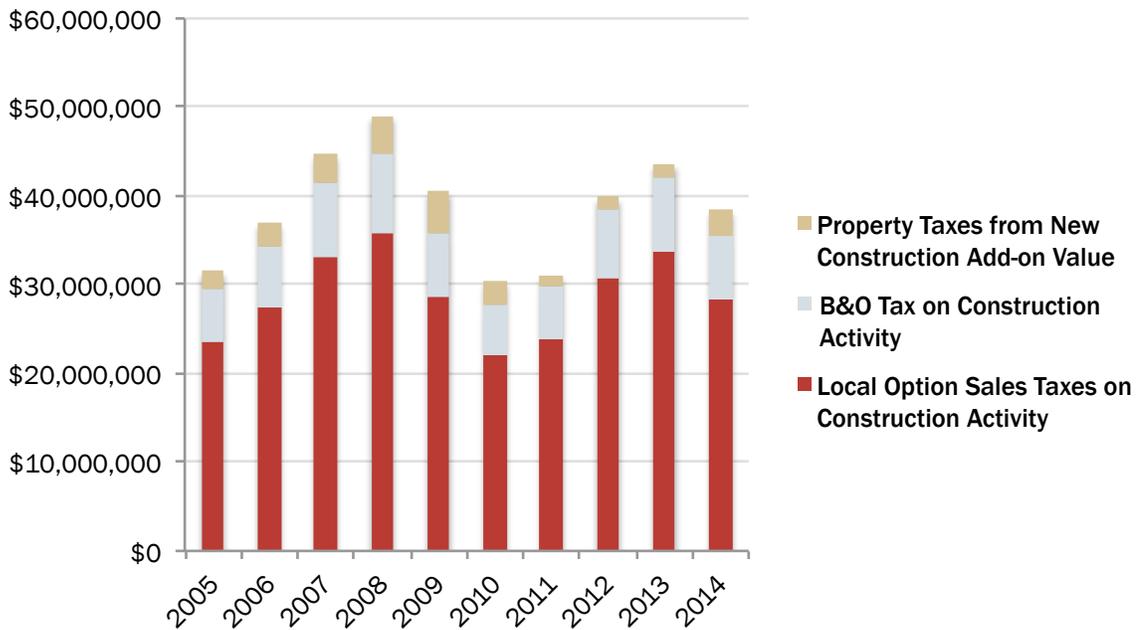
**Figure 9: Potential Funding From “1% for Affordable Housing” Policy**



Source: ECONorthwest, City of Seattle, State Auditor Office

Had it been in place over the last 10 years, a dedication of **Construction-Driven Tax Revenues policy would have generated \$386,403,808**. Annual funds would have ranged from \$30 to \$49 million a year (Figure 10).

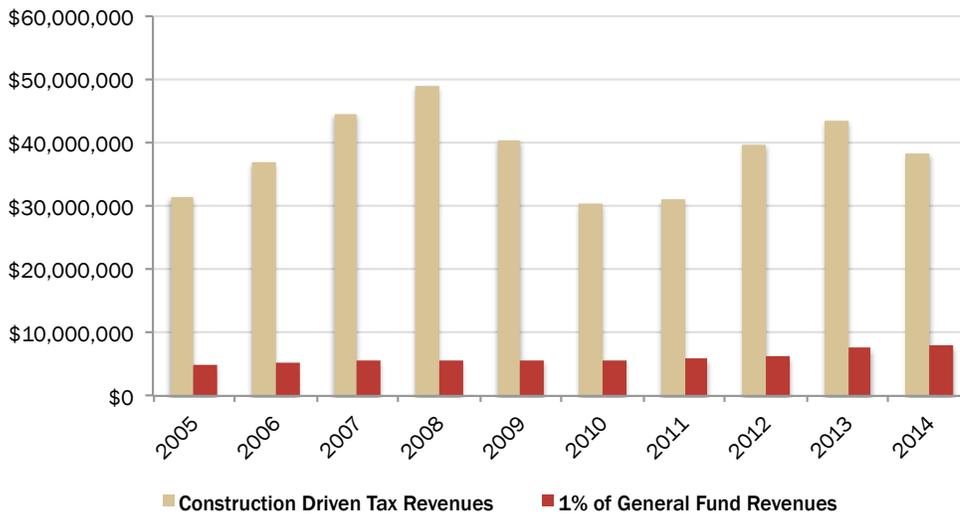
**Figure 10: Potential Funding From “Construction-Driven Tax Revenues” Policy**



Source: ECONorthwest, King County Assessor, Washington Department of Revenue

A construction driven policy is six times greater than a 1% policy. Both policies would force different budget and fiscal responses to new operating challenges and would require some phase in period. While a construction driven policy is more variable following trends in the building cycle, the potential to pool revenues and spend during recessions (when both land and construction costs are lower) could add additional leverage to affordable housing investments (Figure 11).

