

**CITY COUNCIL AGENDA ITEM**  
CITY OF SHORELINE, WASHINGTON

<p><b>AGENDA TITLE:</b> Public Hearing and Adoption of Ordinance No. 664 adopting the Aurora Square Community Renewal Area Project: 12-year Property Tax Exemption</p> <p><b>DEPARTMENT:</b> Economic Development</p> <p><b>PRESENTED BY:</b> Dan Eernisse, Economic Development Manager</p> <p><b>ACTION:</b> <input checked="" type="checkbox"/> Ordinance    <input type="checkbox"/> Resolution    <input type="checkbox"/> Motion    <input type="checkbox"/> Discussion</p>
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**PROBLEM/ISSUE STATEMENT:**

One of the key elements of the Aurora Square Community Renewal Area (CRA) Plan is to build residential development on site. At its [June 10, 2013, meeting](#), Council discussed expanding the existing 5-year market-rate Property Tax Exemption (PTE) program in the CRA with a 12-year PTE program to encourage targeted residential development. At its June 17, 2013, meeting, Council passed [Resolution No. 346](#) which set a public hearing regarding Council’s intention of adding a 12-year affordable-rate PTE program. Staff has drafted Ordinance No. 664 (Attachment A) for possible adoption following the Public Hearing.

**RESOURCE/FINANCIAL IMPACT:**

Staff resources will be used to create the 12-year PTE program and to market the program to potential investors. Once the 12-year PTE program is used by an investor, staff resources will be devoted to annually auditing compliance with the affordability requirements unique to the 12-year PTE program. For every project that utilizes the 12-year PTE program, City property tax revenue from building improvements—as much as \$1,600 per year for every \$1 million invested in the development—will not be collected for 12 years from the first full-year of occupancy. At the same, the City will receive other revenues such as sales and utility taxes from the development during this period.

**RECOMMENDATION**

Staff recommends adoption of Ordinance No. 664 expanding the Aurora Square CRA PTE program to include a 12-year affordable multi-family PTE program capped at 500 units, requiring that 20% of project units be affordable with studios and one bedroom units rented or sold to families with 70% of the median household income or less and two bedroom or larger units to households with income of 80% of the median household income or less.

Approved By:            City Manager **DT**    City Attorney **IS**

## **INTRODUCTION**

According to the Aurora Square Community Renewal Area (CRA) Plan, one of the keys to renewal is building residential development on site. At its June 10, 2013, meeting, Council discussed expanding the existing 5-year market-rate PTE program that now exists in the Aurora Square CRA less the Washington Department of Transportation property with a 12-year Property Tax Exemption (PTE) program to encourage targeted residential development in the CRA. At its June 17, 2013, meeting, Council passed Resolution No. 346 which set a public hearing regarding Council's intention of adding a 12-year affordable-rate PTE program. Staff has drafted Ordinance No. 664 (Attachment A) for possible adoption following the Public Hearing.

## **DISCUSSION**

The City's most cost-effective incentive for multi-family investors is the PTE program, as it combines delayed City property revenue with those collected by other taxing jurisdictions. The result is that for every dollar of City tax revenue delayed, the investor experiences a savings of eight dollars on its property taxes. But not only is it effective, without a PTE program the City of Shoreline will have a difficult time attracting investors who are able to receive such an incentive from another municipality.

Therefore, the City of Shoreline offers three PTE incentive programs for multifamily developers. Ordinance No. 520 created two unique programs for the North City and Ridgecrest commercial areas with differing 8-year and 12-year PTE programs based on various levels of affordability. Ordinance No. 624 created a 5-year market-rate PTE program for most other areas zoned for multifamily housing throughout the City, including the Aurora Ave N. and Westminster Way target area that includes most of the Aurora Square CRA .

### **The Current 12-year PTE Program**

The 12-year PTE program designated for North City is capped at 500-units, and so far it has stimulated 362 units to be built or permitted.

