ATTACHMENT A

WILSONVILLE
ECONOMIC DEVELOPMENT

Memo

DATE: 20 June 2022
TO: Wilsonville City Council
FROM: Matt Lorenzen, Economic Development Manager
SUBJECT: Construction Excise Tax

This memorandum provides an overview of Construction Tax, commonly referred to as "Construction Excise Tax" (CET), for Affordable Housing, as authorized by SB1533, and codified under ORS Chapter 320 – Miscellaneous Taxes. It focuses primarily on mechanics, with some attention to the politics of CET.

Staff is providing this memo in response to **Council's 2021-2023 Goals.**

3.1: Continue implementation of the city's Equitable Housing Strategic Plan (EHSP) and explore funding options including Construction Excise Tax (CET).

3.2 Explore examples of other programs to support home ownership for low-income residents and first-time home buyers as part of the Frog Pond East and South Master Plan

Further, the CET Revenue Forecast found at the end of this memo, provides a data-based model that can be used to estimate how much annual revenue the city *may* be able to realize if a CET were to be enacted in the City of Wilsonville.

In this memorandum, "Affordable Housing" means housing that is *affordable* to households with incomes equal to or higher than 80 percent of the median family income (MFI) for the county in which the housing is built. This is the definition used in SB1533. A unit of housing is said to be *affordable* if its cost is 30% or less of gross household income. Operationally, this means in order for a program or housing development project to be eligible to receive contributions from CET revenues, the units must be priced no higher than 30% of $85,200 (annually) in the Portland-Vancouver-Hillsboro MSA. Monthly that is roughly $2,062 monthly for a family of four.

Why are we talking about a CET now?

1) The adopted Equitable Housing Strategic Plan (2020) calls out the exploration of a CET as a priority for year one of implementation of the plan.
2) Federal support of affordable housing has greatly diminished in recent years, putting more burden on local jurisdictions to come up with new solutions.
3) Locally generated funds can be leveraged in order to access other, limited state and federal funds for affordable housing.

4) Wilsonville is not yet large enough to support a dedicated housing program. There is a need for other creative actions the city can take in order to meet the housing needs of its residents—existing and prospective.
5) A CET would create a dedicated revenue source to support the creation of *new* affordable housing. It could also help support housing-cost-burdened residents, preserve existing affordable housing, and make first-time homeownership a reality for residents for whom it is currently out of reach.
6) Anecdotally, transportation to and from work is one of the biggest challenges many Wilsonville employers face with employee hiring and retention. More workforce housing in the community means more of Wilsonville's workforce has the option to live *and* work in Wilsonville. This supports business and minimizes commute traffic.
7) There are few other politically-feasible options available that could generate revenue to support an affordable housing fund.

What exactly is a CET?

Cities and counties are preempted from passing any taxes on construction unless otherwise allowed in statute. SB 1533, adopted in 2016, changes state law to allow cities and counties to pass a new construction tax designed to support affordable housing. A construction excise tax can be imposed on residential, commercial, and/or industrial construction, within certain parameters.

Residential Construction Excise Tax: A city or county may impose a construction excise tax set at 1% or less of the permit valuation on residential development, including both new structures and construction that results in additional square footage to an existing residential structure.

Commercial and Industrial Construction Excise Tax: A city or county may also impose a construction excise tax on commercial and industrial development, including the commercial portions of a mixed-use property that result in a new structure or additional building square footage. There is *no cap* on the rate of the tax.

How are the revenues to be distributed?

The city or county may retain *up to* 4% of gross construction excise tax revenues as an administrative fee to cover its costs incurred in implementing the construction excise tax. After the administrative fee has been deducted from total revenues, the allocation of net revenue must be as follows:

Residential construction excise tax

- All revenue is distributed toward affordable housing:
  - 50% for developer incentives*
  - 35% for other affordable housing programs and incentives*
  - 15% to Oregon Housing and Community Services (OHCS) to be used toward programs which offer down payment assistance

* Further discussion and definition of these items follows below. See "How, specifically, can CET revenues be spent?"