**Figure 11: Comparison of “Housing Affordability Fund” Funding Policies**



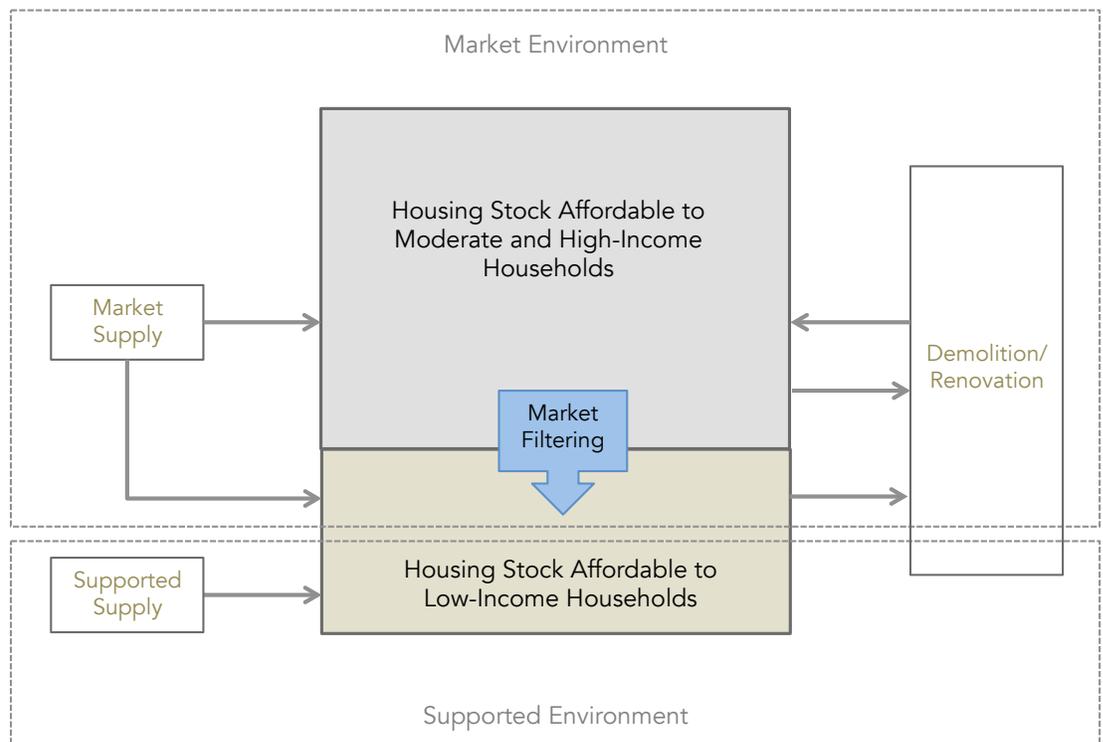
Source: ECONorthwest

## Appendix A

### How Filtering Delivers Affordability

An important feature of housing markets is the filtering of housing units from higher-income households to lower-income households with the passage of time. It is generally understood that this dynamic process is the primary means through which markets provide affordable housing to lower-income households. Developers build housing for purchase and rent in the market, and as this stock of housing depreciates in value over time it becomes affordable to households with lower incomes. This general dynamic is represented in Figure 12 below.

