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MEMORANDUM

To: Kurt Triplett, City Manager

From: Adam Weinstein, Director of Planning and Building
Kevin Raymond, City Attorney
Dawn Nelson, Planning Manager

Date: July 2, 2021

Subject: INTERLOCAL AGREEMENT WITH THE CITY OF SEATTLE REGARDING COMMUNITY ROOTS HOUSING, A PUBLIC DEVELOPMENT AUTHORITY (PDA)

RECOMMENDATION:

It is recommended that the City Council adopt the attached Resolution finding that creating workforce housing is a fundamental government purpose and authorizing the City Manager to enter into an interlocal agreement with the City of Seattle for the purposes of permitting Community Roots Housing, a PDA, to provide affordable workforce housing in Kirkland.

BACKGROUND DISCUSSION:

On June 1, 2021, the City Council held a study session attended by City staff, representatives of Community Roots Housing, Microsoft and a consultant team. The focus of the study session was a pilot proposal for Community Roots Housing, using a "Middle-Income Tax-exempt Mezzanine Financing Model" developed by Microsoft, to provide workforce housing in Kirkland. "Workforce housing," which isn't formally defined, is generally considered to comprise housing that is affordable to middle-income households making between 60 percent and 120 percent of the Area Median Income (AMI).

While the existing housing crisis throughout the region is acute for low-income households, soaring housing costs have also deeply affected the workforce of middle-income households – including households with essential community members such as teachers, nurses, construction workers, and emergency responders – who typically do not have access to regulated or subsidized affordable housing. In the Puget Sound Region, almost 40 percent of middle-income households are cost-burdened, meaning that they pay more than 30 percent of their income to housing costs. This high degree of cost-burden for the workforce has resulted in numerous adverse implications both at the household and regional levels. At the household level, high housing costs generate increased financial instability; reduced homeownership opportunities; and challenges paying for transportation, childcare and other necessary expenses. In addition, these impacts disproportionately affect people of color. At the regional level, increased housing costs for the workforce have resulted in traffic congestion; difficulties in hiring emergency responders, nurses, and teachers; increased homelessness; and overall impacts to the economic vitality and quality of life in the region.

Please see **Attachment 1,** "The Invisible Crisis," a report authored by Challenge Seattle, for more information about the existing dearth of workforce housing, and its effects on the region.

As noted in the June 1 memo, the potential financing model employed by Microsoft and Community Roots Housing offers the possibility to expand the supply of workforce housing in Kirkland and implement a critical strategy within the Housing Strategy Plan: "Provide other non-monetary support for affordable housing," which includes encouraging innovative partnerships between public and private institutions. Taking into account the significant need for workforce housing in Kirkland; the challenges to developing workforce housing in the marketplace; the adverse effects of a shortage of workforce housing on households, the economy, and the environment; and the policy support for such housing in the Housing Strategy Plan, the creation of workforce housing is clearly a fundamental governmental purpose. Affirming workforce housing as a fundamental governmental purpose is a critical component of the Resolution as that finding allows Community Roots Housing to issue tax-exempt financing to build workforce housing or acquire and convert market rate housing to workforce housing.

Please refer to the June 1 memo for additional detail about PDAs, Community Roots Housing, and the proposed financing model. The June 1 memo includes the following four attachments:

> Attachment 1a – An overview of Microsoft's regional commitment to affordable housing;
> Attachment 1b – Accomplishments to date of Microsoft's Affordable Housing Initiative;
> Attachment 2 – An overview of Public Development Authorities provided by Pacifica Law Group;
> Attachment 3 – The King County ordinance authorizing a similar ILA with Seattle; and
> Attachment 4 – Microsoft's "Middle-Income Tax-exempt Mezzanine Financing Model" summary.

The slide show presentation for the study session in included as **Attachment 2** to this memo.

At the June 1 study session, City Council asked questions about the financing model, Community Roots Housing, and the nature of the workforce housing that would be developed by Community Roots Housing, and authorized the City Manager to proceed with next steps in authorizing Community Roots Housing to undertake projects in Kirkland. Attachment 2 is the slide show from the June 1 study session. One question raised by a Councilmember after the meeting pertains to how Community Roots Housing would ensure that the new housing it builds would be affordable to households with a range of incomes. The Microsoft and Community Roots Housing team's response is excerpted below:

> *Microsoft and Community Roots Housing are mission-oriented and they are focused on creating and preserving housing for middle income households, which is why they have worked hard to create tax-exempt bond for middle income housing as a new tool in the toolkit and will be deploying it as such. In fact, Community Roots Housing has a 40-year history of developing, owning and managing affordable housing across a range of income levels. Each opportunity will be underwritten and levels of affordability and number of units will be based on feasibility. Unlike a straight market owner/operator or developer, the goal is to provide units over time that are below-market-rate at the deepest levels of affordability that are feasible. The range within the middle-income band of ~60%-120% will be impacted by several factors including per unit cost and market rents at the time.*

The presentation for the Resolution will be provided by City staff, but representatives of Microsoft and Community Roots Housing will be present and available to answer questions on the range of income issue or any topic related to the pilot project.

If the City Council supports the pilot to allow Community Roots Housing to provide affordable and workforce housing in Kirkland, the primary next step is to authorize the City Manager to enter into an interlocal agreement with the City of Seattle (where Community Roots Housing is chartered), thus inviting Community Roots Housing to operate in Kirkland.

The attached Resolution would authorize the City Manager to enter into an interlocal agreement that is substantially in the form of Attachment A to the Resolution. The interlocal agreement includes provisions to: affirm that local, State, and federal permits may still be required to undertake specific projects; require Community Roots Housing to submit an annual report to the City of Kirkland detailing existing, planned, and underway projects, and the associated affordability levels of completed residential units; and allow for termination or modification of the agreement between the City of Kirkland and the City of Seattle. The termination provision would allow Kirkland to unilaterally terminate the agreement by action of the City Manager (via a signed letter) or City Council (via a Resolution), but any such termination would apply prospectively only and not to Community Roots Housing projects already completed or underway.

Attachment 1: "The Invisible Crisis" – A report authored by Challenge Seattle
Attachment 2: June 1 study session "Middle Income Housing Financing Model" presentation

Attachment 1

THE INVISIBLE CRISIS:
A Call to Action on Middle-Income Housing Affordability

Committed Leaders. Shared Vision. Greater Good.

Dear Residents,

Challenge Seattle—led by the CEOs of 15 companies and 2 philanthropies—is committed to improving our region for the better. We work collectively to address the region's most pressing challenges, from education to transportation to supporting economic prosperity throughout the Cascadia Innovation Corridor from Seattle to Vancouver, B.C.

Today, one of the biggest threats to our region's quality of life and economic future is the lack of affordable housing. The hardest hit, and most visible, are our region's very-low and low-income residents. As a community, we have been hard at work addressing the homeless crisis and building more housing opportunities for low income individuals and families. As individual companies and philanthropies we have, over the last five years, committed hundreds of millions of dollars to these efforts. Our commitment to these families and individuals has not and will not waver.