Commercial or industrial construction excise tax

- 50% of revenues must be dedicated toward programs of the city or county related to housing.
- The remaining 50% of revenue is unrestricted in its allocation.

What is “inclusionary zoning” and how is it related to CET?

Inclusionary Zoning (IZ) policies incentivize or mandate developers to create a certain percentage of affordable housing units in a new or improved residential development. SB 1533 authorizes local jurisdictions to implement both a CET and inclusionary zoning. There is no requirement under SB 1533 that a city or county must adopt an inclusionary zoning ordinance (either voluntary or mandatory) in order to adopt a residential, industrial, or commercial construction excise tax. The design of the construction excise tax complements mandatory or voluntary inclusionary zoning, but CET can be adopted on its own.

At this time, Staff has not received direction to explore inclusionary zoning as a stand-alone or complementary program to a CET, in order to further incentivize or mandate the creation of affordable housing in the City.

How, specifically, can CET revenues be spent?

Residential

50% Developer Incentives

Fifty percent of net revenues (gross revenues, less the city administrative fee, if any) may be spent on “Developer incentives.” Such incentives must increase the number of affordable housing units in a development, decrease the sale or rental price of affordable housing units in a development, *OR* build affordable housing units that are affordable to households with incomes equal to or **lower* than 80 percent of the median family income for the county in which the housing is built. Such incentives can come in multiple forms:

- Whole or partial permit fee waivers or reductions.
- Whole or partial waivers of system development charges or impact fees set by the city or county.
- Finance-based incentives. E.g. guarantees, in-house financing of city fees at low or no interest, and/or public equity or subsidy
- Full or partial exemption from ad valorem property taxes on the terms described in this subparagraph. For purposes of any statute granting a full or partial exemption from ad valorem property taxes that uses a definition of “low income” to mean income at or below 60 percent of the area median income and for which the multifamily structure is otherwise eligible, the city or county shall allow the multifamily structure of the developer to qualify using a definition of “low income” to mean income at or below 80 percent of the area median income.

* Note that this differs from the definition of Affordable Housing in SB 1533, which requires affordability to households at or above 80% MFI. This goes a step further to say that tax abatement incentives can be offered

when developers provide units affordable to households with income below 80% MFI, rather than the 60% threshold which is typically required for low-income developments under HUD guidelines.

35% Other Affordable Housing Programs and Incentives

Thirty-five percent of net revenues, as defined above, may be spent on "other affordable housing programs and incentives." Statute allows the city to define and design such programs and incentives to meet local needs and market dynamics. Examples include, but are in no way limited to:

- Gap financing for the development of new affordable housing
- Acquisition of existing housing that will become affordable
- Acquisition of land for future affordable housing development
- Down payment assistance for home buyers
- Rental or security deposit assistance for people who rent their homes

15% OHCS Down-payment assistance

Fifteen percent of net revenues is distributed to the Housing and Community Services Department (OHCS) to fund home ownership programs that provide down payment assistance. These funds, while distributed to a State agency, are used to fund down payment assistance in the community from which the revenues originated. In other words, the dollars that Wilsonville pays to OHCS will come back to help prospective Wilsonville homeowners.

Commercial/Industrial

50% Programs of the city related to housing

Fifty percent of net revenues may be used for housing-related programs. Staff is unaware of any guidance or administrative rules that specify what types of programs or activities this could include. As such, the city has broad license to determine how to interpret and expend these funds.

50% Unrestricted

While these fund are completely unrestricted, political pressures would likely compel the city to use the funds for projects, programs, staffing and planning efforts that, in some way, support community, economic, and/or workforce development and/or serve the historically underserved in Wilsonville.

When is the tax paid?

CET is not an annual tax. In jurisdictions that have enacted a CET, the tax is collected at the time of building permit issuance. One time and one time only.

