Council Meeting Date: March 26, 2018 **Agenda Item:** 9(b)

CITY COUNCIL AGENDA ITEM

CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Discussion of Ordinance No. 817: Amending Shoreline Municipal Code Title 3 to Establish a New Section 3.01.025 Affordable Housing Fee in Lieu
DEPARTMENT:	Community Services Division
PRESENTED BY:	Rob Beem, CSD Manager, Community Services
ACTION:	____ Ordinance ____ Resolution ____ Motion __X__ Discussion ____ Public Hearing

PROBLEM/ISSUE STATEMENT

The Mixed-Use Residential-45' and -70' (MUR-45' and MUR-70') zoning designations in the Light Rail Station Areas contain provisions requiring for-lease residential developments to provide a certain number of units at specified affordability levels. The Development Code also provides a developer the option to meet this requirement by paying a Fee in Lieu (FIL) of constructing the housing (SMC 20.40.235.E.). In July 2017, the City Council determined that this fee should be set a rate that equated to the "affordability gap" and that it should be available only for fractional affordable housing units; instances where a developer would be required to construct a partial unit. While staff anticipates that the FIL will be used only in rare and unique circumstances as long as the City's Property Tax Exemption (PTE) Program exists in the Station Areas, the FIL must still be established in the Municipal Code.

Tonight, Council is scheduled to discuss proposed Ordinance No. 817 (Attachment A). This proposed ordinance amends Title 3 of the Municipal Code to establish a FIL in the City's fee schedule (SMC 3.01). Proposed Ordinance No. 817 is scheduled to be brought back to Council for adoption on April 16, 2018.

RESOURCE/FINANCIAL IMPACT:

Revenues from this fee are not included in the 2018 budget as there are no projects currently in the development pipeline that are likely to make use of this FIL option. The 2018 Annual Budget provides sufficient funding for staff to administer these code requirements.

RECOMMENDATION

No action is required as tonight's agenda item is for discussion purposes only. When this item is brought back to the City Council for action, staff recommends that Council adopt Ordinance No. 817 to establish an Affordable Housing Fee in Lieu.

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

BACKGROUND

The City is strongly supportive of efforts to expand the supply of housing that is available and affordable to people with moderate and low incomes. Recent examples of this support include providing financial contributions to affordable housing projects like Ronald Commons, providing land for use in partnership with King County on the 198th and Aurora affordable housing project, the affordable housing mandates in the City's Property Tax Exemption (PTE) program, and the inclusionary zoning provisions of the Station Areas.

Both the 145th and 185th Light Rail Station Areas contain inclusionary zoning provisions, which mandate a level of affordability to support the development of "workforce" housing. This is largely considered housing available to households with incomes between 60% and 80% of the King County Area Median Income (AMI). In 2017, for a four-person household, the King County AMI was $96,000. That means that a household making 60% of AMI would have an annual income of $57,600, and a household making 80% of AMI would have an annual income of $76,800. For their housing to be considered "affordable", a household should spend no more than 30% of their income on housing-related expenses, including property taxes and utility bills.

Shoreline Municipal Code (SMC) Section 20.40.235, titled Affordable housing, light rail station subareas, contains a table that outlines voluntary and mandatory affordable housing provisions for new developments built in the Station Areas. In the MUR-45' and MUR-70' zones, the requirement for affordable housing is as follows:

- Studio and one-bedroom apartments -
  - 20% of rental units shall be affordable to households making 70% or less of the median income for King County adjusted for household size, or
  - 10% of rental units shall be affordable to households making 60% or less of the median income for King County adjusted for household size.
- Two-bedroom or larger apartments -
  - 20% of the rental units shall be affordable to households making 80% or less of the median income for King County adjusted for household size, or
  - 10% of the rental units shall be affordable to households making 70% or less of the median income for King County adjusted for household size.

