



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 5608

September 17, 2019

Study Session

AGENDA BILL INFORMATION

TITLE:	AB 5608: HB 1406 and HB 1923 Briefing and ARCH Update	<input checked="" type="checkbox"/> Discussion Only
RECOMMENDED ACTION:	Receive reports. No Action is necessary.	<input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution

DEPARTMENT OF	Community Planning and Development	Alison Van Gorp, Deputy Director Ali Spietz, Assistant to the City Manager
COUNCIL LIAISON	n/a	
EXHIBITS	1. Enter Exhibits Here (Delete number if only one)	
2019-2020 CITY COUNCIL PRIORITY	n/a	

AMOUNT OF EXPENDITURE	\$ n/a
AMOUNT BUDGETED	\$ n/a
APPROPRIATION REQUIRED	\$ n/a

SUMMARY

The purpose of this agenda bill is to provide:

1. A briefing and recommended action steps related to affordable housing legislation passed by the state legislature in 2019, including HB 1406 and HB 1923.
2. An update on ARCH's work with a consultant over the last several months to evaluate program operations and stewardship of the Homeownership Program. The consultant report and recommendations are now complete, and the ARCH Executive Board is taking action on September 13, 2019 to adopt the 2020 Work Plan and Budget, which includes action steps that directly follow from the consultant's recommendations.

HB 1406: SHARED REVENUE FOR AFFORDABLE HOUSING

In the 2019 legislative session, the state adopted Substitute House Bill 1406 (HB 1406), approving a local revenue sharing program for local governments by allowing cities and counties to retain a portion of the sales tax for investment in affordable or supportive housing (see Exhibit 1). This portion is offset by a reduction in the state's portion of sales tax, and therefore does not result in an increased tax on consumers. The tax credit is in place for up to 20 years and can be used for acquiring, rehabilitating, or constructing affordable housing;

operations and maintenance of new affordable or supportive housing facilities; and, for smaller cities and rental assistance. In order to secure the ability to access these funds, cities are required to adopt a resolution of intent to implement the tax credit by January 28, 2020 and implementing legislation by July 28, 2020.

The Association of Washington Cities prepared a brochure "[Implementing HB 1406](#)" which details the process for using the affordable housing revenue. A Regional Coalition for Housing (ARCH) sent a memorandum to all ARCH member cities regarding HB 1406 (see Exhibit 2) and the [Housing Development Consortium sent a letter](#) asking the City Council to consider the strategic use of the revenue as an additional source of funding for the Housing Trust Fund to enhance production and preservation of affordable housing in East King County. The City also received a [letter from King County Councilmember Claudia Balducci](#) on behalf of the Regional Affordable Housing Task Force recommending that cities pool the revenues generated by HB 1406 via regional entities such as ARCH.

Potential Revenue Estimates

The maximum amount a city may collect will be limited by the amount of taxable retail sales within a jurisdiction in fiscal year 2019 times the applicable rate (0.0073%). The revenue potential for the City of Mercer Island, based on taxable retail sales in 2018, is \$36,318.

Eligible Uses of the Funds

HB 1406 details the uses of funds from the sales tax as follows:

- Projects must serve those at or below 60% AMI (area median income).
- Acquiring, rehabilitating, or constructing affordable housing, which may include new units of affordable housing within an existing structure or facilities providing supportive housing services. In addition to investing in traditional subsidized housing projects, this authority could potentially be used to provide for land acquisition, down payment assistance, and home repair so long as recipients meet the income guidelines.
- Funding the operations and maintenance costs of new units of affordable or supportive housing.
- For cities with a population under 100,000, the funds can also be used for rental assistance to tenants.

HB 1406 Next Steps

To become a participating city and collect the single share of the tax, a city must adopt a resolution of intent within six months of July 28, 2019 and impose the tax by July 30, 2020.

Staff recommend that the City Council concurrently pass a resolution of intent and adopt an ordinance to authorize a sales and use tax for affordable and supportive housing in accordance with HB 1406 and to use the collected tax to supplement the City's contribution to the ARCH Housing Trust Fund. The ARCH Housing Trust Fund's mission and purpose is closely aligned with the eligible uses for these funds and would provide a simple way for Mercer Island to leverage our modest share for the most impact. Staff is scheduled to return with the resolution and ordinance at the October 15 meeting.

HB 1923: GRANT OPPORTUNITY

On August 20, 2019 the City Council and Planning Commission conducted a joint study session regarding Regional Growth, Mercer Island, and VISION 2050 (see [AB 5593](#)). A major update to the Mercer Island

Comprehensive Plan by 2023 is anticipated and will include work to address regional growth expectations particularly as it relates to housing. The Growth Management Act (“GMA”) (see [RCW 36.70A.070\(2\)](#)) requires that the City update the Housing Element and make adequate provisions for existing and projected housing needs. Developing a Housing Action Plan (HAP) will provide the opportunity to develop detailed implementation guidelines around the [Housing Element](#) in the City’s Comprehensive plan, something that is also required under the GMA.