- North City's 88-unit Arabella began its 10-year market-rate PTE period in 2007 (its 10-year market-rate program was replaced by Ordinance No. 520). The City will begin receiving property tax on improvements in 2017.
- The 165-unit North City Family Apartment building will likely begin its 12-year exemption in 2014. The PTE program requires that 33 units meet affordability requirements, but because the project also used the more restrictive tax credit financing, all 165-units will meet an affordability level of no more than 60% median household income.
- Construction is anticipated to begin in the fall of 2013 on North City's Arabella II, which currently holds a certificate and building permits for 109 units, 21 units of which will be required to be affordable. The owner indicated that receiving the 12-years of PTE program was a stated condition that HUD placed on its financing.

### **The 5-year Market-rate Program**

Meanwhile, the 5-year PTE program recently instituted is considered by the development community to be a valuable incentive as well. It provides a significant reduction in expense without affordability requirement, and it helps a development to

lease the building and achieve stabilized rents with lower expenses. The developer of the 129-unit project now under construction on N 152<sup>nd</sup> St just east of Aurora Ave N testified before Council that the 5-year program was sufficient to achieve adequate profit-levels.

### **No PTE Program**

Not all recent Shoreline multifamily developments have required the PTE incentive. *The Artiste*, a 148-unit on Aurora and N 201<sup>st</sup> St and the Echo Lake project are examples of projects in the past decade that did not require PTE incentives. A brief description of each will describe the circumstances that led to their construction:

- 1) The property for *The Artiste* was purchased in pre-recession 2007 by Weidner Apartment Homes, a large privately-owned company already familiar with and invested in Shoreline; Weidner owns Forest Hill Apartment Homes to the southeast of City Hall. Weidner may not have purchased *The Artiste* property even months later, given the economic downturn of 2008. Thanks to the financial strength of the company, it wisely held the property yet delayed construction for three years. Beginning construction in 2010 allowed Weidner to take advantage of extraordinarily low construction pricing and to ride the creeping tide of recovery. The combination of an owner willing to weather a three-year delay and the timing of the recovery are conditions that won't often be repeated in Shoreline.
- 2) *The Echo Lake* project was a product of the real estate boom prior to the recession when financing was relatively easy to attain for multi-family and senior housing. In addition, it was a project with an owner-occupant anchor tenant in the YMCA that helped bring the project together. That project would have difficulty being financed in the current market, and the property struggled its first five years. Many similar projects feed the current level of caution and pessimism in the investment community.

Darin Davidson of Inland Construction was asked to comment on the state of multi-family financing, having built both Echo Lake and The North City Family Apartments.

*“Dan – with where costs are today and with where interest rates have moved in the last month and where they're likely headed, we aren't looking at any new sites that do not have property tax exemption available.”*

*“Also, note that the Echo Lake project tied into an existing sewer system that was substantially less expensive than the new(er) system that the North City project will be using. I'm not completely up to speed on this but know that the difference is several thousand dollars per unit in upfront costs.”*

In letters to staff and Council (Attachment B), Sean Hyatt of Mill Creek Residential echoed Mr. Davidson's thoughts, confirming that his proposed project in the CRA will be saddled with extraordinary sewer connection charges (Ronald Wastewater's connection charges will be approximately five times of those of Seattle Public Utilities), and with 40% higher property tax rates than those in Seattle. To even out these costs, given the

relatively low rent level in Shoreline, Mr. Hyatt stated that the success of his project is contingent on receiving not only a 12-year PTE program, but one with no more than a 75% AMI affordability requirement for 20% of the units. An acceptable program for Mr. Hyatt's project would be similar to what is offered throughout the City of Seattle as well as in the North City area.

In conclusion, should Council proceed with expanding the Aurora Square CRA PTE program to include a 12-year PTE option, Staff will explain to the development community that the 5-year market-rate PTE is the baseline incentive offered in Shoreline. The Council's precedent of offering a 12-year PTE program is reserved for those areas that Council has also targeted for public investment and planning such as North City and the Aurora Square CRA. This strategy allows Council to use the 12-year PTE program as a tool to engage City resources alongside private investment to stimulate development in specific areas while—at the same time—creating valuable affordable housing.