Starting in 2017, the City engaged Michael Stanger of *Social Impact Workshop* to develop administrative procedures and requisite documents to implement this Light Rail Station Area Affordable Housing program. This work included establishing guidelines and procedures to integrate these requirements into the City's development and permitting process and crafting the necessary regulatory agreements to ensure long term affordability. These procedures are largely in place and will be complete by August of this year. Mr. Stanger has experience with A Regional Coalition for Housing (ARCH) developing and implementing similar programs in cities on the eastside of Lake Washington. In addition to other aspects of implementing the City's Light Rail Station Area Affordable Housing program, Mr. Stanger has worked with staff to develop this proposal for setting the Fee in Lieu (FIL) amount.

Fee in Lieu (FIL) Policy Direction
At the City Council's July 24, 2017 Council meeting, staff provided an update on work to implement the affordable housing provisions of the Light Rail Station Areas and asked for Council direction on several items, including whether or not to offer a FIL alternative to constructing required affordable units on-site, how the fee should be calculated, and how to administer this fee and resultant Housing Trust Fund. The staff report for this Council discussion can be found at the following link: http://cosweb.ci.shoreline.wa.us/uploads/attachments/cck/council/staffreports/2017/staffreport072417-9a.pdf.

At this meeting, Council gave direction that the FIL should be available only in instances where a developer's obligation was for a fractional affordable housing unit, and should not apply to full units that would need to be constructed on-site. For example, in a 98 unit apartment building, 20% of the total units would equal 19.6 affordable units, so the developer would need to build 19 units as part of their development, but could pay a FIL for the 0.6 fractional unit.

This direction to use the FIL for fractional units only was formally codified on February 26 of this year when Council adopted Ordinance No. 789, which amended SMC Section 20.40.235 to state that:

> *"Payment in lieu of constructing any fractional portion of mandatory units is available upon City Council's establishment of a fee in lieu formula. See subsection (E)(1) of this section. Full units are not eligible for fee in lieu option and must be built on-site."*

Tonight's discussion addresses the creation of the FIL formula.

Usage of the FIL
In April 2017, the Council extended the PTE program to the 145th Street and 185th Street Light Rail Station Areas. The designation of these residential target areas for PTE will automatically expire on December 31, 2021 unless the Council amends the PTE code.

The State statue governing PTE programs requires that 20% of *built* units be affordable to households making a maximum of 80% AMI. Using the example above, since a developer could not build 0.6 of a unit, they would be required to round up and construct a total of 20 units if they were to also apply for the PTE program. Given that it makes rational economic sense for developers to apply for the PTE program if developing in the Station Areas, staff believes that the FIL provision for fractional units will only be utilized in rare and unique circumstances while the PTE Program is in place in the Station Areas. Regardless of how frequently the FIL provision is used however, staff still does recommend that a FIL formula be established in the City's Fee Schedule as directed by Ordinance No. 789. Additionally, if the PTE program in the Station Areas sunsets in 2021 or in a subsequent year if the program is extended by Council, then developers may choose to use FIL for fractional affordable housing units rather than rounding up and building a whole unit on site.

DISCUSSION

The purpose of the FIL is to provide sufficient funds to replace the foregone fractional affordable housing unit. The fee must meet the test contained in the code to provide a "result equal to or better than providing affordable housing on site." This is identified in SMC Section 20.40.235(E), Alternative Compliance.

At the July 24, 2017 Council meeting, Council also considered how to calculate the FIL and determined it should use a methodology dubbed, "the Affordability Gap Method", (see Attachment B). This method meets the code test above and accounts for value (or "public benefit") of the affordable units; i.e., the gap between what a low- or moderate-income household can afford and what they would have to pay on the open market. To calculate the FIL using this approach, one subtracts the affordable rent from the present market rent for comparable new multifamily housing and divides the difference by the current market capitalization rate (cap rate). The result is a lump sum fee per unit.

