BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND

AB 5728
July 21, 2020
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 5728: Repeal of the Multifamily Housing Property Tax Exemption program (2nd Reading)	☐ Discussion Only ☒ Action Needed: ☐ Motion ☒ Ordinance ☐ Resolution
RECOMMENDED ACTION:	Adopt Ordinance No. 20-C14.	

DEPARTMENT:	Community Planning and Development
STAFF:	Evan Maxim, Director of Community Planning and Development
COUNCIL LIAISON:	n/a
EXHIBITS:	1. Ordinance No. 20C-14
CITY COUNCIL PRIORITY:	n/a

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

SUMMARY

On July 7, 2020, the City Council conducted its first reading of an ordinance to repeal the Multifamily Housing Property Tax Exemption (MFTE) program (AB 5723). Following their review, the City Council directed the staff to bring back the ordinance for a second reading on July 21, 2020.

BACKGROUND

The MFTE program is authorized by RCW 84.14, and was originally adopted by the City Council in 2011 (Ord. No. 11C-02) to encourage the creation of new multifamily housing, and the rehabilitation of existing vacant and underutilized buildings for multifamily housing, through a property tax reduction. If a project participated in the MFTE program, the value of the new or rehabilitated housing (i.e. the improvements, not the land) would be exempt from property taxation for 8 or 12 years. In return, the project would set aside affordable housing units for the life of the project: 10% of the units for an 8-year exemption and 20% for a 12-year exemption. The MFTE program is one regulatory tool available intended to encourage residential development that is identified in the Housing Element of the Comprehensive Plan, which reads:

> *"3.9 Use regulatory and financial incentives in the Town Center and PBZ/CO districts such as density bonuses, fee waivers, and property tax reductions to encourage residential development for a range of household and ownership types and income levels. (Housing Element, Goal 3)."*

Elimination of the MFTE program does not require a Comprehensive Plan amendment, as it is one of several different regulatory and financial incentives identified by the City Council in implementing this policy approach. Following the establishment of the MFTE program, no multifamily projects have participated in the program, which likely indicates that the intended financial incentive is not functioning as originally intended by the City Council.

PROPERTY TAX (TAX REVENUE REDUCTION & TAX SHIFT)

At the July 7, 2020 City Council meeting, staff provided a hypothetical example related to a mixed-use building in the Town Center, intended to illustrate the relative benefits of the MFTE program to the participating property owner and the public. Following their review, the City Council requested additional research related to how property taxes were affected by a project's use of the MFTE program and requested that the staff refine the hypothetical example.

In the July 7, 2020 presentation, staff incorrectly indicated that the portion of the property tax exempted through the MFTE program, was entirely paid by the remaining taxpayers on island. New construction that participates in the MFTE program is exempt both from the assessed value used to calculate the tax levy and from the payment of the tax levy. This results in a reduction in the total amount of property tax revenues collected.

The following two tables reflect a simplified hypothetical scenario, wherein only one construction project is built between 2020 and 2030. It is also assumed that the entire value of the single new construction project can be exempted by the MFTE program. No depreciation in construction value is assumed.

Table 1 reflects the effect this additional new construction has on total tax revenues, presuming the project does not participate in the MFTE program. Note that over the 10-year period, the total property tax levy amount increases by $121,191.

Table 2, at the top of page 3, reflects the effect of adding the additional new construction to the tax levy in year 2028, instead of year 2020. Note that over the 10-year period, the total property tax levy amount increases by $120,769; the difference represents the lost property tax revenue to the City for this 10-year period.

Table 1: Hypothetical Scenario, No MFTE

Year	Prior year levy amount	+ 1% increase	+ New construction	Increase over prior year	Total levy
2020	$1,000,000	$10,000	$5,000	$15,000	$1,015,000
2021	$1,015,000	$10,150	$0	$10,150	$1,025,150
2022	$1,025,150	$10,252	$0	$10,252	$1,035,402
2023	$1,035,402	$10,354	$0	$10,354	$1,045,756
2024	$1,045,756	$10,458	$0	$10,458	$1,056,213
2025	$1,056,213	$10,562	$0	$10,562	$1,066,775
2026	$1,066,775	$10,668	$0	$10,668	$1,077,443
2027	$1,077,443	$10,774	$0	$10,774	$1,088,217
2028	$1,088,217	$10,882	$0	$10,882	$1,099,100
2029	$1,099,100	$10,991	$0	$10,991	$1,110,091
2030	$1,110,091	$11,101	$0	$11,101	$1,121,191

Table 2: Hypothetical Scenario, 8-yr MFTE

Year	Prior year levy amount	+ 1% increase	+ New construction	Increase over prior year	Total levy
2020	$1,000,000	$10,000	$0	$10,000	$1,010,000
2021	$1,010,000	$10,100	$0	$10,100	$1,020,100
2022	$1,020,100	$10,201	$0	$10,201	$1,030,301
2023	$1,030,301	$10,303	$0	$10,303	$1,040,604
2024	$1,040,604	$10,406	$0	$10,406	$1,051,010
2025	$1,051,010	$10,510	$0	$10,510	$1,061,520
2026	$1,061,520	$10,615	$0	$10,615	$1,072,135
2027	$1,072,135	$10,721	$0	$10,721	$1,082,857
2028	$1,082,857	$10,829	$5,000	$15,829	$1,098,685
2029	$1,098,685	$10,987	$0	$10,987	$1,109,672
2030	$1,109,672	$11,097	$0	$11,097	$1,120,769

The above tables do not account for the property tax levy amount collected from partial construction on a property prior to the effective date of the tax exemption; this tax levy amount is shifted to other taxpayers on Mercer Island. For example, if the site owner previously paid $2,000 in property taxes, the $2,000 property tax revenue is "shifted" to other taxpayers, while the remaining $3,000 would be lost property tax revenue.

"Hadley" Example

In the hypothetical example of the Hadley mixed use building, the City estimates that the lost property revenue for the 8 years associated with the MFTE program, would have been equivalent to approximately $160,000 per year. The total tax savings for the owner of the Hadley mixed use building would be approximately $610,000 per year. The tax levy amount shifted to other taxpayers on Mercer Island would be approximately $450,000 per year. For a period of 8 years, the reduction of tax payments by the owner of the Hadley would be approximately $4,175,452 (present value), in return for providing the 21 affordable units.

The Hadley example presented on July 7, 2020 reflected the provision of 13 affordable housing units, however, to qualify for the MFTE program, 10 percent of the units (21 apartment units) in the Hadley would have to qualify as affordable housing. The estimated average market rate for a unit in the Hadley is $2,148 per month. The estimated rental rate for a unit affordable at 60% of area median income in the Hadley is $1,131 per month, resulting in an estimated average public benefit (rent gap) of $1,005 per month. The lifetime public benefit (rent gap) of the project, based upon an assumed capitalization rate of 5%, would be $241,314 per unit or $5,067,600 for the 21 units.

For more information, the City Council may wish to review the Washington State Legislative Auditor's report from December 2019, available here: http://leg.wa.gov/jlarc/taxReports/2019/MFTE/f_ii/print.pdf

Staff recommends that the City Council consider repealing the MFTE program in MICC 4.50. As part of a future work plan, staff also recommends that the City Council take up a more comprehensive discussion of the City's affordable housing goals, policies, and programs.

RECOMMENDATION

Adopt Ordinance No. 20C-14.