The 2019 Washington State Legislature passed Engrossed Second Substitute House Bill 1923 (HB 1923) encouraging all cities planning under the GMA to, in short, adopt actions to either increase residential building capacity (Option 1), or develop a Housing Action Plan (HAP) (Option 2) to encourage construction of housing to meet the needs of people at all income levels (see Exhibit 3). The City does not believe Option 1 will provide additional public benefit to Mercer Island. However, Option 2 may provide opportunities for the City to address necessary planning associated with the 2023 major Comprehensive Plan update and additional regional growth expectations.

As part of the bill, \$5 million in grant assistance is available to encourage local cities (with populations over 20,000) to participate. A city may receive up to \$100,000 in grant funds. Exhibit 4 details additional information about the options and actions summarized above.

HB 1923 Next Steps

After carefully reviewing the options presented in HB 1923, staff do not recommend pursuing a grant under Option 1 as the requirements of most of the activities are too onerous or not consistent with the direction Mercer Island is taking in accommodating growth (focusing most growth in the Town Center while seeking to protect single-family neighborhoods).

However, staff does anticipate applying for grant funding under Option 2, to create a Housing Action Plan. If awarded the grant, the City can expand capacity, likely through consultant resources, to implement planning work in 2020 that the City is obligated to complete but has not been able to complete due to capacity limitations. This same planning work will aid the City in beginning a conversation with the community around regional growth, and how to meet the housing needs for Mercer Island residents in the coming decades, including affordable and accessible options for “aging in place”.

The grant application is due by September 30 and grant awards will be announced on October 30. If grant funding is secured, staff will return and seek City Council direction on a proposed scope of work and community engagement strategy.

ARCH UPDATE

Beginning in October 2018, several news reports indicated that a few owners of affordable units stewarded under ARCH’s Homeownership Program were not in compliance with ARCH rules. Additional reports noted the loss of units to foreclosure. ARCH’s Homeownership Program provides affordable ownership opportunities to buyers of low to moderate incomes while seeking to maintain affordability by limiting resale prices for future buyers.

ARCH took the issues raised in these reports very seriously and took the following actions:

1. Audited each unit in its Homeownership Program using publicly available data, which was reviewed and supplemented with additional data provided by a consultant. The audit identified three main

types of compliance issues (foreclosures, non-owner occupancy, and sales or transfers without proper notification).

2. Conducted follow-up investigations on over 50 units. These efforts resulted in identifying compliance violations in 25 units, or 3.6% of the total portfolio.

Consultant's Report

In February 2019, ARCH hired Street Level Advisors to conduct a program assessment and to provide additional support to complete the audit of the Homeownership Program. The consultant's report, released in June 2019, summarized key findings and recommendations for specific changes in policies and administrative procedures that ARCH can make to strengthen the program. A [summary of the consultant's report](#) was shared with Council in June 2019, and the full report is included as Exhibit 5.

Key findings of the program assessment include the following (*summary excerpted from the Street Level Advisors report*):

- 1. The program is serving households in the target income range.**
The roughly 700 units in the program were designed to target households at a range of incomes from 50% to 120% AMI, with the vast majority targeted at 80 to 120% AMI. For the sample of buyers tested, the median household income was 70.9% of local AMI adjusted for household size.
- 2. The public share of equity in ARCH homes ("Value in Trust") has grown substantially over time.**
The typical ARCH home was initially sold at a restricted price approximately \$130,000 less than market value, but now has a current formula price that is \$330,000 less than market value. Taken together the difference between affordable prices and market values totals \$274 million. This \$274 million is the value that ARCH is entrusted to steward. For most homes (74.2%), the discount relative to market value that the current formula price provides is now larger than it was at initial sale. The result is that although the program's resale formulas are allowing a steady erosion of affordability overall, they have nonetheless consistently deepened the homes' market discounts.
- 3. ARCH's Homeownership Program has provided meaningful opportunities for homeowners to build equity.**
Generally, participating homeowners build significant wealth and benefit from their homes' market appreciation. For a typical unit, a homeowner who has owned the unit since it was placed in ARCH's portfolio will gain \$65,000 at resale (appreciation minus closing costs and down payment). This results in a typical rate of return on investment of 13.86% annually – nearly double what owners would have earned by investing in the S&P 500.
- 4. Due to rising home prices and varying resale formulas in member cities, a "significant share" of units have not remained affordable to the same income level over time.**
The program has utilized a variety of resale formulas over time and across different jurisdictions that have all performed differently. Overall, 67% of units are now affordable to a higher income group than they were at initial sale and the typical home has lost 7.4 percentage points of affordability.
- 5. Affordable units lost due to foreclosure have been "meaningful," but are not a common occurrence in recent years.**
43 ARCH properties have experienced a foreclosure (5.8% of the portfolio); 20 foreclosures occurred without any formal notification to ARCH. In most cases where ARCH was notified, ARCH was unable to preserve the resale covenants on these homes. This was largely due to ARCH not having the resources readily available for the purpose of purchasing units at risk of foreclosure.