To derive the proposed fees, Mr. Stanger took 100% of AMI as the basis for market rents, relying on survey data reported by Dupre+Scott as well as staff expertise on local markets and pipeline projects. A cap rate of 4.9% was determined in part from apartment market reports by Dylan Simon of Colliers. On this basis, an average market rate unit produced a capitalized value of $477,000. The recommended fees represent the difference between $477,000 and the income produced by the various affordability levels. More detailed support for these figures can be found in Attachment B of this staff report.

The FIL will vary depending on levels of affordability. As noted above, developments in MUR-45' and MUR-70' zones are required to provide either 10% or 20% of their units as affordable to households making either 60% or 70% of AMI, respectively. Staff recommends establishing the FIL at the following amounts for the different percentage of units required and in the different MUR zones:

Zoning District	**Fee Per Unit if Providing 10% of Total Units As Affordable**	**Fee Per Unit if Providing 20% of Total Units As Affordable**
MUR-45' and MUR-70'	$206,152	$158,448
MUR-70' with development agreement	$253,855	$206,152

Proposed Ordinance No. 817 amends the City's Fee Schedule (SMC 3.01) to incorporate these proposed FILs for affordable housing in these zones. As is noted in proposed Ordinance No. 817, the FIL is calculated by multiplying the fee shown in the table above by the fractional mandated affordable housing unit. The proposed Ordinance also has the following example to highlight how this would work: "For example, a 0.40 fractional unit x $206,152 would result in a Fee in Lieu of $82,460.80."

Collected FIL Payments

Funds collected through FIL payments will be used to further the goal of providing additional units of affordable housing, at deeper levels of affordability than required in market-rate developments. While it was initially thought that this would require establishing a separate fund, this is not required. The City can receive, track and manage monies received through the FIL within the existing accounting structures in the City's General Fund. No separate action is required by the City Council for this.

While staff anticipates very low usage of the FIL while the PTE Program is in place, if FIL payments are received, staff estimates that with a balance of between $50,000 and $200,000 of funding, the City would be in a position to provide very useful assistance to an affordable housing project that intends to locate in Shoreline. It will likely require upwards of $200,000 to have sufficient funding to attract a project to Shoreline.

When enough funding has been collected through this program, the City will allocate those funds to a housing development partner through a completive selection process similar to the process used for allocating Human Services funding. The City will set forth specific criteria through an RFP for the allocation based on needs and opportunities present in the market. Staff recommends the following general criteria be used to guide allocation of collected funds:

1. Funds should be used to support the costs related to the development or preservation of housing, including land acquisition, predevelopment, design, and construction costs. Funds will not be used to support ongoing staffing or operations costs of the City.
2. Funds should be used to support housing affordable to households with incomes less than 60% of the King County AMI. This is a segment of the housing market that will not be served by the private for-profit sector; to develop this type of housing will require a subsidy.

COUNCIL GOAL(S) ADDRESSED

This item addresses the following Council Goals and Action Steps:

Council Goal 3: Continue preparation for regional mass transit in Shoreline

- Action Step 8 - Implement the Affordable Housing Program as identified in light rail station subarea plans.

Council Goal 4: Expand the City's focus on equity and inclusion to enhance opportunities for community engagement.

- Action Step 2 - Facilitate the development of affordable housing projects in Shoreline and engage in regional efforts focused on addressing homelessness.

RESOURCE/FINANCIAL IMPACT

Revenues from this fee are not included in the 2018 budget as there are no projects currently in the development pipeline that are likely to make use of this FIL option. The 2018 Annual Budget provides sufficient funding for staff to administer these code requirements.

RECOMMENDATION

No action is required as tonight's agenda item is for discussion purposes only. When this item is brought back to the City Council for action, staff recommends that Council adopt Ordinance No. 817 to establish an Affordable Housing Fee in Lieu.

