U District Urban Design

Appendix F: Relationship between Payment and Performance Amounts

RCW 36.70A.540 provides that "Affordable housing incentive programs may allow a payment of money or property in lieu of low-income housing units if the jurisdiction determines that the payment achieves a result equal to or better than providing the affordable housing on-site, as long as the payment does not exceed the approximate cost of developing the same number and quality of housing units that would otherwise be developed." This document outlines how the proposed MHA-R payment and performance requirements for zones in the U District would met this standard.

Relationship of payment to cost of developing

In setting required performance and payment amounts for the various zones in the U District, the City established a conversion factor for determining the relationship between the payment amount and the performance amount. The conversion factor reflects the following methodology:

Payment amount = Capitalized value of difference between market and affordable rental rate (e.g., rent subsidy) + 10%

The capitalized value of the rent differential is intended to reflect the value of the revenue that would be lost by an owner due to providing rent-restricted units under the performance option. The 10% adjustment reflects a number of factors associated with provision of affordable housing by the City using payment proceeds, specifically the City's cost to administer payment revenue and the resulting delay between the time payments are collected and the ultimate production of affordable housing. Administering payment revenue entails a wide range of activities, including tracking of funds, soliciting and underwriting affordable housing proposals, preparing and reviewing legal documents, closing and disbursement of loans in coordination with other investors and lenders, monitoring of construction progress, and general oversight of projects to ensure consistency with funding policies and procedures. These activities mean some amount of time to translate payments into the actual production of affordable housing. Additional time can be expected based on the time it takes projects to assemble financing and obtain building permits.

The City created several different scenarios for capturing the relationship between performance and payment using the foregoing methodology, based on high, medium, and low areas. The "medium" scenario was used for the U District. The scenarios used average rents for buildings 85 feet in height or less. Residential buildings of this scale generally use significant wood-frame construction which is lower cost than the steel and concrete construction used for high-rise structures. High-rise construction is generally associated with higher rents. This means that, while a mix of payment and performance is expected for non-high-rise buildings, for high-rise buildings one would expect the relationship between performance and payment to favor choosing the payment option.

Table A shows the calculations that were used to determine the payment amount per unit of affordable housing required.

Table A: Calculation of Payment Amount Per Affordable Unit Required

	Market Rate			Affordable Rate (60% of AMI)
	High	Medium	Low	
Rent per net square foot	$3.04	$2.72	$2.26	
Average One-bedroom Unit Size (Net SF)	654	627	642	
Monthly Gross Rent per Unit	$1,988	$1,705	$1,451	$1,008
Annual Gross Rent per Unit	$23,858	$20,465	$17,411	$12,096
Less Vacancy	($1,193)	($1,023)	($871)	($605)
Less Monitoring Fee				($150)
Annual Net Income per Unit	$22,665	$19,442	$16,540	$11,341
Capitalized Value of Net Income per Unit with 5.25% Cap Rate	$431,715	$370,324	$315,057	$216,023
Rent Subsidy (Market Value – Affordable Value)	$215,692	$154,301	$99,034	
Payment Amount per Affordable Unit Required (Rent Subsidy plus 10%)	$237,261	$169,731	$108,937	
Payment Amount per Net Square Foot of Affordable Unit Required	$363	$271	$170	

The Payment Amount per Affordable Unit Required figures represent the payment cost for one performance unit in areas with different rent levels. The "medium" number was used to create the conversion factor between the performance and payment requirements for the various zones in the U District. The City started with the performance amount and used the conversion factor to set the payment amount.

Table B shows the cost of development of a unit in market-rate development in comparison to the cost of the payment option per affordable unit calculated above. The Cost of Development figures come directly from the Seattle Affordable Housing Incentive Program Economic Analysis Report created by David Paul Rosen and Associates (DRA), October 10, 2014.

Table B: Cost of Development and Cost of Payment Option per Net Square Foot of Affordable Unit

	Area or Zone (DRA Prototype Numbers)	Rental Units			Ownership Units		
		High	Medium	Low	High	Medium	Low
Cost of Development from DRA Study (per net square foot)	Downtown highrise (1A, 2A)	$523	n/a	n/a	$620	n/a	n/a
	South Lake Union highrise (4A, 5A)	$511	n/a	n/a	$595	n/a	n/a
	South Lake Union Mid-rise (4B, 5B)	$414	n/a	n/a	$476	n/a	n/a
	LR3 (7B, 8B)	$458	$391	$334	$503	$431	$370
	MR (7A, 8A)	$442	$392	$347	$496	$441	$391
	NC40 (9B, 10B)	$448	$382	$327	$500	$429	$369
	NC65 (9A, 10A)	$469	$414	$364	$525	$465	$411
	NC85 (11A, 12A)	$521	$457	$401	$523	$458	$402
Payment Amount per Net SF of Affordable Unit Required (from Table A)		$363	$271	$170	$363	$271	$170