### **COUNCIL GOALS ADDRESSED**

Renewal of Aurora Square will promote the Council's Goal 1: Strengthen Shoreline's economic base. The City Council adopted a six-year comprehensive Economic Development Strategy in January of 2012 that specifically calls out the need to improve Aurora Square as one of the city-shaping place-making opportunities in Shoreline.

### **RESOURCE/FINANCIAL IMPACT**

Staff resources are necessary to complete the action necessary to create the 12-year PTE program and to market the program to potential investors. Once the 12-year PTE program is used, Staff resources will be necessary to annually audit compliance with the affordability requirements unique to the 12-year PTE program. For every project that utilizes the 12-year PTE program, City property tax revenue from building improvements—as much as \$1,600 per year for every \$1 million invested in the development—will not be collected for 12 years from the first full-year of occupancy. At the same, the City will receive other revenues such as sales and utility taxes from the development during this period.

### **RECOMMENDATION**

Staff recommends adoption of Ordinance No. 664 expanding the Aurora Square CRA PTE program to include a 12-year affordable multi-family PTE program capped at 500 units, requiring that 20% of project units be affordable with studios and one bedroom units rented or sold to families with 70% of the median household income or less and two bedroom or larger units to households with income of 80% of the median household income or less.

### **ATTACHMENTS**

Attachment A: Ordinance No. 664

Attachment B: Letters to Council and Staff from Sean Hyatt, Mill Creek Residential

**ORDINANCE NO. 664**

**AN ORDINANCE ESTABLISHING A 12-YEAR EXEMPTION FROM REAL PROPERTY TAXATION FOR AFFORDABLE MULTIFAMILY HOUSING IN THE AURORA SQUARE TARGET AREA AND ADOPTING; AND AMENDING SHORELINE MUNICIPAL CODE SECTION 3.27.030**

WHEREAS, Chapter 84.14 of the Revised Code of Washington provides for exemptions from ad valorem property taxation for qualifying multi-family housing located in designated target areas within urban centers and authorizes the City to adopt necessary procedures to implement the State legislation; and

WHEREAS, in order to establish a tax exemption program, the City must designate one or more target areas within which tax exemption projects may be considered; and

WHEREAS, Ordinance No. 624 established a portion of the Aurora Square CRA as a Residential Target Area to allow a 5-year exemption from ad valorem property taxation for multi-family housing; and

WHEREAS, the City conducted a public hearing to consider expansion of the tax exemption period within the Aurora Square and Westminster Way Target Area up to 12 years for housing projects that meet certain affordable housing criteria pursuant to RCW 84.14.020(1)(a)(ii)(B) ; and

WHEREAS, Council finds that provision of additional housing opportunities, including affordable housing, will assist in promoting further economic development and growth management goals by bringing new residents to utilize urban services and encourage additional residential and mixed use opportunities in the Aurora Square and Westminster target area; now therefore

**THE CITY COUNCIL OF THE CITY OF SHORELINE, WASHINGTON, DO ORDAIN AS FOLLOWS:**

**Section 1. Amendment.** Section 3.27.030 *Standards and guidelines* is amended to read as follows:

3.27.030 Standards and Guidelines

- A. Project Eligibility. A proposed project must meet the following requirements for consideration for a property tax exemption:
  - 1. Location. The project must be located within one of the targeted residential areas designated in section 3.
  - 2. Size. The project must provide for a minimum of fifty percent of the space for permanent residential occupancy. At least four additional

residential units must be added to existing occupied multi-family housing. Existing multi-family housing that has been vacant for 12 months does not have to provide additional units so long as the project provides at least fifty percent of the space for permanent residential occupancy and rehabilitated units failed to comply with one or more standards of the applicable state or local building or housing codes. Transient housing units (rental of less than one month) are not eligible for exemption.

3. Proposed Completion Date. New construction multi-family housing and rehabilitation improvements must be scheduled to be completed within three years from the date of approval of the application.
4. Compliance with Guidelines and Standards. The project must be designed to comply with the City's comprehensive plan, building, and zoning codes and any other applicable regulations in effect at the time the application is approved.