**Figure 12: Housing Market Dynamics with Filtering**



Source: ECONorthwest

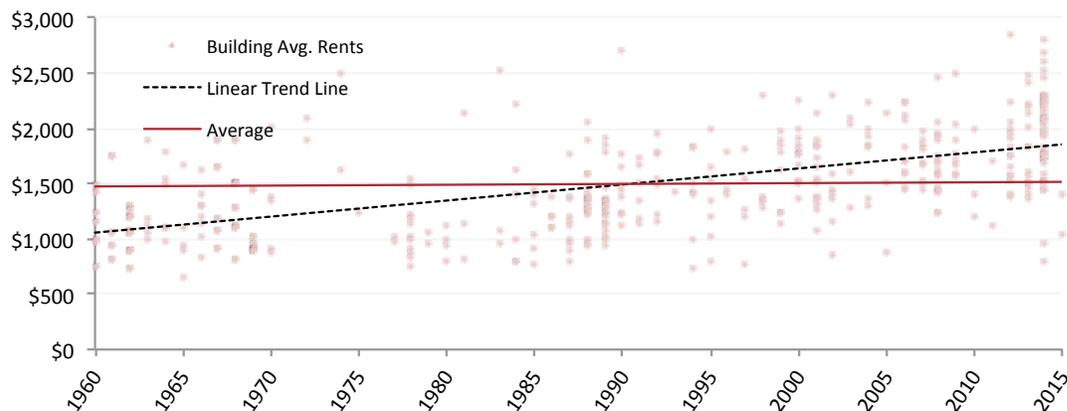
There is little debate that this process occurs, but it has been difficult to quantify the rate of filtering and whether the filtering process is sufficient to address affordable housing demands. Estimates of housing stock depreciation alone suggest filtering will be slow and probably fail to supply affordable units in a sufficiently large number. But in addition to depreciation there are other forces at work in the market that contribute to the rate of filtering—such as household income growth, housing stock tenure transitions, changing housing preferences, and constraints on the provision of new housing supply. **In other words, the rate of housing filtering is a result of more than just changes in housing asset**

values but also depends on how effectively the affordable units turn over from one household to another.

A high-level examination of some local market data provides a starting point for understanding the magnitude of the housing filtering process in Seattle. A reasonably comprehensive inventory of the rental housing market is available through CoStar (a proprietary commercial property service that provides a database on characteristics of multifamily properties). The CoStar data has rental rates for a subset of the Seattle rental inventory with year-built structures dating back to before 1900.

The rental rates for rental units decline with age. Depreciation and the filtering of housing units are comparatively rapid initially and slow over time. Rental rates for units over 50 years old may even rise again due to a survivability selection process as inferior older units are demolished or renovated. The depreciation of housing values are seen in Figure 13 below, which displays the 2015 rental rates for apartment structures with 1-bedroom rental units built between 1960 and 2014.

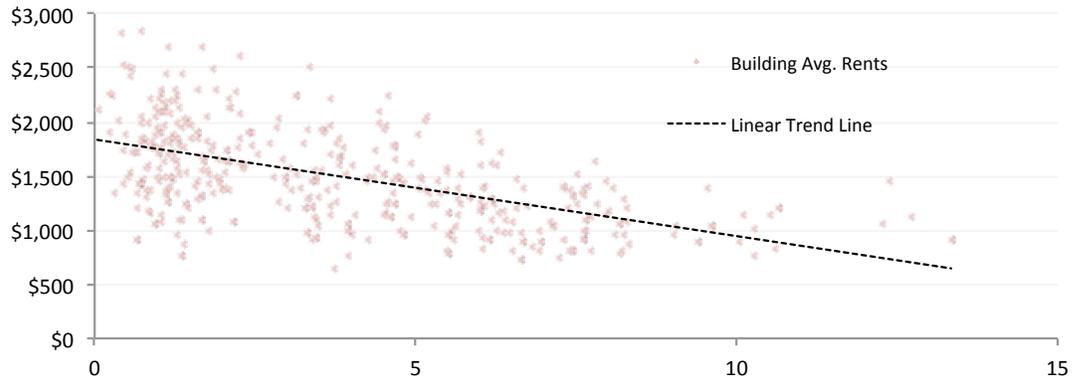
**Figure 13: Average 2015 Market Rate Rents (1BR) by Year Built/Renovated**



Source: CoStar, ECONorthwest

A similar depreciation pattern is evident for other unit types. Housing values also vary by location as seen in Figure 14, which displays 2015 rental rates for the same apartment structures and their distance in miles from the Seattle central business district (CBD).