For all prototypes, the development costs in Table B are greater than the amounts used for purposes of establishing the relationship between performance and payment as set forth in Table A and shown by the last row in the chart. This data also indicates that the cost of the payment option would in all cases be less than the cost of development by non-profit developers, who tend to build low- to mid-rise projects (e.g., the type typical in LR3, MR, and NC zones) and have development costs that are generally equal to or slightly higher than market-rate costs. While no data was generated for highrise development outside of High areas, this type of development is significantly more expensive than development in LR, MR, NC40 or NC65 zones so it can be assumed that development costs in these areas would also be greater than the payment amount.

The cost of the payment option per affordable unit also remains below an affordability gap cost as determined by DRA (e.g., the capital subsidy required to develop housing affordable to families at target income levels). DRA's affordability gap analysis in the Seattle Non-Residential Affordable Housing Impact and Mitigation Study (DRA, September 15, 2015, pp. 11-13) calculated the cost to make housing affordable to households at the target income level by subtracting per unit development costs from the per unit mortgage supportable from affordable rents at 60% of area median income, based on the cost of building new low- or mid-rise multifamily housing. Table C shows how these figures compare to cost of the payment option, based on the 650 net square foot unit size used by DRA.

Table C: DRA Affordability Gap and Cost of Payment Option

	High	Medium	Low
DRA Affordability Gap (per NSF)	$371	$319	$293
Payment Amount per NSF of Affordable Unit Required (from Table A)	$363	$271	$170

For all of the foregoing reasons, the payment amount per required affordable unit used for purposes of the conversion factor does not exceed the cost of developing the same quality of unit that would otherwise be developed under the performance option. Thus, the performance and payment requirements for zones in the U District, whose relationship was determined using that conversion factor, ensure that the payment for a building does not exceed the approximate cost of developing the same number and quality of housing units that would otherwise be developed under the performance option, in compliance with the statutory requirement of RCW 36.70A.540.

Equal or better result

For purposes of implementing MHA-R in the U District, payment achieves a result equal to or better than providing the affordable housing on-site.

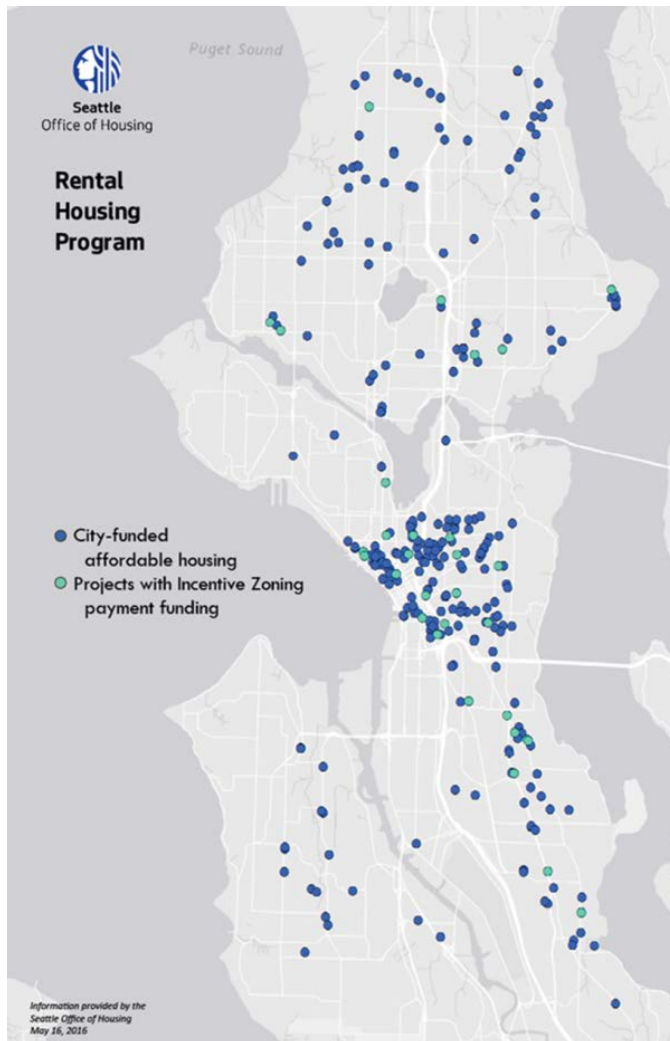
First, when creating housing with the same level of income and rent restrictions, payment results in the production of far more units of affordable housing than would be produced by on-site performance, due to the City's ability to use payment proceeds to leverage additional funds that would otherwise not be available. In the past, the City's Office of Housing has leveraged approximately $3.50 in non-City funding for every $1 of City funding invested. Among projects that utilize 4% Low Income Housing Tax Credits and tax exempt bonds, which are currently non-competitive and leave a large portion available for additional projects to access in Washington State, the City has leveraged approximately $3 in non-City funding for every $1 of City funding invested. Using an even more conservative estimate of $2.25 in leverage for every $1 of City funding going forward, the Office of Housing estimates it will still produce substantially more affordable housing than would be achieved through on-site performance. The Office of Housing, which administers in-lieu payments, has a history of effectiveness in aligning resources to maximize production, and has been particularly successful in leading statewide efforts to streamline and coordinate capital funding as well as long-term asset management and compliance monitoring of affordable housing.