Which development projects/permits are subject to the CET?

ORS § 320.173 states, *"Construction taxes may not be imposed on the following:*

1) *Private school improvements.*
2) *Public improvements as defined in ORS 279A.010.*

3) *Residential housing that is guaranteed to be affordable, under guidelines established by the United States Department of Housing and Urban Development, to households that earn no more than 80 percent of the median household income for the area in which the construction tax is imposed, for a period of at least 60 years following the date of construction of the residential housing.*

4) *Public or private hospital improvements.*

5) *Improvements to religious facilities primarily used for worship or education associated with worship.*

6) *Agricultural buildings, as defined in ORS 455.315 (2)(a).*

7) *Facilities that are operated by a not-for-profit corporation and that are:*
   (a) *Long term care facilities, as defined in ORS 442.015;*
   (b) *Residential care facilities, as defined in ORS 443.400; or*
   (c) *Continuing care retirement communities, as defined in ORS 101.020.*

8) *Residential housing being constructed on a lot or parcel of land to replace residential housing on the lot or parcel of land that was destroyed or damaged by wildfire or another event or circumstance that is the basis for a state of emergency declared under ORS 401.165 or 401.309 or for the exercise of authority under ORS 476.510 to 476.610."*

Additionally, precedent in other Oregon jurisdictions is to **exempt** the following types of development projects from CET:

- Residential housing units, including detached housing, that are subject to a deed restriction or other mechanism acceptable to City ensuring that the unit(s) are affordable under guidelines established by the United States Department of Housing and Urban Development, to households that earn no more than eighty percent of the median household income for a period of at least thirty years following the date of issuance of the building permit on which the improvement value is based and that remain affordable.
- Accessory dwelling units (for a limited duration of time after the enactment of a CET)
- Improvements having a total improvement value of less than $100,000.
- Improvements to religious facilities primarily used for worship or education associated with worship.

What are the alternatives to CET?

The market for new housing functions fundamentally the same as a market for any other good. That is, pricing is set as a function of supply and demand, finding equilibrium at a point never lower than the cost of production.

Lowering the cost of production is one way to lower the cost of housing. While a jurisdiction cannot control things like the costs of building materials, there are a number of ways a jurisdiction can lower front-end and ongoing operating costs for developers and property investors, including the programs, fee waivers, incentives and subsidies discussed above, but those come at a cost. Zoning and development ordinances that are conducive to the creation of affordable forms of housing are also critical. However, a local policy or incentive can only do so much, particularly in Oregon where land is a very scarce resource due to the Urban Growth Boundary.

Generally speaking, the housing affordable to households earning incomes lower than the area MFI, without public subsidy, is housing that is affordable *de facto*. That is, factors such as the the age, condition, or location of the housing set the price at affordable levels. But the inventory of such housing is limited, and certainly insufficient to meet growing demand, according to the EHSP.

To drive housing prices down to levels affordable to households earning area median wages and even below, some form of subsidy is required. Affordable housing (below market-rate) will not be built or sustained by the private sector without public subsidy as it is inherently unprofitable.

If the public must subsidize affordable housing, this begs the question: Where will the money come from? *None* of the policies or incentives mentioned above generates revenue—quite the contrary. A CET is one of few revenue-generating tools available to cities and counties for the creation and continuation of below-market-rate affordable housing. A general obligation bond and rate increase on all property owners is theoretically an alternative, but politically challenging—an understatement to be sure.

Without a revenue source to fill the gap that exists between market rate and affordable housing, there will be little if any affordable housing constructed, particularly in markets like Wilsonville (and the Portland Metro generally) where land is scarce and thus development costs are particularly high.

How much revenue can the city expect if it enacts a CET?

Of course, it depends. The CET Revenue Forecasting table at the end of this memo attempts to forecast potential revenue, based on historic permit valuation data, 2007-2021. Several scenarios are provided. Preliminary estimates show the city could realize, on average, **+/- 750k-$1.0M annually**, depending on final rates and administrative fees, which may be set by the enacting ordinance, up to maximum rates dictated by ORS.