B. Exemption - Duration.

1. Market-rate Exemption. The value of improvements qualifying under this chapter for a Market-rate Multiple Family Tax Exemption will be exempt from ad valorem property taxation for five successive years beginning January 1 of the year immediately following the calendar year after issuance of the Final Certificate of Tax Exemption.

2. Affordable-rate Exemption. Projects qualifying in the Aurora Avenue N. Corridor target area within the Aurora Square Community Renewal Area that rent or sell at least twenty percent (20%) of the residential units as affordable housing units as defined by Chapter 84.14 RCW will be exempt from ad valorem property taxation for twelve successive years beginning January 1 of the year immediately following the calendar year after issuance of the Final Certificate of Tax Exemption; provided, however, that for this target area, the household income may in no case exceed 70% of the area median household income adjusted for family size for studio and one bedroom units, and may in no case exceed 80% of the area median household income adjusted for family size for two or more bedroom units. No more than 500 units will be approved under this subsection, aggregating affordable-rate units of all Projects in this target area.

C. Limits on Exemption. The exemption does not apply to the value of land or nonhousing-related improvement, nor does the exemption apply to increases in assessed valuation of land and non-qualifying improvements. In the case of rehabilitation of existing buildings, the exemption does not include the value of improvements constructed prior to submission of the completed application required under this chapter.

D. Contract. The applicant must enter into a contract with the city approved by the City Manager or designee under which the applicant has agreed to the implementation of the development on terms and conditions satisfactory to the City Manager or designee.

ATTACHMENT A

**Section 3. Effective Date.** A summary of this ordinance consisting of the title shall be published in the official newspaper and the ordinance shall take effect five days after publication.

**ADOPTED BY THE CITY COUNCIL ON JULY 8, 2013.**

\_\_\_\_\_  
Keith A. McGlashan, Mayor

**ATTEST:**

**APPROVED AS TO FORM:**

\_\_\_\_\_  
Scott Passey, MMC  
City Clerk

\_\_\_\_\_  
Ian Sievers  
City Attorney

Publication Date: , 2013  
Effective Date: , 2013



May 3, 2013

Mr. Dan Eernisse  
Economic Development Manager  
City of Shoreline  
Address  
City, State, ZIP

RE: Aurora Square Community Redevelopment Area – Multi-Family Tax Exemption

Dear Mr. Eernisse:

As you and I have discussed over the past few months, my company, Mill Creek Residential Trust (MCR) is pursuing an apartment development opportunity at the intersection of the North 155<sup>th</sup> Street, Westminster Way NE and Aurora Avenue North (former Joshua Green Corporation property).

MCR's corporate background is attached, but in summary, we are the successor organization to Trammell Crow Residential. We have a significant track record in the Puget Sound area, including recent deals in Ballard, Green Lake and Redmond. MCR formed in 2010, and by the end of 2013 will have 15,000 units and \$3 billion under ownership or development nationwide.

In our underwriting of this opportunity, we have determined that in order to be attractive to the capital markets, this project needs two primary things: a 12-year property tax exemption consistent with RCW 84.14, and the ability to be permitted, ready to close a construction loan, and begin construction by the end of 2013.

In determining the need for the property tax exemption, we have evaluated the key components of any development deal: achievable rents, costs to construct, and the economic return required to attract capital. We have correlated rents for a class "A" apartment community with market information for comparable properties throughout Shoreline and north Seattle submarkets. We have prepared internal cost estimates and solicited third party general contractor cost estimates to construct the development (based on conceptual plans), and our capital markets team has discussed with numerous investment groups the terms and performance necessary to access capital.

The underwriting for this deal results in a yield on cost (total cost divided by total net income) of approximately 5.3% – too low to attract investment capital from our discretionary investment fund or



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separate account investors. However, with a 12-year property tax exemption, the yield is slightly over 6.00%. This yield compensates investors for taking development risk versus the equivalent cap rates currently in the market. There are two reasons the tax exemption is so accretive. The first is the comparable levy rate in the City of Seattle is 10.51 while Shoreline's is 14.76 or 40% higher for equivalent valuations. Secondly, market rate rents in the City of Shoreline are lower than Seattle's due to the economic realities of concentric drive times from major employment centers and the near linear decline in rents from those employment centers.