However, another threat is less known and less understood. It is "The Invisible Crisis"—the lack of affordable housing for middle-income families and individuals. These are the people our community depends on every day: the people who educate our children, care for us when we are sick, respond to natural and man-made disasters, protect us from harm, fight fires and build our homes and cities. And they are being priced out of almost every zip code in King County.

The health and vitality of our region is at grave risk. Our traffic congestion could get even worse, economic growth stagnate, our quality of life decline. If we do not act, we will not leave the legacy we must to the next generation.

It is time for us, and the region as a whole, to take action to address The Invisible Crisis.

In our research, we spoke to cities around the world who have attempted to address their housing affordability crisis. While nobody can claim to have conquered the issue, the clear takeaway is that success is only possible with commitment and action from the public and private sectors along with support from every member of the community. While daunting, we don't intend to shy away from the challenge. Our teachers, nurses, first responders, construction workers and others need us and our community needs them. Failure is not an option.

Significant first steps have already been taken: 1) Microsoft, a Challenge Seattle member, recently announced an unprecedented private-sector investment, and 2) Challenge Seattle has partnered with the mayors of King County's largest cities and the King County Executive who have publicly committed to advance middle-income housing affordability in the region.

It is time for action. We will succeed only if everybody joins in. Challenge Seattle is ready to join you to ensure that our region preserves its quality of life and that we can all continue to call this place home.

Let's get going.

Thank you.

Chris Gregoire

Chris Gregoire

EXECUTIVE SUMMARY

The high cost of housing in the greater Seattle region has reached crisis level, threatening our quality of life, economic vitality, and the future of our community. Challenge Seattle—led by the CEOs of 17 of the region's leading businesses and philanthropies—is committed to tackling our region's toughest issues. In this Call to Action, we raise awareness of a growing, and often invisible, aspect of the housing affordability crisis: the lack of affordable homes for middle-income residents. We lay out the problem and why it matters, and we recommend a set of public- and private-sector actions that can address the current market gap in affordable homes. Importantly, these actions must be taken together. This is a challenge that cannot be solved by a subset of stakeholders, no matter how well-intentioned. But if we can bring a spirit of partnership and the full suite of recommendations to bear, we can set an example to the rest of the world on how to tackle the Invisible Crisis of middle-income housing affordability.

THE PROBLEM

Year by year, middle-income residents are being priced out of more and more communities. In the last decade, home prices have risen nearly 60%, three times the national growth rate. Housing prices are seven times the median income in King County, and nearly 40% of middle-income households find themselves cost burdened by housing. Today, a middle-income household can no longer afford to rent, let alone buy, a home in most of the county's zip codes.

WHY THIS MATTERS

Our community fabric is unraveling. Teachers, nurses, utility workers, police officers and others are moving out of the communities they serve, with far-ranging impacts, from longer emergency-response times to fewer hours spent after school with students. Traffic congestion is now among the worst in the nation as more and more workers can't afford homes close to job centers.

We are at risk of losing our economic edge. Our relatively low cost of doing business and our high quality of life have helped make us a global center of innovation and allowed us to attract and retain leading businesses and talent from around the world. If we do not act, we risk our economic future.

THE SOLUTION

We must build more housing at the right price, of the right size, in the right location. In this segment of the market, however, the economics of market-rate development don't pencil and few public financing tools are available. If we want to provide more options for middle-income households, it will take new sources of capital and land from the private sector, smart policy changes and public investments, and a community willing to embrace change and make room for new neighbors.

We lay out 15 recommendations that, if deployed in concert, can materially move the needle on housing affordability in our region. We call for new sources of below-market, patient capital and discounted land; zoning changes to increase density and encourage transit-oriented development; streamlined permitting and relaxed parking requirements; new community investment vehicles; deployment of construction technology and innovations; and more.

CALL TO ACTION

Collectively, we have the tools and capabilities to address the middle-income affordability crisis. But it will take all of us. In our research of cities around the world, we found that success requires everyone doing their part—the public sector, the private sector, and the community each have an important role to play and each must play that role.

Challenge Seattle is committed to action. We will lend our voice, data, expertise, and resources. We will encourage investment, and we will support the public-private partnership needed for success. If we all work together, we can ensure the future vitality of our region for generations to come.

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1 INTRODUCTION

Nearly four million people call the Greater Seattle region home.[1] Whether born here or drawn here, we share a love for the region's unsurpassed natural beauty, culture of diversity and inclusion, spirit of innovation and creativity, and high quality of life. Our world-class companies, philanthropies, and universities are at the cutting edge of innovation and progress, and we are attracting talent and ideas from around the world. These attributes have made us one of the leading economies of the 21st century.

Over the last decade, our region's* economic success surpassed expectations. In King County, we added jobs at twice the national rate, and our population grew by around 300,000 people—roughly double the rate of growth of the U.S. as a whole (Figure 1).[2]

Figure 1: Key economic indicators (2008-17)

	King County	United States
Population	+16%	+7%
Jobs	+14%	+7%
Median household income	+28%	+16%

With great success, however, come challenges. Chief among them is housing affordability.

Across the entire income spectrum, renting or buying an affordable home in our region has never seemed more daunting. In the last decade, median home prices rose nearly 60%—three times the national growth rate.[3] We have all seen the impacts: skyrocketing rents, bidding wars, disrupted communities, displaced families, increased commute times, and rising homelessness. Our region's quality of life—the very engine of our growth—is at risk.

* For the remainder of this paper, unless otherwise specified, "our region" refers to King County.

As a region, we did not stand idly by as housing prices climbed. Rather, we added new housing stock at twice the national rate in the last decade and even accelerated this growth in recent years (Figure 2). In 2017 alone, 24,000 units of new housing were added—more than double the average yearly growth from 2012–2016.[4] Moreover, the pipeline of new units is robust, with similar additions estimated for 2018 and 2019.[5] Rents and home prices are beginning to stabilize, however, much of this new development has gone toward high-priced units.

Figure 2: Key housing indicators

	King County	United States
Housing stock (2008-2017)	+12%	+6%
Median home value (2008-2017)	+58%	+19%
Median rental housing costs as % of median household Income (2017)	35%	32%

The reality is that housing prices remain out of reach for many of our region's families. While this is most acute for our low-income and homeless community members, there is an underreported—and growing—middle-income affordability crisis.

Today, with few exceptions, a middle-income family cannot afford to buy a median-priced home in King County. Teachers cannot afford to live comfortably in the districts where they teach, and first responders are moving out of the communities they serve. Families are faced with a difficult choice: either they move farther away from their jobs, or they bear a significant financial burden to pay for housing.

The consequences of this growing crisis threaten our quality of life, our culture of inclusion, and our future economic prosperity. We must act to increase the supply of the right type of housing, at the right price, in the right location. We must leverage the investments being made in our regional transit system, and support job growth and economic development in the urban centers throughout the region.

Challenge Seattle is committed to addressing our region's housing affordability crisis. First, it fits with who we are: we take on the issues

We have a middle-income housing affordability crisis in our region. This crisis is growing and to date has received relatively little attention. It will require the private and public sectors working side-by-side, supported by the broader community, to create change.

that are critical to our region's success. Second, we understand that we, the private sector, must be part of the solution. As we lay out in the following pages, the solution to this crisis lies in bold partnership between the private and public sectors. Both are essential to addressing this issue. Third, we care deeply about this region—it is our home, and it is where we choose to grow our businesses and invest in our future. Ensuring that families across the income spectrum can afford to live in our community is essential to its health and vibrancy.