Methodology: Staff procured historic permit valuation data from the city's Building Official and adjusted for inflation, using Consumer Price Indices. Because permit volume and valuation fluctuate from year to year, the statistical mean was derived from the inflation-adjusted valuation data in order to account for both high and low years. This averaged, inflation-adjusted permit valuation was then multiplied with hypothetical rate and fee percentages in order to forecast gross and net revenues. While there will inevitably be years with lower and higher permit valuations, volume trends steadily upward as the city grows, so while there may be years with revenue lower than the forecast, the general trend should be upward.

Which Oregon jurisdictions have already enacted a CET?

Jurisdiction	Date Enacted	Rate(s)
Bend	2006 (predates SB 1533)	**0.33% on all permits**
Portland	2016	1% on all permits
Corvallis	2016	Residential – 1% **Comm/Ind – 1.5%**
Hood River County	2017	1% on all permits – 1%
City of Hood River	2017	1% on all permits
Cannon Beach	2017	1% on all permits

Tillamook County	2017 (subsequently repealed by voters)	1% on all permits
Newport	2017	1% on all permits
Milwaukie	2017	1% on all permits
Medford	2018	**0.33% on all permits (maximum $50,000 on comm/ind)**
Eugene	2019	**0.5% on all permits (0.33% in year 1)**

Next Steps

Today Determine if interest and consensus exists among Councilors, sufficient to direct staff to continue work toward the development of a CET program.

Next Meeting Evaluate and discuss staff-provided analysis and information, looking at the following questions, among others:

- Should the CET apply to both residential and commercial / industrial development?
- What rate would be appropriate and sufficient for each type of development included, balancing revenue generation with impacts to development feasibility?
- What exemptions might the City want to establish, in addition to those required under statute (see above)? For example, would the City want to exempt projects under a certain size or permit value, certain housing types, or a broader definition of affordable housing?

Beyond Convene a task force of stakeholders to recommend how the city would use CET revenues (as allowed by ORS)

Seek broad stakeholder input (developers, business leaders, affordable housing providers and advocates, residents)

Adoption and Administration

[Revenue forecast scenarios follow]

CET Revenue Forecast
Wilsonville, Oregon

Scenario A

Net Revenues; statutorily required uses

Residential	Permit Valuation*	Alowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Developer Incentives (local)	Affordable Housing Programs (local)	OHCS (State)
		1% cap		4.00%	50%	35%	15%
New SFD	$41,290,547	0.80%	$330,324	$13,213	$158,556	$110,989	$47,567
SFD Additions/Alterations	$856,539	0.00%	$0	$0	$0	$0	$0
Subtotals	$42,147,086		$330,324	$13,213	$158,556	$110,989	$47,567

Commercial/Industrial	Permit Valuation*	Alowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Housing-related programs (local)	Unrestricted (local)
		no cap		4.00%	50%	50%
New Commercial/Industrial	$34,533,216	1.25%	$431,665	$17,267	$207,199	$207,199
Commercial/Industrial Additions/Alterations	$26,450,997	1.25%	$330,637	$13,225	$158,706	$158,706
Subtotals	$60,984,213	-	$762,303	$30,492	$365,905	$365,905
Total Annual City Admin. Fee				$43,705		

Total Local, Annual CET Revenue Forecast (Net)	**$1,001,355**

* inflate annually by a factor of ~2.89%

adjust rates to change total forecast

* Permit valuation amounts were derived using methodology described in the memo that corresponds with this workbook.