I realize there is an existing 5-year property tax exemption in place for the property due to the Community Renewal Area you have adopted. However, due to the hold horizons of investors, a 5-year exemption is not underwriting in operating expenses (resulting in higher expenses and lower NOI) but is added back as a premium to the sales price. This results in a yield too low to compensate for the risk of the initial investment. A 12-year exemption, as it eclipses the term of original permanent financing, is underwritten as a reduction in operating expenses (resulting in higher NOI) and therefore an increase in value.

We are confident in our evaluation of this opportunity, and hope that the City of Shoreline will accommodate our request to adopt a 12-year property tax exemption for this property. To be clear, we have made this a contingency of our agreement to purchase the land, and hope that the exemption designation can be adopted within 120 days. I can be reached at (425) 739-7669 if there are any questions, and look forward to discussing this further with you and City of Shoreline council members in the near future.

Sincerely,  
Mill Creek Residential Trust, LLC



Sean G. Hyatt  
Managing Director

Cc: Mr. Tsang

Attachments



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# MILL CREEK

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RESIDENTIAL TRUST LLC

## COMPANY DESCRIPTION

*January 2013*

Launched in 2010, Mill Creek Residential (MCR) is a new company with a long and rich history. Established by former Trammell Crow Residential executives, who have spent decades working together as a team, we provide the perfect platform to build upon our expertise and bring innovative vision to our investments. Our team of multifamily experts offers a renowned level of experience, integrity, and reliability along with a fresh outlook and strategic new ideas for the future. Together, we have participated in the development and acquisition of over 260,000 apartment units, executed over \$15 billion in transactions since 1993, and have a proven ability to identify and optimally address market conditions.

Operating in major geographic markets across the U.S., Mill Creek Residential employs approximately 210 associates. Our executive management team represents an average of 28 years of industry experience, and our regional development and construction teams' expertise and knowledge also runs deep with numerous years of successful and notable experience.

Mill Creek Residential targets core market areas that have been historically profitable in development, construction, and acquisition endeavors and that demonstrate above-average population growth, strong employment characteristics, and consistent and sizable institutional investment demand. Our team boasts a proven strategy and platform that has historically delivered strong returns to our investors.

Mill Creek Residential organizes its business geographically, allowing the executives to be the "local experts" and positioning them to take advantage of local opportunities. This local real estate expertise is coupled with key national operating procedures and standards and is supported by a Management Committee that directs the strategic day-to-day operations of the firm. The MCR Management Committee includes **Charlie Brindell**, *CEO*; **Bill MacDonald**, *Executive Managing Director—East Region*; **Mike Collins**, *Executive Managing Director—West Region*; **Mike Hefley**, *Executive Managing Director—Operations*; **Sherry Brown**, *Chief Finance Officer*; **Mark Dempsey**, *Executive Managing Director—Acquisitions*; **Michael Melaugh**, *Executive Managing Director—National Capital Markets*; **Kevin Andrade**, *Senior Managing Director*, and **Chip Bay**, *Senior Managing Director*.

### DEVELOPMENT CAPABILITIES

Our development team is one of the most experienced and successful in the multifamily industry. Our senior management team oversees a development team of 90+ experienced associates.

The West and East regions are supported by divisional Senior Managing Directors (SMD's) who report to the EMD's and oversee the day-to-day operations for their respective business divisions. These individuals include:

<b>Northeast</b>	<i>Peter Porraro</i>
<b>Mid-Atlantic/Carolinas</b>	<i>Chip Bay</i>
<b>North Florida/Southeast</b>	<i>Alan Kolar</i>
<b>South Florida</b>	<i>Callum Parrott</i>
<b>Texas &amp; Colorado</b>	<i>Darren Schackman</i>
<b>West Coast</b>	<i>Kevin Andrade</i>
<b>East Acquisitions</b>	<i>Wes Dickerson</i>
<b>West Acquisitions</b>	<i>Alex Gill</i>

### **CONSTRUCTION CAPABILITY**

Mill Creek Residential has one of the most experienced and well-respected construction teams in the multifamily industry. Our construction executives and associates are located in every key region in which we operate and leverage from their many years of experience. They bring expertise in all types of multifamily construction and rehabilitation—including garden product and high-density residential and mixed-use communities—and have a deep knowledge of current construction economics. We support our construction teams via an array of services throughout the development process; and they are an invaluable resource during due diligence, concept analysis, pre-construction, project design, and acquisition of stabilized assets.