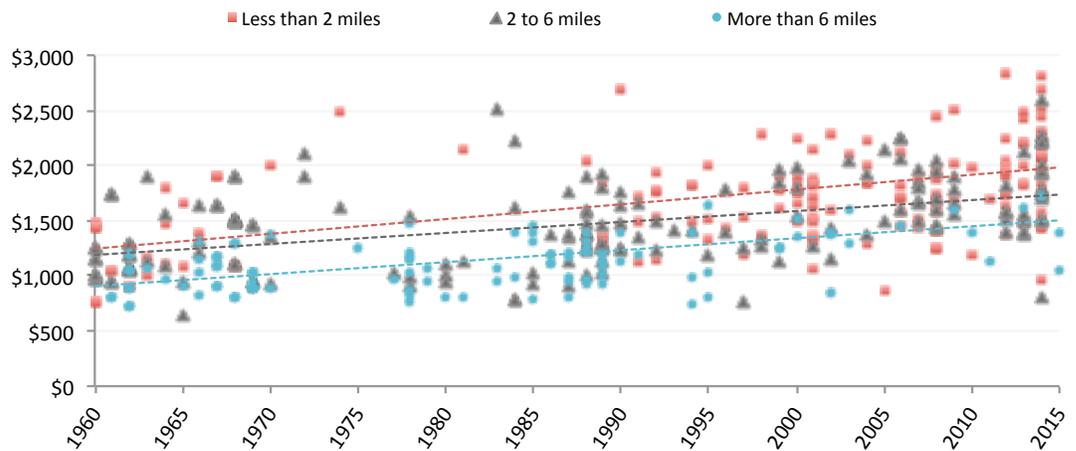
**Figure 14: Average 2015 Market Rate Rents (1BR) by Distance from CBD 1960-2015**



Source: CoStar, ECONorthwest

The relationship between rental rates, location and age of structure is shown in Figure 15; which also displays apartment structures built between 1960 and 2014.

**Figure 15: Average 2015 Market Rate Rents (1BR) by Year Built/Renovated and Distance from CBD**



Source: CoStar, ECONorthwest

The depreciation in the value of the housing stock is only part of the dynamics of housing filtering. The rate at which housing stock turns over from higher income households to lower income households is the primary determinant of the filtering process. A recent empirical study of housing market filtering adds some

important bounds around many of the important factors that influence the filtering process.<sup>6</sup> This study provides the following insights.

- Filtering rates are substantially higher than can be accounted for by depreciation alone.
- Filtering is fairly rapid during the first few years after construction, but the process slows over time.
- Income elasticities of demand for housing are positive but below one; which amplifies the filtering rate especially for rental housing.
- In aggregate, rental housing filters faster than owner-occupied housing.
- Local market filtering rates vary inversely with housing price inflation.

These empirical findings have important implications for a market strategy designed to address Seattle's affordable housing needs.

1. First, the rapid rate of initial filtering suggests that maintaining a healthy new supply of moderate cost market rate housing is critical for maintaining a healthy future stock of affordable housing.
2. Second, maintaining a strong rental housing market in general will increase the filtering of housing to lower income households due to a lower demand for rental housing with respect to household incomes.
3. Third, since the filtering process is sensitive to housing price inflation, keeping price inflation in check (through elimination of housing supply barriers) will be important.