In this report on the middle-income housing crisis, we hope to raise awareness and lay out a course of action. We have researched best practices around the world and analyzed local housing economics. One thing has become clear—the solution will take all of us. The private sector must step up in new ways—particularly to provide low-cost capital and affordable land. The public sector must adopt smart policies and regulations that break down barriers and incent development. One will not work without the other, and both will fail without community support. The community must be willing to embrace change and support our leaders.

We are clear-eyed that this is not an easy task. As we learned from cities across the globe, no community has yet claimed victory. But if any region can do it—it is ours. We are a community of creators and innovators who have put airplanes in flight, helped to cure cancer, and invented personal computing. If we bring together our vision and collective determination, we can preserve our high quality of life and establish affordability for generations to come.

Figure 3: Definitions of key terms

Affordable housing: Housing for which the monthly housing cost is less than 30% of gross monthly income. Please see the graphic below for a more detailed breakdown of affordability levels.

Housing cost: Monthly costs of housing for a household, which includes rent and utilities for renter households, and mortgage, insurance, taxes, and utilities for owner households.

Housing cost-burdened: A household that spends more than 30% of gross monthly income on housing costs.

Region: For the purposes of this paper, refers to King County.

Affordability
(Spending up to 30% of gross monthly income on housing costs)

King County median household income: $89,700

Low-income household	**Middle-income household**	**High-income household**
Earns <60% of region's median household income	Earns 60–120% of region's median household income	Earns >120% of region's median household income
< $53,800	$53,800 – 107,600	> $107,600

“

I am married with two small children under the age of five... We are both public servants and don’t make a ton of money. By the end of 2018, we will fall short by several thousand dollars of meeting all of our financial obligations... so my husband is starting to look into ways to supplement our income. We dream of buying a home, but housing costs in this area are through the roof. Add the high cost of daycare for two children, the high cost of rent, and our student loan debts, and it is impossible to save any money to put towards a home, much less set aside for a rainy day.

”

—Administrator at a local community college

2 THE PROBLEM

By any reasonable estimate, Seattle and its surrounding areas are some of the most expensive housing markets in the United States. Over time, median home values have far outpaced median household income in our region, with marked acceleration in the last decade (Figure 4). Today, the median home price is nearly seven times the median household income (Figure 5). Moreover, median rental housing costs are now 35% of median household income—diverging from the national average over the past five years.

Figure 4: King County home value and gross rents over time

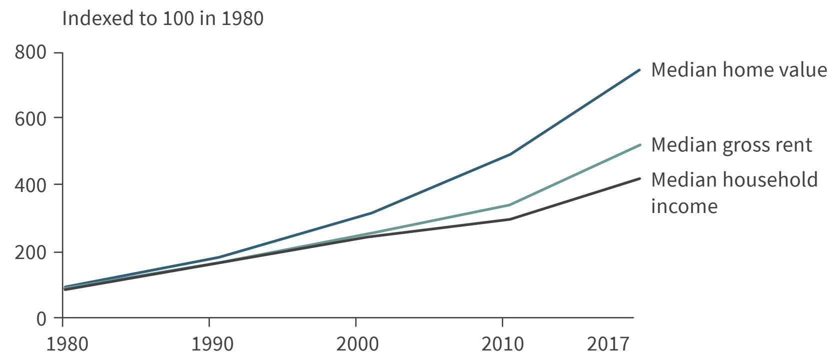
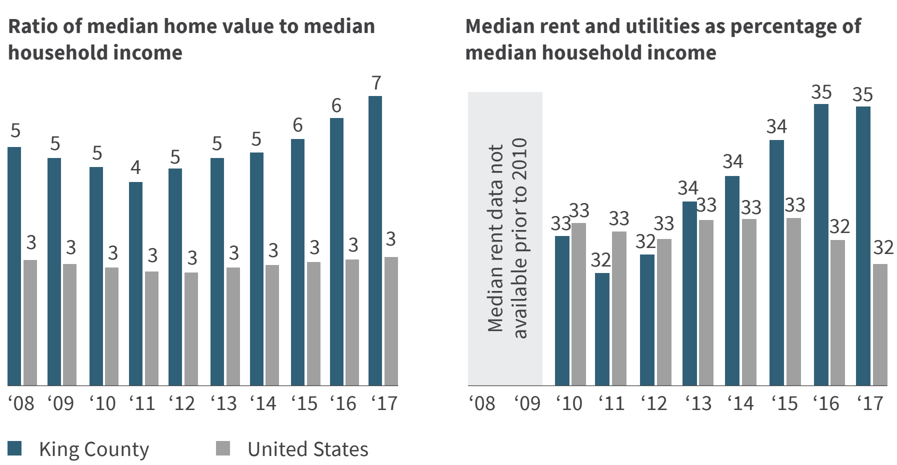


Figure 5: Housing affordability metrics over time



Labels rounded to the nearest whole number

> Housing costs are having a major impact on our company's ability to attract the talent we need. The voluntary turnover rate of first responders serving King County is nearly three times the rest of our company's average. The recruiting team has had multiple candidates renege on job offers that had been accepted once the candidates considered the housing options they would be able to afford.
>
> —Report from a local utility company

The overall affordability story has been widely publicized and is well known to all of us in the region. The part of the story that has received less attention, however, is the toll that rising housing prices are having on our middle-income families—our teachers, nurses, electricians, civil engineers, carpenters, accountants, machinists, and police—our neighbors.

In our region, nearly 40% of middle-income households find themselves cost-burdened by housing, meaning they must allocate more than 30% of their income to housing costs each month.[6] Housing cost burden matters. Families with greater housing cost burdens must compromise on other expenses such as child care, student debt, and transportation. These families also experience greater financial instability in the face of the unexpected, including job loss, workplace injury, or medical issues. For renters, it limits the ability to save for a down payment and the opportunity to build wealth through home ownership. The options to avoid a high housing cost burden are rapidly dwindling for middle-income families. Today, with few exceptions, residents cannot afford to purchase a home in King County (Figure 6). Vast parts of neighboring Pierce and Snohomish Counties are also out of reach. Rental rates in King County are similarly becoming unaffordable for many middle-income households (Figure 7). Projections show that even communities that are today more affordable will become out of reach in the coming years.