The promotion of teamwork, communication, attention to detail, and the highest level of quality construction are a focus for each of our construction executives. Our quality control systems include strict guidelines for budget management, cost control, safety, and communication. We recognize, embrace, and apply the best management practices and standards of care necessary to protect and preserve the environments around us and strive to incorporate green building practices wherever possible. Together, we have executed the construction of more than 240,000 apartment homes nationwide.

### **ACQUISITIONS CAPABILITY**

Mill Creek Residential is pursuing multifamily acquisitions in targeted markets across the United States. Our competitive advantage derives from a broad and deep reach into primary markets across the country supported by a seasoned team of acquisitions, development, construction, finance, and asset management associates in 16 offices. We possess demonstrated investment expertise in the acquisition of existing assets that have opportunity to improve through physical upgrades or operational improvements, transforming them into exceptional leading-edge properties. We target core markets that have been historically profitable in development, construction, and acquisition endeavors and demonstrate above-average population growth, strong employment characteristics, and consistent and sizeable institutional investment demand.

*For additional information on Mill Creek Residential, please visit us at [www.MCRTrust.com](http://www.MCRTrust.com)*

# MILL CREEK

RESIDENTIAL TRUST LLC

## FACT SHEET

*January 2013*

<b>Name:</b>	Mill Creek Residential Trust LLC
<b>Corporate Office Address:</b>	2001 Bryan Street, Suite 3275 Dallas, TX 75201
<b>Phone:</b>	214.922.8500
<b>Fax:</b>	214.922.8510
<b>Year Formed:</b>	2010
<b>Ownership:</b>	Privately held limited liability corporation
<b>Number of Associates:</b>	Approximately 210
<b>Senior Management:</b>	Charles R. Brindell, Jr.— <i>Chairman and CEO</i> Sheryl A. Brown— <i>Chief Finance Officer</i> Michael A. Collins— <i>Executive Managing Director, West Region</i> William C. MacDonald— <i>Executive Managing Director, East Region</i> Mark R. Dempsey— <i>Executive Managing Director, Acquisitions</i> Michael M. Hefley— <i>Executive Managing Director, Operations</i> Michael G. Melaugh— <i>Executive Managing Director, Capital Markets</i> Rachel R. Purcell— <i>Chief Administrative Officer</i>
<b>Company Focus:</b>	Land entitlement, development, construction, acquisition, and sale of multifamily communities in major U.S. markets
<b>History:</b>	<p><u>2012 Highlights</u></p> <ul style="list-style-type: none"> <li>• Focused on new apartment development and acquisition of existing apartment communities <ul style="list-style-type: none"> <li>○ Initiated development on approximately 5,000 multifamily rental units</li> <li>○ Acquired 1,326 existing rental apartment units at total capitalization of \$178.5MM</li> </ul> </li> </ul> <p><u>2013 Outlook</u></p> <ul style="list-style-type: none"> <li>• Expect to start construction on more than 4,500 additional multifamily rental units</li> <li>• Focus on value added acquisitions of existing apartment communities</li> </ul>

*For additional information on Mill Creek Residential, please visit us at [www.MCRTrust.com](http://www.MCRTrust.com)*

**Dan Eernisse**

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**From:** Sean Hyatt [SHyatt@mcrtrust.com]  
**Sent:** Tuesday, May 28, 2013 1:46 PM  
**To:** Dan Eernisse  
**Subject:** RE: Westminster project MFTE proposal

**Importance:** High

Dan,

The rough delta on a 60% AMI versus a “blended” 75% AMI is about \$200,000 less in annual NOI. Our programming is not complete so this will change as that advances. This does not include ancillary analysis of things such as ability to pay utilities, credit loss, parking, etc. Nor does it include the weighting of the vacancy that you suggested, which I am not familiar with from past affordable operations, but which I don’t think the market will accept (saying that your vacancy factor blends down your affordability requirement). As you know, vacancy assumptions are standardized and mathematically applied, and until there is a real community to operate analysis that fine needs to be immaterial.