Second, unlike with housing produced on-site, the investment of payment funds allows the flexibility to create housing affordable to households with incomes even lower than 60% AMI. While this may create some tradeoffs with the amount of housing produced, the City has in many cases made the policy choice to support housing for individuals and families with incomes lower than the maximum target income level, due to compelling cases that can be made for prioritizing housing for those with the greatest needs.

Third, the Office of Housing has a history of affirmatively furthering fair housing choice by investing in housing throughout the city. This record has been confirmed by independent study and is reflected in adopted policies that establish criteria for where funds are invested. The following map illustrates where the City has funded affordable housing, including the locations of projects that have received funding from payments under the City's existing incentive zoning system.

In the proposed MHA program, the City will invest funds in locations that advance the following factors:

a. Affirmatively furthering fair housing choice;
b. Locating within an urban center or urban village;
c. Locating in proximity to frequent bus service or current or planned light rail or streetcar stops; and
d. Furthering City policies to promote economic opportunity and community development and addressing the needs of communities vulnerable to displacement.
e. Locating near developments that generate cash contributions.



While requiring an affordable unit to be in a market-rate building is one way of trying to ensure that low-income residents are integrated with higher-income residents, the City has not found compelling research-based evidence that this strategy results in more meaningful integration than investing in affordable housing projects in strategic locations throughout the city, particularly where that investment occurs in neighborhoods that provide high levels of opportunity. In addition, the City has received input that some low-income residents place greater value on the opportunity to live in their communities and benefit from existing social networks, as compared to moving to a neighborhood with no existing social supports.

With the new Seattle 2035 Comprehensive Plan, the City has developed a highly nuanced approach to analyzing issues related to displacement and access to opportunity. *See* Seattle 2035 Growth and Equity report, May 2016. The locational factors for investing payment proceeds under MHA support the recommended equitable development strategies identified in the Growth and Equity report. *See* Growth and Equity report, pp. 11-12.

Comparing the geographic analysis of access to opportunity in the Growth and Equity report to the City's practice in investing payment proceeds confirms that the City has been quite successful in targeting affordable housing investments in areas with high access to opportunity, and high risk of displacement. This demonstrates the importance of a strategic approach to investing in affordable housing projects in a variety of locations based on criteria such as those applicable under MHA.

Finally, funds invested in affordable housing can result in a range of other community benefits. For instance, public investment can stimulate economic development in areas of the city that lack private investment; preserve historic buildings that would otherwise be lost to deterioration or demolition; and help stabilize rents in areas where residents are at risk of displacement. On the whole, funds can be strategically invested to maximize housing choice throughout the city. Projects funded by the City must comply with the statewide Evergreen Sustainable Development Standard, which furthers energy and water efficiency, improves health and safety, and creates operational savings that benefit low-income residents over the long-term. In addition to leveraging other investment in housing, other public funds can also leverage investments in a range of non-residential spaces such as affordable childcare, small business space, and social service facilities. Finally, affordable housing projects often include resident service programs and other connections to social services that help individuals and families to thrive. These types of benefits are generally not achieved through new market rate developments.

Based on the foregoing, City staff has concluded that the investment of payment funds will result in outcomes that are equal or better than those resulting from provision of affordable housing on-site.