Figure 6: Household income required to afford to buy a median-priced home

2010 | **2018** | **2030** (Projection)

Percentile of median household income that can afford to buy a median-priced home

Below 80% | 80%–100% | 100%–120% | Above 120%

Figure 7: Household income required to afford median rent

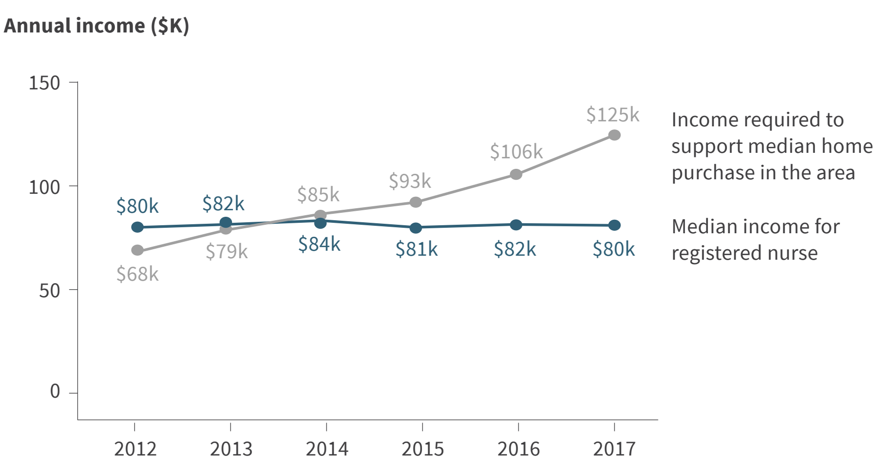
2010 | **2018** | **2030** (Projection)

Percentile of median household income in King County that can afford median rent

Below 80% | 80%–100% | 100%–120% | Above 120%

Today, a registered nurse earning $80,000 per year cannot afford to buy a median-priced house in the area.[7] In fact, nurses were "priced out" of the area in 2014 (Figure 8). The trend continues to hit city after city: 2013 was the last year a nurse could afford to buy a house in Seattle; in 2017, Renton became too expensive.

Figure 8: Typical registered nurse wage vs. income needed to afford to buy a home



City	Year priced out
Seattle	2013
Kirkland	2013
Area median	2014
Renton	2017
Auburn	Currently affordable
Federal Way	Currently affordable
Kent	Currently affordable

Note: Registered nurses were "priced out" of Bellevue, Issaquah, Redmond, and Sammamish prior to the analysis period.

While King County added a total of 90,000 new households since 2010, only 11,000 new middle-income households were added over that time.[8] To find affordable options, middle-income families are increasingly choosing to live farther away. While not a direct cause, the decline in affordability has coincided with an additional 150,000 King County residents commuting more than 30 minutes and an additional 40,000 residents commuting more than 60 minutes each way.[9] These trends have consequences for congestion, commute times, and our environment.

If the trends we have summarized above continue, we foresee far-reaching negative impacts.

3 WHY THIS MATTERS

If we do not act to address the middle-income housing affordability crisis, quality of life and economic vitality in our region will be at stake. This is not a problem that impacts only middle-income families. All parts of our community will feel the effects of the crisis if we do not move swiftly.

Public education. Education is a core pillar of a healthy community and, as the training ground for our future workforce, a vital part of our economic foundation. Around the country, public education suffers in communities with extreme housing affordability challenges. School districts struggle to maintain sufficient funding and to attract and retain high-quality teachers.[10] In South San Jose, California in the Bay Area, the Oak Grove School District was forced to close three elementary schools as enrollment declined precipitously for multiple years as young families found it increasingly challenging to afford housing in the area.[11] The shrinking student population cost the district more than $2 million in annual funding, straining the district's budget and forcing the closures.

The impact of unaffordable housing on the education system extends beyond school administration and resources. Teachers who must live outside the district can invest less time helping students after school, as they face long commutes home. Students pay the price when rising housing costs or rents force families to move and change schools, which can have damaging effects on academic outcomes, including on-time graduation.[12]

Community safety. In a middle-income housing crunch, many first responders such as police officers and firefighters cannot afford to live in the communities they serve. In Menlo Park, California, the fire department resorted to providing monthly stipends to help firefighters move closer to work in 2016.[13] As the fire chief stated, "If I saw someone sleeping in a chair… it's because they have to travel farther to get to work."[14]

Similar issues are emerging in our region. We have spoken to local police chiefs who have had to move away from the cities they serve to find affordable housing. After-hours emergency utility response times are reportedly higher in some high-cost communities because workers have to travel in from more affordable outlying areas. For instance, at one regional utility, only three after-hours emergency first responders live in a particular, central service area.[15]

Traffic congestion. As people are forced to move farther from their jobs to find affordable housing, traffic congestion increases—wasting time, increasing pollution, and reducing quality of life. In addition to the trends reviewed in the previous section, we have seen dramatic statistics involving "mega-commuters" who commute 90 minutes or more each way. In 2017, the Seattle-Tacoma-Bellevue metro area had the 3rd fastest-growing population of mega-commuters in the nation. Our population of mega-commuters has increased more than

70% since the start of the decade (surpassed only by the Bay Area, California). By 2020, we can expect nearly 100,000 mega-commuters in our metro area if current trends hold.[16]

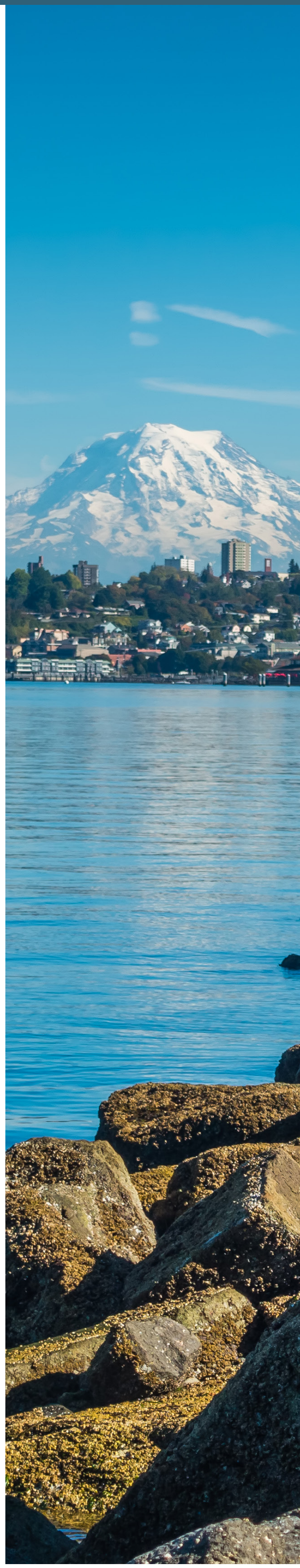
Socioeconomic diversity. A key ingredient to a healthy, vibrant community is socioeconomic diversity. Long term trends show that we are losing economic diversity as the middle-income share of the population shrinks.[17] This foreshadows local economic segregation, which has been linked to lower inter-generational economic mobility.[18] As middle-income households are priced out of an increasing number of zip codes in our region, concentrations of wealth and poverty will deepen.

Homelessness and low-income affordability. A shortage of affordable middle-income housing hurts households further down the income scale by increasing competition for affordable units. This "cascading effect" takes place when rent exceeds middle-income affordability, pushing middle-income renters into housing once occupied by lower-income households, who then displace even lower-income households, and so on. Renters at the lowest income level are already at risk of homelessness by even small increases in rent and the cascade pushes them past the brink. Recent research by Zillow found this correlation between homelessness and median income affordability. Specifically when median rent exceeds 32% of median income, cities see faster growth in homelessness. For example, Zillow estimates that if rent increases by 2% in Los Angeles, another 4,000 people are expected to become homeless.[19]

Economic growth. Our region's economic growth in recent years was fueled in part by our relatively low cost of doing business and high quality of life compared to peer cities. This edge allowed us to attract businesses to the region and recruit and retain talent. The housing affordability crisis has significantly dulled that edge. We are now one of the most expensive regions in the country, and our high housing costs are making it hard to retain—let alone attract—talent.