Using the market cap rate the ‘value’ of that difference is over \$4 Million. More importantly the yield drops well below a 6.0% current yield on cost with the loss of NOI.

Your observations about the differential between Shoreline and Seattle rents are apt if comparing Westminster to Broadway, but don’t include the cost to build. For the same building in Shoreline, the costs are actually higher than in Seattle. Subcontractors don’t care what side of the line you are on – it costs the same to build the same box. Unfortunately, development is saddled with muni fees in Shoreline (i.e. Ronald) that aren’t charged in Seattle. Granted, land values reflect this, so the pro forma needs to, and does, cover all of these adjustments.

At the end of the day, if the City wants to catalyze this spectrum of development, a catalyst needs to be provided. I know the land owner already feels that he is getting less than the land is ‘worth’ and has asked if we are going to cancel the contract as a result of this, so I do not think the difference will be made up there. There are a number of thresholds for us as well (spread over adjusted cap rates, current yield on cost, profitability, and ultimately market approval – which includes timing) that I need to meet.

Given the level of affordability sought in the other two PTE areas adopted by the City, it seems reasonable to work toward something similar here.




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## MEMORANDUM

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To: File

From: Sean G. Hyatt, Managing Director –

Date: Wednesday, June 12, 2013

Subject: City of Shoreline Council Hearing - RE Westminster

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Introduction - MCR

*“Since Mill Creek’s start in 2010, we have established a strategic presence in many of the nation’s most desirable apartment markets through our healthy development pipeline and our ‘buy where we build’ acquisition strategy. At the end of 2012, we had nearly 9,000 apartment homes comprising 29 communities operating or under construction coast-to-coast. By the end of 2013, we anticipate that our portfolio will grow to 15,000 units and more than \$3 billion of total capitalization. It’s important to underscore that our success is a function of simultaneously and purposefully serving the needs of our residents, investment partners, associates and the communities in which we live, work, and invest. We are grateful for each and every relationship.”*

Recently purchased the \$95 MM Skye @ Belltown. Previously developed numerous Seattle-area communities including Circa Green Lake which recently sold for \$420,000 per unit, and Veloce in downtown Redmond which sold for \$96MM.

We are currently under contract on property at 155<sup>th</sup>, Westmisnter, and Aurora in the Aurora Square Community Redevelopment Area.

Propose 300 – 350 apartment homes in a podium style building. Catalyzing redevelopment in the area much as we did for downtown Redmond with Lionsgate.

Have evaluated this deal internally and identified two primary contingencies:

- need to receive a capital allocation in calendar year 2013, requiring permits by year’s end
- need to receive a 12-year property tax exemption to ensure financeable economic returns

The timing is a matter of capitalizing on market forces. Allocations need placed due to recent years of inactivity, but investors are becoming more selective when faced with perceived oversupply in Seattle.

Shoreline has market rents lower than other closer in north Seattle submarkets. Lower rents support lower costs. However, hard costs for a podium development are equal in Shoreline and South Lake Union.

**Market study prepared by the Concord Group out of the Bay Area indicating discrete current market rents, which are aggressively placed above the comparable market.**

Area	Central King County	North Downtown	Shoreline	Lynnwood
Rent	\$1920 – \$2.57/SF	\$2192 - \$2.77/SF	\$1166 – \$1.43/SF	\$1421 = \$1.22/SF



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Shoreline has the lowest rents of the compared areas.

Additionally, tax rates are higher in Shoreline than in Seattle, and Lynnwood. Seattle has higher rents, Lynnwood lower, but Lynnwood sees less dense, less costly construction in garden style and surface parked communities.

**Shorelines levy rates are 40% higher than Seattle's.**

To offset this, expand the current 5-year property tax exception of 12-years.

Investors will look a 5-year exemption as a discounted lump sum increase to property value, but still underwrite full property taxes.