6. Compliance violations, such as subleasing and unauthorized sales, represent a small percentage of units in the program.

ARCH identified 51 homes (7% of the portfolio) that merited review for possible compliance violations, either due to mail being forwarded to a different address, an apparent change of ownership, or other reason. Of the 51 homes identified, 24 were determined to be in violation (3.5%), 16 were determined to be in compliance, and 11 are still under review. Violations were identified in 3 categories: unauthorized sales (1.3%), non-owner occupancy (1.7%), and unauthorized quit claim deed transfers (0.4%). Mercer Island does not have any units in the Homeownership Program; thus, none of the units in violation are located on the island.

7. ARCH is already implementing over half of the recommended industry best practices.

ARCH's covenant and other legal documents are state of the art, incorporating many thoughtful and strong protections for the public interest in ARCH homes. Based on a comprehensive review of current practices and procedures, ARCH is currently implementing just over half of the 70 industry best practices covered by the assessment tool.

8. Adding compliance and enforcement resources will greatly strengthen the program.

ARCH has been operating with less staff than is necessary to successfully preserve affordability and monitor compliance for such a large portfolio of homes. ARCH has less than one full time equivalent (FTE) position dedicated to the homeownership program. This means that ARCH has had to take a relatively "hands off" approach to stewardship.

The consultant's report noted that staffing levels for ARCH's Homeownership Program fall well below peer programs and recommended best practices. In fact, ARCH has had the same staffing level (5 FTEs) since the early 2000s, while the number of homeownership units monitored by ARCH has increased from just over 100 to almost 700. At the same time, the number of rental units produced by local incentive programs grew from less than 300 to over 1,000 (with another 600 in the pipeline) and an additional 1,800 units were funded through the Housing Trust Fund. It is anticipated that these numbers will continue to grow as ARCH member cities continue to adopt incentive programs to ensure new development contributes to affordability. The consultant report recommended expanding staffing levels by 1 to 3 FTEs, with at least one additional full-time position dedicated to the Homeownership Program. To help create a more sustainable staffing model, the consultant also recommended that ARCH develop a plan for implementing new fees at the time of resale.

The consultant report also included a suite of recommendations targeted at strengthening enforcement, program requirements, and operations.

ARCH Action Steps

ARCH is taking the following near-term action steps to strengthen compliance monitoring and program administration, and implement the consultant's recommendations:

1. Work with legal counsel from each individual jurisdiction with a potential violation to help define cities' enforcement options. In the majority of cases, homeowners are working cooperatively with ARCH to sell to new qualified buyers. As of September, eight homes were sold to new owners, and three were pending or listed for sale.
2. Increase staff capacity to implement recommended changes to program policies and procedures. In June, the Executive Board approved a resolution to authorize the Executive Manager to use up to \$415,000 in one-time funds from ARCH reserves and City of Kirkland housing funds for recruitment of

two new limited-term employees. In July, ARCH welcomed two interns to assist with administrative duties and special data projects that will help inform program design going forward.

3. Solicit consultant assistance to conduct an analysis and prepare specific recommendations for ARCH's resale formula, and level of resale fees.

As ARCH incorporates new staff and grows the portfolio of homes in the program, the ARCH Executive Board plans to continue to evaluate the needs of the organization to carry out critical functions on behalf of its members and the public. In the next year, ARCH plans to undertake an organizational assessment to build on the evaluation of monitoring functions in 2019. This broader evaluation will examine all areas of the ARCH Work Program, as well as ARCH's organizational structure and governance model.

Next Steps

The increased ARCH staffing recommended by the consultant will require additional ongoing funding; 2019 costs will be covered with one-time funds and staff anticipate a request for additional funding to support expanded ARCH staffing going forward. The ARCH Executive Board will discuss the 2020 Work Program and budget in September 2019 and will recommend budget and staffing levels for approval by each member city. Staff anticipate that the work plan and associated budget will increase Mercer Island's annual contribution to the ARCH administrative budget by approximately \$17,000 to \$23,000, depending on the budget option advanced by the ARCH Executive Board. This represents a 51-65% increase over the budgeted administrative contribution of \$33,327.

Staff intend to bring a budget amendment back to Council later this fall to account for the increase to the 2020 annual contribution to ARCH's administrative budget, along with the ARCH 2020 work plan and administrative budget for Council approval.

RECOMMENDATION

Receive reports. No action necessary.