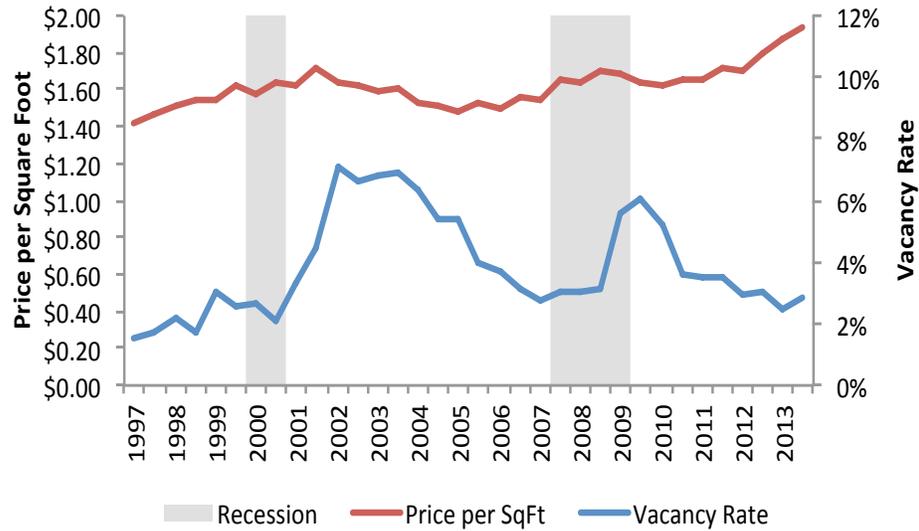
## Timing, Short-run and Long-run

This general characterization of the filtering process is consistent with theory and with empirical findings, but it is important to keep in mind some limits to the effectiveness of addressing housing affordability through the provision of market rate housing. Increasing housing supply drives up vacancies and puts downward pressure on prices, but in the short-run there is a limit to this dynamic. Figure 16 displays rental prices and vacancy rates for Seattle between 1997 and 2014.

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<sup>6</sup> Rosenthal, Stuart S. 2014. "Are Private Markets and Filtering a Viable Source of Low-Income Housing? Estimates from a "Repeat Income" Model." *American Economic Review*, 104(2): 687-706.  
Sweeney (1974) Sweeney, James. 1974. "A Commodity Hierarchy Model of the Rental Housing Market." *Journal of Urban Economics*. 1:3, pp. 288 -323.

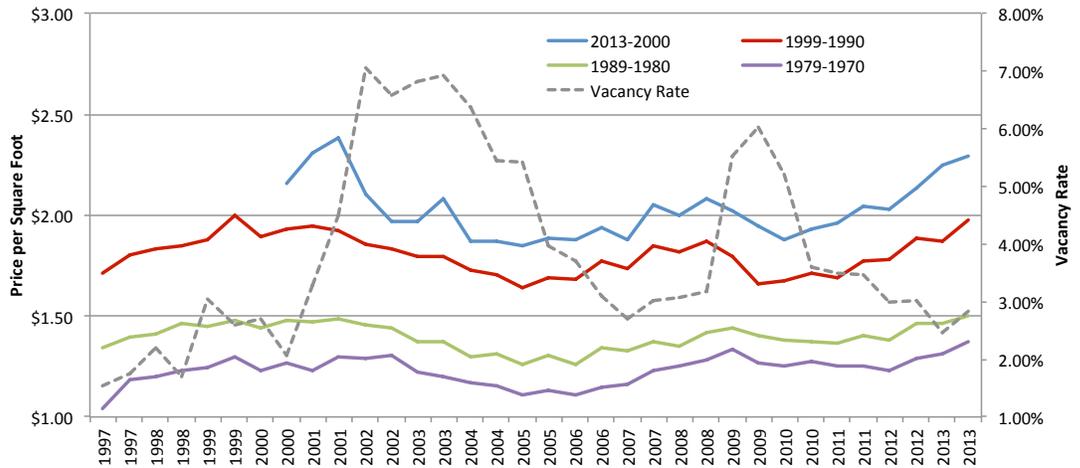
Figure 16: Real Rental Rates per Sq. Ft. and Vacancies (1997-2014)



Source: Dupree & Scott, ECONorthwest

The housing market cannot produce more market rate housing than the market demands at a given cost of supplying housing. If high vacancy rates drive down expectations for rental income below what will justify the costs of development of new projects then the supply will slow – triggering the typical cycle of development as vacancies drop once more. This suggests that effectively increasing the supply of market rate housing must meaningfully involve lowering the costs of supplying the market. **Lower cost, and lower priced housing is less sensitive to price fluctuations due to temporary over-supply in the market.** As is seen in Figure 17 the older and less costly inventory of rental units demonstrates less price variability in relation to vacancy conditions.