Meanwhile they will look at a 12-year exemption as a true reduction in expenses, increasing NOI. There is still a penalty to cap rates on the investment stream, of between 25 bps and 75 basis points for having the tax exemption due to impacts to terminal value after year 12, which usually falls outside the first hold period evaluation based on fund cycles and debt terms.

Capitalization rates express the relationship between value and income (how much someone will pay for a stream of income – lower cap rates indicate better quality / safer income stream. Yield is a measure of that same NOI to cost. The difference in cost to value is the risk premium required to invest the capital.

Current capitalization rates are approximately 5.1% in King County per Dupre+Scott, but we are able to underwrite a lower cap rate given the quality of our communities (such as Green Lake which traded at about a 4.0% cap rate) and are using 4.25% as our base cap rate and 4.75% as our adjusted cap rate .

**Having the 12-year abatement at 80% of AMI results in a yield on cost of approximately 6.15%. Which is about 150 bps spread over current unadjusted cap rates, giving maybe 15 bps of spread for the terminal discount. In other words, this is not a slam dunk deal, and any number of additional expectations, including affordable rents at 60% of AMI could make it infeasible.**

Having a 12-year abatement with rents at 60% of AMI results in a yield of 5.85%. Or a spread of only 135 basis points over an aggressive current cap rates, due to the decrease in NOI. This spread does not accommodate the premium/discount for the termination value when the tax exemption expires.

The yield with full property taxes and full market rents is only 5.3%. Barely above current capitalization rates, providing no incentive to make the investment given how many other options are available in the market.

I hope I've demonstrated why the 12-year tax exemption, with 80% of King County AMI rents is important for the viability of this new community.

Any questions or follow up can be directed through Mr. Eernisse. Thank you for your time and consideration.



**Dan Eernisse**

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**From:** Sean Hyatt [SHyatt@mcrtrust.com]  
**Sent:** Wednesday, June 12, 2013 1:26 PM  
**To:** Dan Eernisse  
**Cc:** rickts@comcast.net; Brian Leibsohn  
**Subject:** RE: thanks  
**Attachments:** mem-COS Council Hearing 6-10-13.pdf

Dan,

I am generally reluctant to draw distinctions between projects (ours and others'), as that opens up off-point quibbling and sets the table for future finger pointing. I don't know enough about their cost basis, their quality of finish, their construction execution, their timing, etc. to compare their completed projects to our conceptual one. I do know that conclusions can be drawn based on who did what, and whether they are lined up to do more, but I'd rather be non-committal on that front for various reasons. I will say that our market study evaluated Artiste, and we have underwritten rents higher than they are achieving.

The case for the exemption on this property for this development is clear to me: based on the current design concept (by others), the land price (mutually agreed to), an independent third party market study, preliminary hard costs (by a third party GC), and our 'pulse' on the investment market for MFR in Puget Sound - all evaluated through our underwriting - we need the 12-year exemption to make this deal economically attractive for investment. We are grappling with a schedule issue as well, but for the time being this economic threshold has taken due precedence.

One aphorism I like, is "development is like institutional gambling." No one will know how successful this project will be for any of us, until a few years after it is complete. The architect will get paid, the land owner will get paid, the City will get a new development, the bank will have our guarantee, and the last one standing will be MCR and our partner. My job is to put us in the best position possible to make sure that at the end of the day, we pick winning projects to allocate our resources to. Given the various yield scenarios I outlined in the memo I left with the clerk (attached again here for reference) we have determined that for us to evaluate this project, the predicate was a 12-year exemption. Something that seems achievable given the City's past willingness, and the demonstration of interest through the CRA adoption. Even though it is sometimes my job, I am not good at predicting the future. Is it possible we get this project stabilized and it is an absolute home run and the exemption was superfluous? Yes. Is it likely? Unfortunately not.

In some ways, this gets down to that excerpt from the market study I sent you last week. Why is Shoreline getting skipped over for quality development, and what is the City prepared to do about it?

Please clarify if the attached memo isn't what you were referring to for a letter to include in your package. Thanks for the opportunity to speak on Monday. I apologize for flying in and out.