Quality of life. We all call this area home via different paths, but we all choose to stay here in part because of the high quality of life and sense of an inclusive, diverse, and innovative community. Longer commutes, worsening air quality, homogenized neighborhoods, community displacement, and financial insecurity threaten the very essence of what we all love about this region.

If we do not act to provide affordable housing for low- and middle-income families, we risk losing what we hold dear about our community. We need to ask ourselves a critical question: are we willing to risk our quality of life and the future of our middle-income families? If not, then doing nothing is not an option.



4 SOLUTIONS

Then, what should we do? Communities around the world have been grappling with affordable housing challenges for decades. We spoke to leaders in cities all over the globe, including Vancouver, Sydney, London, New York, and San Francisco, to understand best practices and lessons learned. Unfortunately, no easy answers emerged.

That said, one common theme prevailed—it takes everyone: the public sector, the private sector, and the broader community working together to address the crisis. We must influence the economics of development, adopt smart policies, and as a community, change our mindset. To see how these all come together to solve the problem, we must first understand the basic dynamics of our real estate market.

Housing prices are determined by supply and demand. As discussed, our region's economic success over the last decade has fueled a population boom, dramatically increasing demand for housing. At the same time, housing supply has not kept pace, and when supply is lower than demand, prices tend to rise.

So how do we increase the supply of affordable middle-income housing? A short term strategy is to preserve affordable middle-income units (see sidebar on preservation). For long term success, we must sustainably influence the market to build enough new units to meet demand. In doing so, we must remember one unit of housing is not equal to all others. A one-bedroom apartment in an urban center close to transit is not the same as a three-bedroom, single-family home in the suburbs. Our goal is to build the right types of housing at the right price and in the right locations to serve the needs of our community.

PRESERVATION

It takes time to build new housing to add to our supply—time during which prices can continue to rise and more families could find themselves priced out. As such, the preservation of existing affordable housing must go hand-in-hand with efforts to increase housing supply.

Affordable housing preservation typically involves a non-profit entity buying existing multi-family properties which have rents that are already affordable to low-and-middle income families. The new non-profit owner then maintains the price stability of these units over time, keeping rents lower than they otherwise would be if left to the private market.

This strategy lessens the risk of displacement of existing residents, often preserves historic buildings and neighborhood character, and supports affordable housing in areas where there is less available land to build new units. Importantly, this strategy can be implemented quickly and cost effectively. Maintaining the affordability of existing housing is a valuable tool that can provide a much-needed backstop while we work to increase supply.

Currently, the economics of middle-income housing development do not pencil out. To understand why, let's look at the basic economics of a development project. There are three main cost drivers:

(1) Land. Land acquisition—whether public or private—is a sizable portion of development costs, typically accounting for 15–30% percent of overall costs.[20] The Seattle region has the 13th highest land values in the country out of over 200 metro areas.[21] The availability of land is affected by zoning and density decisions, as well as the cost of preparing land for development.

(2) Financing. Developers need capital to acquire land and pay for permitting, construction, and other costs. Capital comes in two main forms—debt and equity. Debt is typically provided by banks in the form of loans, and its cost is the interest rate charged on the loan. In the case of equity, investors require a return on their capital. That return is typically realized through annual payments yielding a percentage of the investment plus a lump-sum payout when the development is sold. To attract equity, the returns must be competitive with other investment options of similar risk. In our region, equity investors are currently requiring 13–16% return on investment.[22]

(3) Construction. Construction costs—labor and materials—typically account for one-half to two-thirds of the cost of a new multi-family development.[23] In Seattle, construction costs have increased by over 30% in the past decade, flowing directly to higher prices for homeowners and tenants.[24] High demand for labor and shortages in skilled trades have contributed to the rise in costs. Material costs have also increased nation-wide, in part due to international trade developments over the past year, with particularly acute impacts on multi-family development.[25, 26]

In addition, regulatory requirements and fees that affect building design, permitting, and time to construction contribute to the overall cost of constructing a project and impact all of the above costs.

In our region today, we estimate that in order to cover the costs of financing, construction, and land, a developer must be able to rent a 700 square foot apartment at $2,800 a month. Adding utilities of $150 a month brings the total housing costs to $2,950.[27] However, the median-income family in our region can afford a monthly housing cost of $2,200, leaving a gap of $750. A family earning 60% of median household income can afford a monthly housing cost of $1,300, leaving a gap of nearly $1,700.[28]

It will take everyone: the public sector, the private sector, and the broader community working together to address the crisis.

INFLUENCING THE ECONOMICS OF DEVELOPMENT

To make the market economics of middle-income housing work, we must bend the cost curve, lowering the cost of financing, construction, and land. Lower development costs means lower housing costs for buyers and renters. Our community is already tackling the low-income affordability crisis with an impressive suite of public sector tools (see table below). Drawing inspiration from this toolkit, we propose a set of complementary tools that target middle-income housing, yet have benefits across the income spectrum.

EXAMPLES OF THE LOW-INCOME TOOLKIT, WHICH IS NOT CURRENTLY FOCUSED ON MIDDLE-INCOME

- **Low Income Housing Tax Credit:** a federal tax credit program that provides incentives for private sector investment in affordable housing developments serving families up to 80% of Area Median Income (AMI).[29] Since the early 1980s, more than $3.5 billion worth of investment has gone to low-income housing projects in King County through this program.[30]
- **Seattle Housing Levy**: Since 1981, this voter-approved levy has provided $678 million to assist low-income families by supporting loans for construction and preservation, assistance to first-time home buyers, and rental assistance and stabilization for those at risk of homelessness.[31]
- **Washington State Housing Trust Fund**: Since 1986, this state fund has provided $1 billion in capital statewide to develop and preserve affordable housing for low-income residents, with the majority at 30% AMI or below.[32]
- **Federal HUD Programs:** The U.S. Department of Housing and Urban Development has historically had a suite of programs that provide grants and low-interest loans to help communities build low-income housing and to help low-income households access homeownership. HUD also provides “Section 8” vouchers that provide rental subsidies to very low-income families.
- **Multi-Family Tax Exemptions (MFTE)**: Authorized by state law, many cities in Washington provide a property tax exemption on new multi-family buildings in exchange for setting aside a certain percent of units as income- and rent-restricted.

Non-profit organizations have long played an important role in supporting low-income housing by harnessing these and other tools.

The recommendations that follow provide actions that the public and private sector can take to begin to bend the cost curve. For the private sector, the focus should be on providing low-cost capital, land, and other investments. For the public sector, donating land and adopting smart policies and regulations will break down barriers and incent the creation of more middle-income housing. While it is difficult to model the complete impact of these recommendations, our analysis shows that we can markedly reduce development costs and therefore reduce required rents through these actions.