ATTACHMENTS

Attachment A: Proposed Ordinance No. 817
Attachment B: Calculating the Affordability Gap

ORDINANCE NO. 817

AN ORDINANCE OF THE CITY OF SHORELINE, WASHINGTON AMENDING SHORELINE MUNICIPAL CODE TITLE 3 TO ESTABLISH A NEW SECTION 3.01.025 AFFORDABLE HOUSING FEE IN LIEU.

WHEREAS, the City of Shoreline is a non-charter optional municipal code city as provided in Title 35A RCW, incorporated under the laws of the state of Washington, and planning under the Growth Management Act, chapter 36.70A RCW; and

WHEREAS, RCW 36.70A.540 permits the City to create affordable housing programs and to allow a payment of money in lieu of housing units if the City determines that the payment achieves a result equal to or better than providing the units on-site; and

WHEREAS, in 2015 and 2016, the City adopted the 145th Street Station Subarea Plan and the 185th Street Station Subarea Plan and development regulations to implement these Subarea Plans as provided by the Growth Management Act, chapter 36.70A RCW; and

WHEREAS, two of the zoning districts for these subareas, the MUR-70 and the MUR-45, mandate the provision of affordable housing; and

WHEREAS, via SMC 20.40.235 (B)(2) and 20.40.235(E)(1), the City may allow for a payment in lieu of constructing any fractional portion of the mandatory units; and

WHEREAS, the City has determined that the affordability gap methodology is to be utilized for establishing the fee in lieu and such a few will achieve an equal or better result by allowing the City to use these funds to support the development of affordable housing within the City; and

WHEREAS, the City Council has determined that creation of the affordable housing fee in lieu will be in the best interest of the public health, safety, and welfare;

THEREFORE, THE CITY COUNCIL OF THE CITY OF SHORELINE, WASINGTON DO ORDAIN AS FOLLOWS:

Section 1. Amendment to Title 3 Revenue and Finance. Chapter 3.01 Fee Schedule is amended to add a new section, SMC 3.01.025 *Affordable Housing Fee in Lieu*, as follows:

SMC 3.01.025 Affordable Housing Fee in Lieu

Zoning district	**Fee per unit if providing 10% of total units as affordable**	**Fee per unit if providing 20% of total units as affordable**
MUR-45	$206,152.00	$158,448.00
MUR-70	$206,152.00	$158,448.00
MUR-70 *with development agreement*	$253,855.00	$206,152.00

Note: The Fee in Lieu is calculated by multiplying the fee shown in the table by the fractional mandated unit. For example, a 0.40 fractional unit x $206,152 would result in a Fee in Lieu of $82,460.80.

Section 2. Corrections by City Clerk or Code Reviser. Upon approval of the City Attorney, the City Clerk and/or the Code Reviser are authorized to make necessary corrections to this ordinance, including the corrections of scrivener or clerical errors; references to other local, state, or federal laws, codes, rules, or regulations; or ordinance numbering and section/subsection numbering and references.

Section 3. Severability. Should any section, subsection, paragraph, sentence, clause, or phrase of this ordinance or its application to any person or situation be declared unconstitutional or invalid for any reason, such decision shall not affect the validity of the remaining portions of this ordinance or its application to any person or situation.

Section 4. Publication and Effective Date. A summary of this Ordinance consisting of the title shall be published in the official newspaper. This Ordinance shall take effect five days after publication.

PASSED BY THE CITY COUNCIL ON APRIL 16, 2018

____
Mayor Will Hall

ATTEST: APPROVED AS TO FORM:

____
Jessica Simulcik-Smith
City Clerk

____
Margaret King
City Attorney

Date of Publication: , 2017
Effective Date: , 2017

Attachment B

Affordability Gap Example
On Fees in Lieu of Affordable Housing

The "affordability gap" method to setting a fee in lieu of affordable housing is to have the owner/developer pay the amount they see themselves "losing" if they provided the affordable units themselves. In the case of a rental housing project, the idea is to calculate the value of a negative income stream over time from the difference between market-rate and affordable rents.