CET Revenue Forecast
Wilsonville, Oregon

Scenario B

Residential	**Permit Valuation***	**Alowable Rate**	**Gross Annual Revenue**	**Admin. Fee (retained by City)**	**Developer Incentives (local)**	**Affordable Housing Programs (local)**	**OHCS (State)**
					Net Revenues; statutorily required uses		
		1% cap		4.00%	50%	35%	15%
New SFD	$41,290,547	0.00%	$0	$0	$0	$0	$0
SFD Additions/Alterations	$856,539	0.00%	$0	$0	$0	$0	$0
Subtotals	$42,147,086		$0	$0	$0	$0	$0

Commercial/Industrial	**Permit Valuation***	**Alowable Rate**	**Gross Annual Revenue**	**Admin. Fee (retained by City)**	**Housing-related programs (local)**	**Unrestricted (local)**
		no cap		4.00%	50%	50%
New Commercial/Industrial	$34,533,216	1.25%	$431,665	$17,267	$207,199	$207,199
Commercial/Industrial Additions/Alterations	$26,450,997	1.25%	$330,637	$13,225	$158,706	$158,706
Subtotals	$60,984,213	-	$762,303	$30,492	$365,905	$365,905
Total Annual City Admin. Fee				$30,492		

Total Local, Annual CET Revenue Forecast (Net)	**$731,811**

* inflate annually by a factor of ~2.89%

adjust rates to change total forecast

* Permit valuation amounts were derived using methodology described in the memo that corresponds with this workbook.

CET Revenue Forecast
Wilsonville, Oregon

Scenario C

Net Revenues; statutorily required uses

Residential	Permit Valuation*	Allowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Developer Incentives (local)	Affordable Housing Programs (local)	OHCS (State)
		1% cap		4.00%	50%	35%	15%
New SFD	$41,290,547	0.80%	$330,324	$13,213	$158,556	$110,989	$48,553
SFD Additions/Alterations	$856,539	0.80%	$6,852	$274	$3,289	$2,302	$987
Subtotals	$42,147,086		$337,177	$13,487	$161,845	$113,291	$49,540

Commercial/Industrial	Permit Valuation*	Allowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Housing-related programs (local)	Unrestricted (local)
		no cap		4.00%	50%	50%
New Commercial/Industrial	$34,533,216	0.80%	$276,266	$11,051	$132,608	$132,608
Commercial/Industrial Additions/Alterations	$26,450,997	0.80%	$211,608	$8,464	$101,572	$101,572
Subtotals	$60,984,213	-	$487,874	$19,515	$234,179	$234,179
Total Annual City Admin. Fee				$33,002		

Total Local, Annual CET Revenue Forecast (Net)	**$743,495**

* inflate annually by a factor of ~2.89%

adjust rates to change total forecast

* Permit valuation amounts were derived using methodology described in the memo that corresponds with this workbook.

CET Revenue Forecast
Wilsonville, Oregon

Scenario D

Net Revenues; statutorily required uses

Residential	Permit Valuation*	Allowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Developer Incentives (local)	Affordable Housing Programs (local)	OHCS (State)
		1% cap		4.00%	50%	35%	15%
New SFD	$41,290,547	1.00%	$412,905	$16,516	$198,195	$138,736	$59,458
SFD Additions/Alterations	$856,539	0.00%	$0	$0	$0	$0	$0
Subtotals	$42,147,086		$412,905	$16,516	$198,195	$138,736	$59,458

Commercial/Industrial	Permit Valuation*	Allowable Rate	Gross Annual Revenue	Admin. Fee (retained by City)	Housing-related programs (local)	Unrestricted (local)
		no cap		4.00%	50%	50%
New Commercial/Industrial	$34,533,216	0.85%	$293,532	$11,741	$140,896	$140,896
Commercial/Industrial Additions/Alterations	$26,450,997	0.85%	$224,833	$8,993	$107,920	$107,920
Subtotals	$60,984,213	-	$518,366	$20,735	$248,816	$248,816
Total Annual City Admin. Fee				$37,251		

Total Local, Annual CET Revenue Forecast (Net)	**$834,562**

* inflate annually by a factor of ~2.89%

adjust rates to change total forecast

* Permit valuation amounts were derived using methodology described in the memo that corresponds with this workbook.