OUR MODEL

We consulted with local developers and real estate experts to construct a bottom-up model of the cost of building a new multifamily development in a high-cost land area of our region. The model predicts that rents required to cover costs must be roughly $2,800 per month, plus $150 in utilities. We subsequently modeled the potential cost savings of a number of our recommendations that directly influence the micro-economics of a development project. Please note that, due to the dynamic interactions modeled between various actions, the total dollar impact does not equal the summed impacts of each individual action.

Figure 9: Actions we can take to reduce costs and increase supply

	Action	**Illustrative rent reduction/month** Original rent: $2,800 + $150 utilities
Land	Contribute desirable land, ideally near transit	$100–300
Land	Change zoning to increase density	Primary impact to increase supply
Land	Encourage transit-oriented development	Long term opportunity
Land	Support job growth near affordable housing supply and transit corridors	Long term opportunity
Financing	Provide below-market loans	$200–300
Financing	Provide patient, below-market equity	$100–200
Financing	Extend housing tax incentives to middle-income	$200
Financing	Provide short term, early-stage loans	Primary impact to increase supply
Financing	Create community investment opportunities	Long term opportunity
Financing	Encourage private investment through consistent & transparent policy decisions	Primary impact to increase supply
Construction	Reduce requirements for expensive-to-build parking in transit corridors	$100–300
Construction	Reduce impact and other development-related fees	$100
Construction	Streamline and accelerate the permitting process	Primary impact to increase supply
Construction	Reform condominium liability laws	Primary impact to increase supply
Construction	Support construction innovation and technology advances	Long term opportunity
	New rent for example apartment:	**Approximately $1,700–$2,100 plus $150 utilities**

Note: Due to dynamic interaction of levers in our model, impact of full implementation is not equal to the sum of the individual levers' impact

LAND

(1) Contribute desirable land, ideally near transit | $100–300 reduction in monthly rent
Discounting the cost of land—or even donating land—is one significant way that both public and private sector landowners can increase the supply of middle-income housing. As mentioned, land typically accounts for 15–30% of the total cost of a housing development.[33] With Washington State ranking fifth for the highest land values in the U.S., land costs are a major reason the market is not supplying middle-income housing.[34] Policy makers should ensure that local and state laws allow jurisdictions to discount or donate land for middle-income housing development.

In addition to discounting the price, landowners can lower the costs of a project through other means. For example, entities that would like to retain ownership over currently under-utilized land parcels can offer long-term leases at below-market rates. Additionally, landowners can invest land as equity in a project, patiently accepting longer-term returns over the life of the project and reducing upfront costs. In our model, offering land at 50–75% of market value could reduce monthly rent by $100–300 per unit.

(2) Change zoning to increase density | Primary impact to increase supply
Increasing housing density is fundamental to addressing the housing affordability crisis. We have a fixed amount of land in our cities. We cannot house more families unless we increase the number of housing units that can be built on a given parcel of land.

Cities around the world are recognizing that prioritizing single-family zoning is no longer working. Vancouver, B.C. voted to rezone 99% of single-family lots to allow higher density duplexes.[35] Minneapolis recently eliminated all single-family home zoning to allow duplexes and triplexes in neighborhoods citywide.[36]

In Seattle, 75% of residential land is zoned as single-family.[37] By comparison, single-family houses occupy less than 40% of residential land plots in Chicago, Brooklyn, and Boston.[38] As a community, we must take a hard look at the percentage of land we dedicate to single-family zoning—particularly near transit—and be willing to increase density.

In addition, relaxing height restrictions to allow for building more floors, reducing minimum property size requirements to allow properties to be sub-divided, and allowing for cottage housing and accessory dwelling units (ADUs) can all increase the social value that each parcel of land provides in housing our region's residents.

(3) Encourage transit-oriented development | Long term opportunity
Given the already-formidable commute times for drivers and the limited land availability in existing job centers, the development of housing near public transit is becoming increasingly important. This means building new housing in existing transit corridors as well as responding to planned transit expansions that will connect job centers to new areas.

Sound Transit's ST3 expansion plan will add over 60 miles of new light rail, expand rapid transit and express bus service, and increase the service area of the Sounder rail line.[39] To fully realize the benefits of this major investment in public transit, the expansion must be met with new affordable housing development throughout the future footprint of our public transit system. Strategies such as Sound Transit's policy to offer 80% of surplus property to affordable housing projects can encourage the transit-oriented development that our region needs.[40] However, this program currently targets only up to 80% of an area's median income. We should expand it to include a broader set of middle-income households.

(4) Support job growth near affordable housing supply and transit corridors | Long term opportunity
Where people live, where they work, and how they move between the two is a dynamic system. While we typically focus on where to put housing, the location of jobs matters as well. Both public and private sector employers should evaluate how they can provide workspaces in areas with easy access to sufficient affordable housing and transit.

FINANCING

(1) Provide below-market loans | $200–300 reduction in monthly rent
Loans typically make up 65–75% of the funding for a housing development, but most available loans are at prevailing market rates. Lenders willing to offer loans at lower rates can reduce the cost of monthly interest payments, consequently lowering the rent needed to recoup costs. Impact-oriented investors, banks, non-profits, and a variety of other institutions have the power to provide below-market loans. In our model, reducing interest rates on loans by 1–2% from the current market rates of roughly 5% can decrease rents by $200–300 per month.

Lenders have additional levers that could reduce financing costs on middle-income housing projects. For example, extending the term—or time over which the loan is repaid—can reduce monthly interest payments. Additionally, providing low-cost subordinate debt—debt that is repaid after senior bank loans are repaid—provides much needed capital and allows projects to access more favorable terms on their primary debt.

Example: In Denver, a public-private partnership created the Regional Transit-Oriented Development Fund, which offers a pool of $24 million in low-interest rate loans to finance property development for affordable housing projects.[41] As a result of this partnership, over 1,300 affordable homes have been created.[42]

(2) Provide patient, below-market equity | $100–200 reduction in monthly rent
Equity typically makes up 25–35% of funding for housing developments.[43] Equity investors expect to earn a return when they sell the property, but also expect an annual dividend, or cash yield, on their investment. Typically the annual cash yield is 6–9% of their total investment, and is an important driver of housing costs.

Impact investors, such as private-sector companies, institutions, or individuals, can support middle-income housing development. By offering patient equity investments, they can lower costs by extending "patient" equity investments, which lower costs by extending the time horizon before returns are realized. Additionally, some equity investors are willing to define "return" holistically to include social impact, as well as financial returns. These investors may be willing to accept below-market rate financial returns. In our model reducing annual cash yields by 1–2%, from our example rate of 7.5%, could reduce monthly rent by $100–200 per unit.

Example: The Healthy Neighborhoods Equity Fund is a private equity fund that provides patient equity and loans to development projects that combine community impact with financial returns. This fund focuses on development projects that improve community health outcomes with a goal of creating over 550 housing units close to local transit in the Greater Boston area.[44,45]

(3) Extend housing tax incentives to middle-income | $200 reduction in monthly rent
As discussed, several local, state, and national programs provide financial support and incentives for low-income housing projects. Increasing the scope of programs to include eligibility for middle-income housing projects would boost supply. Extending the timeframe associated with tax incentives can keep units affordable for longer.

