Mandatory Housing Affordability Economic Feasibility Analysis

In January 2016, a small group of people, including neighborhood advocates and local developers, asked to review the numbers behind the “Grand Bargain”. There was a perception that the amount of production / in-lieu payments required by the Mandatory Housing Affordability (MHA) Residential Framework Legislation (Ordinance 125108) was not a fair “bargain” and that the fees should be increased. The City convened two meetings in June and August and provided some information. However, we could not complete our analysis until the release of the MHA Economic Feasibility Analysis in November 2016.
Here are our observations

Observation 1 - Program will not perform as expected per the Framework legislation (50% on site, 50% payment)

Observation 2 - The MHA program will stop private development in some areas and have adverse tax implications

Observation 3 – Goal is unachievable as currently designed

Observation 4 – Other programs may be working better than MHA proposal

Observation 5 – Instant profitability is totally unrealistic

Observation 6 – Selling zoning creates a slippery slope with adverse impacts

Observation 1 - MHA Program will not perform as expected per the Framework legislation (50% on site, 50% payment)

It appears that the consultants report reflects the early indicators we got from OPCD staff – the MHA percentage amounts were not set so low as to leave untapped profit margins.

The percentage amounts set would lead to the following behaviors

- Developers would likely not build projects in the low market areas in most forms of housing (see page 3 and the “in the red” tables pp 16-20). Analysis shows that production even without the MHA requirement is currently suppressed due to negative rate of return (pp 21 -25)

- Developers would most likely build in the high market areas, as they could use the high rents to offset the MHA impact.
- In the mid market areas, it's hard to predict and is likely to be dependent on local specific conditions, as the consultants observe (pp 3, 11- 12)

When the developers chose to build

- When building in high market areas, it is highly predictable that the developers will chose the payment option
- When building in mid market areas, it's likely that more market-rate developers will chose the payment options and the non-profits will chose the on-site option - although current market property valuations may unfortunately force this development elsewhere on land of lesser value.
- When building in the low market areas, should any occur, it will most likely be non-profit developers, and they will naturally chose the on-site option

Conclusion (and predictable outcome)

- Low market areas will end up hosting the bulk of the non-profits creating affordable housing, very few market rate projects will be built in those areas
- Mid market areas, depending on trending property valuation, may have the broadest range of MHA results; some market rate construction, both with and without Affordable Housing (AH), and some non-profit construction containing mostly AH.
- High market areas will have no AH construction unless the Office of Housing is able to buy it's way into the areas or legislation is advanced that requires providing AH on-site.

Observation 2 - The MHA program will stop private development in some areas and have adverse tax implications

Following upon the conclusions above, as a mandatory program MHA will stop private development in some middle income areas and stop all private development in low income areas. Building an extra floor is not a good enough incentive in these geographical areas. When the law goes into affect as a mandatory requirement, property taxes will increase based on the added density on each site. It is unclear what the tax assessor will do and there's a high likelihood that taxes will rise. That will cause a ripple effect depressing development in the middle and low income areas. This will start a land selling period that will be unpredictable. With this, businesses and small private investors will lose their equity stakes. Real estate speculators will have a field day sweeping up. Little or no development will occur in marginalized areas.
A mandatory requirement will not work and other alternatives should be sought.

Observation 3 – Goal is unachievable as currently designed.

If we continue with the mandatory program, it is likely based on Observation 1 that the already busy non-profits will be overwhelmed by the burden of constructing all the AH in the city (per city's own chart over 5,000 of the targeted 6,000 will be produced using pay-in-lieu dollars). Market rate developers should

be significantly incentivized or required to access those dollars in order to encourage on site AH rather than using the payment option.
In addition to high-end developers and non-profits there are others who remain interested in building affordable housing but are inhibited by escalating land costs, which is further exaggerated by upzoning and especially in areas where rents do not “keep up”, such as in the “unfashionable” extremities of the city.

Observation 4 – Other programs may be working better than MHA proposal.
The 75 year restriction for AH units is a major disincentive to developers. The 12 year term for the MFTE is much more attractive. A question was raised as to why the MFTE wasn’t just made more attractive as it was creating hundreds of AH units in 2015 and 2016 (actually 1,434 in 2015 and projected for over 2,000 in 2016).
Instead of the MHA upzones, modify MFTE to make more attractive. Work with Seattle legislators to lengthen or otherwise modify the 12-year term restriction in State law.

Observation 5 – Instant profitability is totally unrealistic
The CAI report does not recognize the cash flow and capital gains that add to the ultimate profitability of development. Lease/rent payments effectively pay the developers’ mortgage and the developer realizes their real return when selling the project to institutional investors at future (higher) prices. Very few developers retain their properties as landlords and those that do ultimately realize significant positive cash flow as well as capital gain.
The Residual Land Value method should not be used to assign value for selling zoning. It misrepresents actual cash flow and ignores the most likely profit center. The time period for long term capital gains marks many potential sales. Even operative builders ultimately realize significant capital gain in addition to significant positive cash flow after initial rents have paid down the mortgage and risen along with land values, which, unlike the building, are not depreciable, i.e. depreciated allover again at each resale.

Observation 6 – Selling zoning creates a slippery slope with adverse impacts, including tax implications.
The concept of “selling zoning” for any purpose, even if that purpose has a social value, creates a slippery slope. Sweeping citywide zoning changes under HALA are contrary to policies affording respect to neighborhood plans and the grouping of buildings and open space over time, i.e. urban design https://en.wikipedia.org/wiki/Urban_design. The top down zoning approach with limited involvement by city-selected focus groups and no plan to notify all property owners in affected area is just plain wrong. A true and respectful commitment to follow our previous Neighborhood Planning initiative is a much more inclusive and nuanced planning tool.

We will be happy to discuss our findings further,

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