**Figure 17: Real Rental Rates per Sq. Ft. by Year Built and Vacancies (1997-2014)**



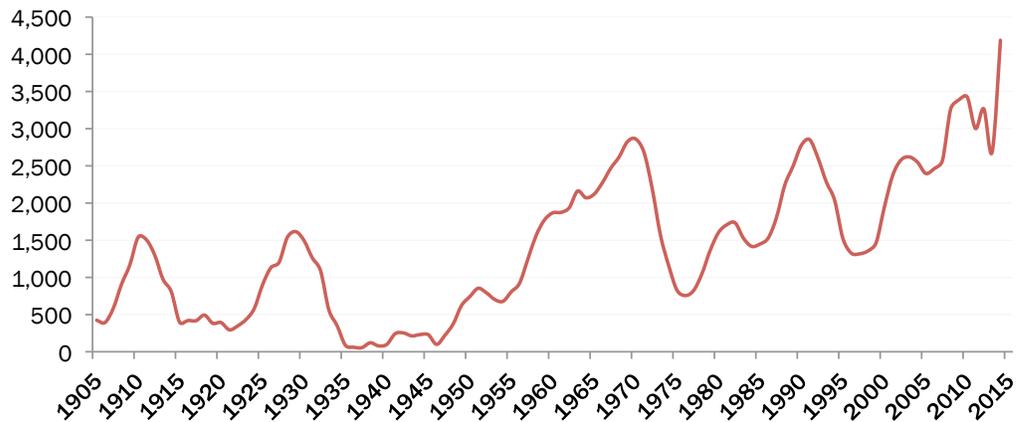
Source: Dupree and Scott

Increasing the amount and timing of market rate housing production is a housing affordability strategy that operates over the longer-term and will not sufficiently address near-term affordable housing needs. In the near-term the supply of affordable housing is a product of existing stock plus whatever net new affordable supply that gets added directly to that stock without waiting for the filtering process to run its course.

Again, an examination of the Seattle market data on units built since 1900 provides insights into the current state of housing affordability. **The comparatively lower amount of market rate supply introduced during the period between 1970 and 2009 will have limited the filtering process from that point onward, and contributed to the affordability challenge faced by Seattle today.**

Using a 5-year moving average of the data on new stock clearly shows that while recent market performance has resulted in about 3,000 new rental-housing units per year there was a 30-year period where production of new units averaged about 1,000 per year with few years topping out above 2,000 new units.

Figure 18: Housing Units by Year Built (5-Year Moving Average)



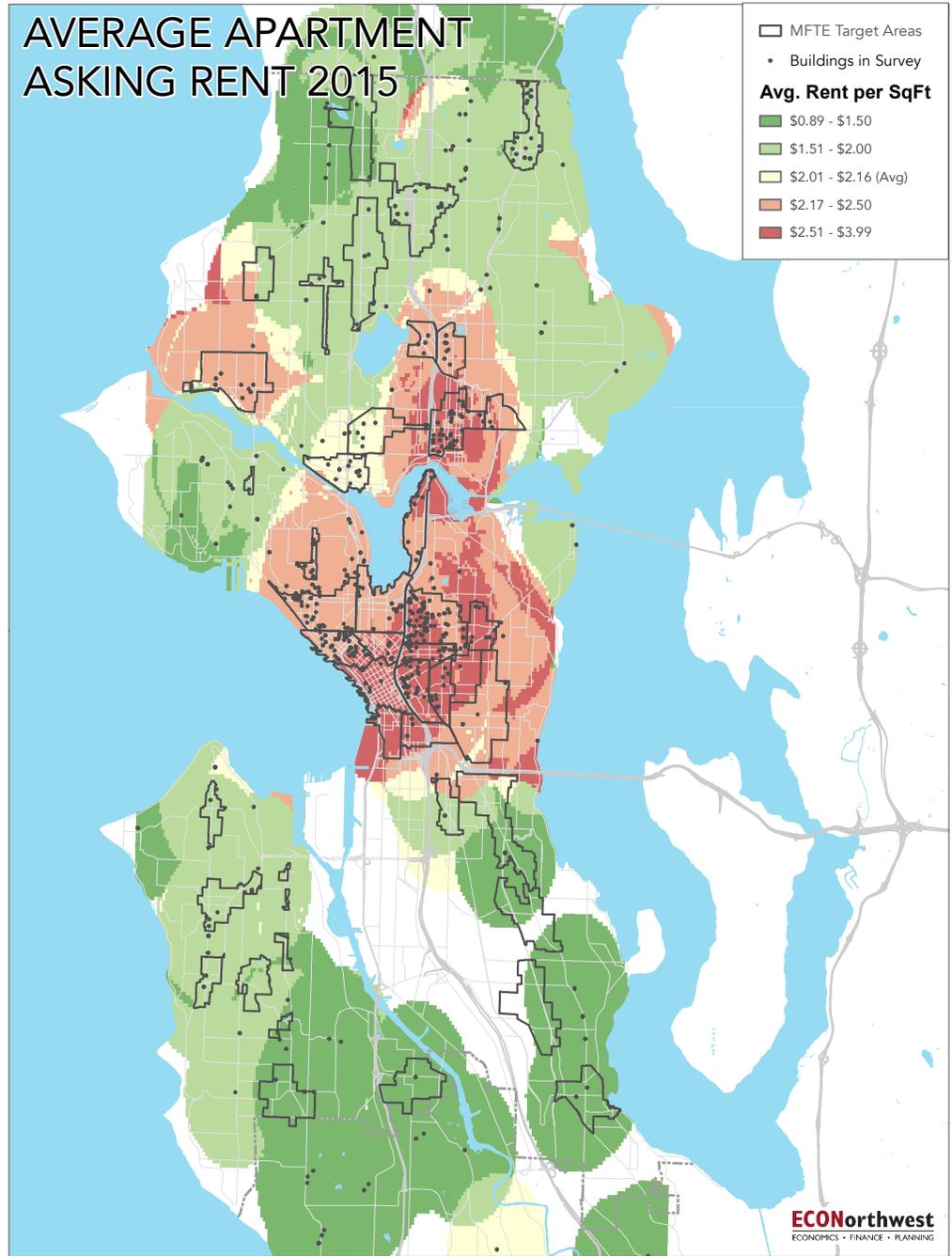
Source: King County Assessor, ECONorthwest