For example, jurisdictions should explore expanding and extending existing property tax exemption programs with a proven track record for spurring low-income development. In our model, if owners receive a 50% property tax exemption on affordable middle-income multifamily development projects, monthly rents could be reduced by $200 per unit.

Example: The Low Income Housing Tax Credit (LIHTC) has been an effective mechanism for encouraging affordable low-income housing development for families earning less than 60% of the area median income. In 2018, Congress finalized a federal spending bill that expanded the LIHTC to now serve some middle-income households, specifically those earning up to 80% of the median income in their areas.[46]

(4) Provide short term, early-stage loans | Primary impact to increase supply

Development projects proceed in phases and require financing at each step in their lifecycle. One of the riskiest stages, and therefore one of the hardest for which to obtain financing, is the period prior to construction. This is when design, permitting, environmental reviews and other time-consuming, non-revenue-generating activities take place. Lenders willing to increase the supply of short term loans at reasonable rates can help spur developments that otherwise could not have gotten off the ground.

Example: The Housing Trust of Silicon Valley's TECH Fund provides short term, early-stage loans to projects that might not otherwise receive them. These loans ensure affordable housing projects have the capital and agility to compete with higher cost developments.[47] Overall, the TECH Fund has helped to create and preserve over 1,400 affordable housing units since its launch in 2017.[48]

(5) Create community investment opportunities | Long term opportunity

The lack of affordable housing impacts all of us. Many individuals and organizations are willing to join the ranks of impact investors, but they are often uncertain how they can participate. Our region should explore creating innovative investment products that allow non-traditional real estate investors—including local residents—to provide funding in exchange for modest financial returns and high social impact. Additionally, the federal Opportunity Zone program may offer additional avenues to incent investment in affordable housing development in certain parts of our region. By exploring new investment opportunities, we can leverage the financial power of all parts of our community.

(6) Encourage private investment through consistent and transparent policy decisions | Primary impact to increase supply

When making financial investments, investors consider not only returns, but also the risk associated with those returns. There are many sources of risk. For instance, the housing market might enter into a downturn when it is time to sell a project, or a natural disaster might destroy the existing supply of lumber. Some risks are more within our control as a region; importantly, we can lower the "regulatory risk" associated with a changing policy environment.

If we want to encourage lenders and investors to provide low-cost capital, policy makers must reduce regulatory risk by providing transparency into decision-making and consistency over time in the rules and regulations that govern a given development project. For example, mid-stream changes in rent restrictions or income eligibility requirements that apply to existing projects can significantly alter investors' returns, potentially resulting in a loss. If investors worry about future policy changes jeopardizing their expected returns, they will not invest and the market for low-cost capital will dry up. As such, our region must create a transparent, predictable policy environment that allows investors to confidently invest.

CONSTRUCTION

(1) Reduce requirements for expensive-to-build parking in transit corridors | $100–300 reduction in monthly rent

In our region, underground parking construction costs up to $50,000 per parking spot.[49] Local city policies govern parking requirements for new housing developments, which add to construction costs and ultimately rent. Some cities even require more than one parking spot per housing unit.[50]

With a regional investment of $50 billion to build out our transit infrastructure and a future of shared and autonomous vehicles on the horizon, it is worth revisiting how many parking spots are really needed per unit, particularly in developments near transit. In our model, if cities relax requirements from 1.2 to 0.6–0.9 parking stalls per unit, monthly rent could be reduced by $100–300 per unit.

(2) Reduce impact and other development-related fees | $100 reduction in monthly rent

Impact fees are one-time local city charges used to fund infrastructure expansion. Today, impact fees can total up to $25,000 per unit in our region.[51] Cities can make a major dent in the cost curve by reducing, restructuring, or waiving impact and other development fees on some middle-income housing projects. In our model, this could reduce monthly rent of targeted projects by $100 per unit.

(3) Streamline and accelerate the permitting process | Primary impact to increase supply

In the life of a middle-income housing project, time is money and certainty is gold. Housing projects must gain numerous permits and approvals on everything from design to environmental impact. Currently, however, permitting timelines are variable, processes and forms change between localities, and duplicative information must be provided to multiple agencies—all of which create uncertainty and take time. To address this, King County cities could develop predictable, uniform approval processes that achieve necessary assessments through a more streamlined approach. Cities can also fast-track projects that meet certain criteria.

(4) Reform condominium liability laws | Primary impact to increase supply

Condos are an attractive housing type for sustaining our region's growth. They allow for home ownership—protecting residents against displacement and enabling families to build wealth—while making better use of scarce land in high-density areas. Condos also regularly serve as homes for younger residents, empty-nesters, and retirees.

The Washington State Condominium Act, initially passed in 1990 to protect condo buyers from shoddy workmanship, has created a 10-year implied warranty for construction. This has unintentionally resulted in high insurance costs to cover the liability, and increased the financing needed to build and operate condo buildings.[52] As a result, condo development in Washington State has slowed with the exception of luxury buildings.[53] Reforming the Act to ensure that condo buyers are protected while eliminating unreasonable liability requirements could allow more affordable condo projects to become viable.

(5) Support construction innovation and technology advances | Long term opportunity
Construction accounts for more than half of the cost of most development projects, offering an opportunity to harness the power of technology and innovation to save money. For example, new products such as new mass timber products are emerging as a potentially cost-effective alternative to steel for mid-rise and even high-rise developments. Production of these products also results in fewer greenhouse gas emissions compared to steel production.[54]

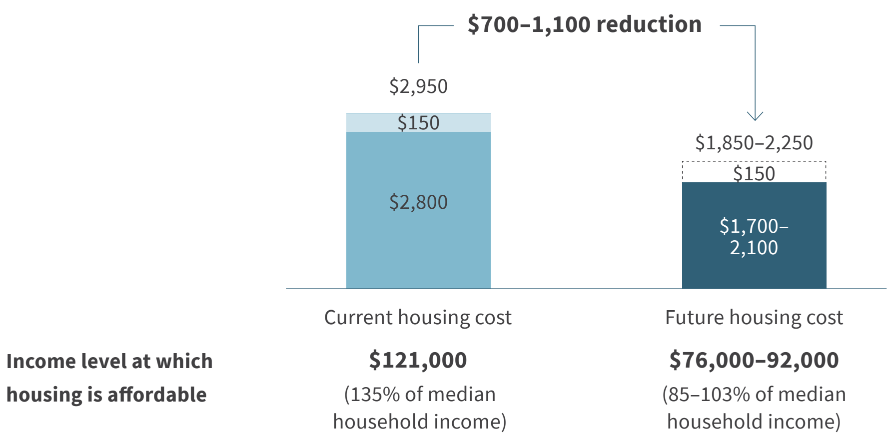
Prefabrication offers another potential strategy to reduce costs, through a combination of off-site production and on-site assembly.[55] We must ensure that our local building codes and regulations safely facilitate these opportunities to reduce development costs.