The formula is not very complicated. The fee-in-lieu is derived by subtracting the maximum housing expense of an affordable unit, including utilities, from the market rent of an equivalent unit, and dividing the result by the current market capitalization rate. (See box.) The property owner's long-term income loss is now converted to a current value in the same basic way that an investor would calculate how much he or she might pay for a rental property based on the property's net operating income.

For "market rent," the city can choose a survey average (from the American Community Survey or a survey research firm, such as Dupre+Scott Apartment Advisors) or another basis believed to represent the current market rate of new apartments in Shoreline. To the extent possible, the market rent and capitalization rate should each adhere to consistent sources year to year. Utility allowances come from the King County Housing Authority.

What is the "capitalization rate?"

The capitalization rate, or "cap rate," is the rate of return on a real estate investment property based on the income that the property is expected to generate. The capitalization rate is used to estimate the investor's potential return on his or her investment.

The capitalization rate of an investment may be calculated by dividing the investment's net operating income (NOI) by the current market value of the property, where NOI is the annual return on the property minus all operating costs. The formula for calculating the capitalization rate can be expressed in the following way:

Capitalization Rate = Net Operating Income / Current Market Value

Some consider the capitalization rate to be, in essence, the discount rate of a perpetuity, though the use of perpetuity in this case may be slightly misleading as it implies cash flows will be steady on an annual basis.

Direct capitalization is a method used for valuing a real estate investment that incorporates the capitalization rate. With this method, one can divide NOI by the cap rate in order to determine the investment's capital cost.
http://www.investopedia.com/terms/c/capitalizationrate.asp#ixzz4RAzkCLkL

Here's an example taken from the accompanying spreadsheet: A studio unit has a market rent of $1,680, and a 50 AMI affordable rent (less utility allowance) of $732. The difference (affordability gap) between the two is $948 per month. Dividing by the cap rate yields $232,163, which would be the fee in lieu of an affordable studio apartment.

Studio Apartment	
Monthly Rent, 100 AMI	$1,680
Maximum Housing Expense, 50 AMI	$840
Utility Allowance	$108
Affordable Monthly Rent	$732
Rent Loss per Unit per Month	$948
Capitalized Value (4.9%)	$232,163

Utilities are deducted from the affordable rent, and not the market rent, assuming that all tenants pay their own utility bills, and utility expenses must be included in the maximum monthly cost of affordable housing (i.e., 30% of household income).

The fees proposed in 2018 use the following inputs:

Unit Type	"Market Rent"--affordable at 100 AMI	Affordable Rent at 60 AMI	Affordable Rent at 70 AMI	Affordable Rent at 80 AMI	Utility Allowances
Studio	$1,680	$1,008	$1,176	$1,344	$108
1-bed	$1,920	$1,152	$1,344	$1,536	$108
2-bed	$2,160	$1,296	$1,512	$1,728	$134
3-bed	$2,400	$1,440	$1,680	$1,920	$170

AMI (Area Median Income) is determined by HUD once a year (typically in late winter-early spring). In 2017, the AMI for King County was $96,000 for a family of four, which equates to a three-bedroom unit. The AMI for a two-bedroom unit is 90% of that for a three-bedroom; the AMI for a one-bedroom is 80% of that for a three-bedroom; and the AMI for a studio is 70% of a three-bedroom's. "Affordable rent" is 30% of the monthly AMI.

The consultant considered using survey data of Shoreline rents. Dupre+Scott (who closed their business late in 2017) found average rents of projects built in 2010 or newer that ran 70% to 94% of AMI. But they also reported that rents in Shoreline have increased at least 6% each year for the past three years, faster than the AMI. Moreover, staff's expertise and knowledge of newer and pipeline projects indicate we should expect rents in projects opening in 2018 to average about 100% of AMI.

The consultant weighted the incomes from each unit type based in part on the average unit mix of properties surveyed by Dupre+Scott; i.e., 20% studios, 56% one-bedrooms, 20% two-bedrooms and 4% three-bedrooms.