A substantial stock of multi-family rental housing was developed approximately 50 years ago in Seattle. Over the next decades some of this older stock of housing will depreciate in value to the point where it will be susceptible to redevelopment or renovation. Given the relationship between age of stock and rental price this process represents erosion in housing affordability.

## Adding Supply in the Right Locations Offers More Affordability

The location of multi-family rental housing supply is a determining factor in housing unit rental rates. This is a well-understood fact. The value of land in neighborhoods close to the CBD is bid up by competing uses. Housing tends to lose out to other uses in very central locations. In the case of 1-bedroom multi-family housing stock built after 1960 in Seattle (see Figure 14), **for each mile it is located further from the CBD the average rental rate declines by \$90 per month.** Figure 19 is a map of a sample of building-level observations of average rents in Seattle.

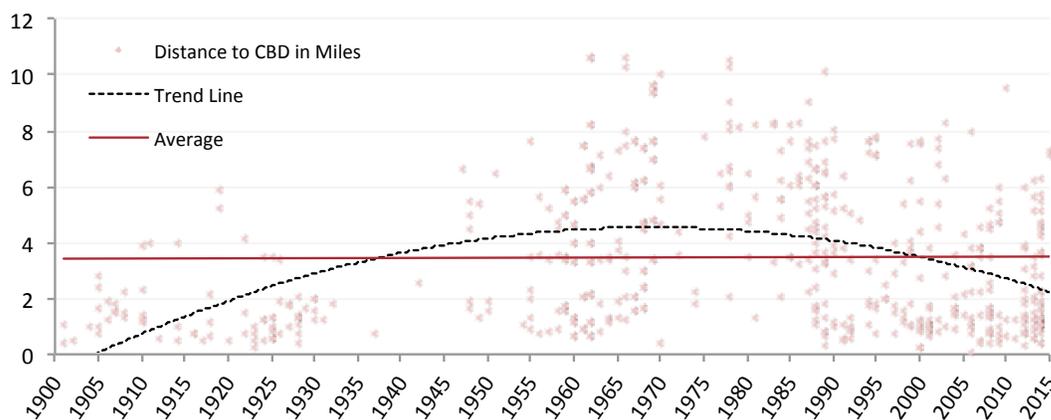
Figure 19: Seattle Average Apartment Asking Rents



Historically, the pattern of the location of multi-family rental unit development in Seattle has been one where older units were located closer in to the center of Seattle; for example in Downtown, Pioneer Square, International District, First Hill, Capital Hill, Lower Queen Anne neighborhoods. Beginning around 1950

more development occurred in further out neighborhoods. Figure 20 displays rental unit location in terms of distance to CBD and year built.

**Figure 20: Market Rate Units (1 BR) by Distance to CBD (miles) and Year Built/Renovated**



Source: CoStar, ECONorthwest

But this decentralizing trend appears to have reversed itself to some degree in recent years. The reversal is likely a combination of changes in housing location preferences of renters but also a function of where appropriately zoned development capacity is located. **It is pretty clear that a successful market rate affordable housing strategy must involve developing new multi-family rental housing stock in neighborhoods that are not dominated by higher bidding uses.**