IT ADDS UP

We quantified the dollar impacts of a subset of these actions and found they could reduce a unit's monthly rental price by $700-1,100 (Figure 10). Acting on the entire set of recommendations will have an even greater impact on supply, speed-to-market, and sustainable growth. Everyone—the public sector, the private sector, and the community—can play a significant role in bringing these recommendations to life.

Figure 10: Impact of actions

(that have quantifiable, direct links to per unit rent)



5 CALL TO ACTION

FIRST STEPS HAVE BEEN TAKEN

Microsoft has made a historic and unprecedented commitment of $500 million to address the housing affordability crisis. The commitment includes the first substantial investment focused on middle-income housing in our region—$225 million in low-cost capital.

Nine mayors from some of King County's largest cities have committed to advancing housing affordability in the region by exploring this paper's recommended public sector actions.

We recognize that achieving the full scope of our recommendations will not be easy. Affordable housing is a complex and multi-faceted issue, and the magnitude of the crisis we face is daunting. It will require us to take risks and to try things that have never been done here before.

And most importantly—as we have stated throughout this report—it will take everyone. We need new sources of capital and land from the private sector, smart policy changes and public investments, and a community willing to embrace change and make room for new neighbors. First steps have already been taken (see sidebar).

Collectively, we have the tools and capabilities we need to succeed. And in this region, we have a history of tackling big problems with bold, innovative thinking and action.

If we succeed, we will not only safeguard affordability for our own communities for generations to come, but also establish a new benchmark for what can be done on housing affordability for other fast-growing regions across the globe.

Imagine what the future could hold. If we work together, we can:

- Ensure **households across the income spectrum** can afford to live in the communities they serve
- Reduce the cascade effect of unaffordable middle-income housing and **stem the rising tide of homelessness**
- Retain and attract the talent we need to **fuel our economy**
- **Reduce commute times** and improve air quality
- Preserve access to our **beautiful, natural environment**
- **Protect our culture** of inclusivity, creativity, and innovation

As the leaders of 17 of our region's largest businesses and philanthropies, we commit as Challenge Seattle to rise to the occasion. We will lend our voice, our data, our expertise, and our resources to the effort. We will nurture the public-private partnerships needed for success and support smart policies and effective programs. We will encourage investments of all kinds from all corners of our community that can advance the cause.

If we all work together, the future we imagine is within our reach.

We invite you to join us.

ACKNOWLEDGMENTS

Special thanks to Boston Consulting Group for their insights and contributions to this work. We are particularly grateful to Microsoft Corporation for their partnership in this effort and Zillow Group for generously sharing their data and research.

Challenge Seattle is immensely grateful for the contributions of the following experts and organizations, who have provided valuable insights that informed this work. We have made a genuine effort to incorporate their thoughtful inputs, but final responsibility for this paper and its analysis and recommendations rests with us.

- Challenge Seattle's 17 member organizations
- David Hoffman
- Dow Constantine, King County Executive
- Enterprise Community Partners
- Homesight
- Housing Trust Silicon Valley
- Kate Joncas
- King County Housing Authority
- Mayor Christie Malchow, City of Sammamish
- Mayor Dana Ralph, City of Kent
- Mayor Denis Law, City of Renton
- Mayor Jenny Durkan, City of Seattle
- Mayor Jim Ferrell, City of Federal Way
- Mayor John Chelminiak, City of Bellevue
- Mayor John Marchione, City of Redmond
- Mayor Mary Lou Pauly, City of Issaquah
- Mayor Nancy Backus, City of Auburn
- Mayor Penny Sweet, City of Kirkland
- Peter Orser
- Seattle Foundation
- Security Properties
- Sound Cities Association
- Sound Transit
- Spectrum Development Solutions
- University of Washington
- Vulcan Real Estate
- Wright Runstad & Company

APPENDIX A

LOCAL MAYORS' STATEMENT

We are some of the largest city mayors in King County representing communities outside Seattle and we believe that healthy, vibrant communities are ones that offer affordable housing options for families and individuals all along the income spectrum.

In recent years, the speed of economic and population growth in our region has outpaced the growth in housing supply, creating a shortage of affordable housing-pricing out too many households and threatening the fabric of our community.

We will continue our work to address homelessness and low-income housing and we will also work to address the growing crisis of the lack of affordability of middle-income housing in the area.

Too many of our teachers can no longer afford to live near the schools where they teach. Too many nurses, teachers, police and other first responders are moving out of the communities they serve to find homes they can reasonably afford. Homelessness continues to rise, and our local workforce is commuting from farther and farther away- worsening congestion and eroding our sense of community.

To address this problem, we intend to do our part to break down barriers and provide incentives to substantially increase the supply of quality housing for all households in our community.

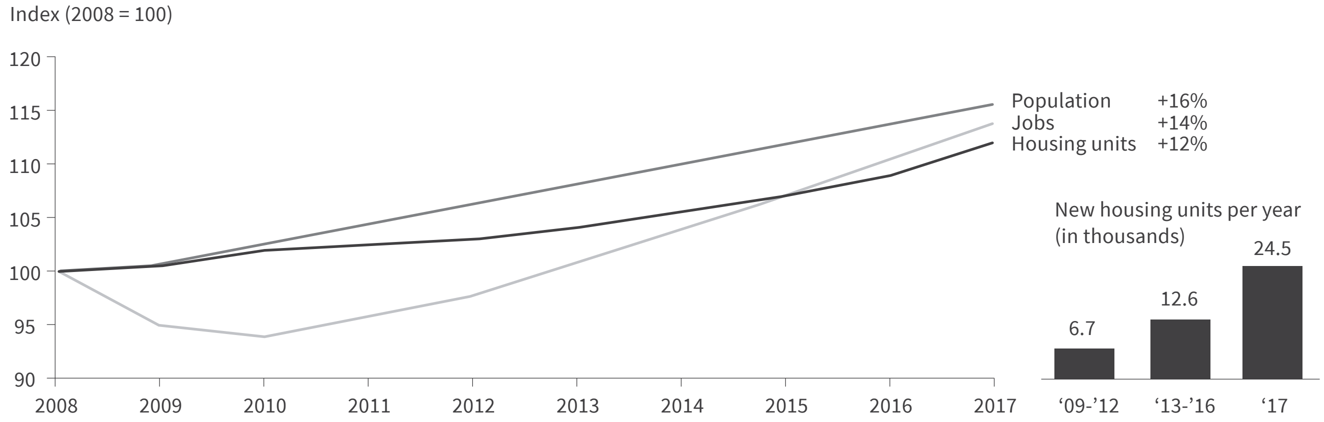
We will consider opportunities to advance housing affordability in the region, including but not limited to:

1. Making available at no cost, at deep discount, or for long-term lease, under-utilized publicly-owned properties,
2. Updating zoning and land use regulations to increase density near current and planned public transit,
3. Reducing or waiving parking requirements in transit corridors to help reduce overall development costs,
4. Reducing or waiving impact and other development-related fees,
5. Streamlining and accelerating the permitting process for low- and middle-income housing projects to improve developer certainty,
6. Providing tax exemptions and credits to incent low- and middle-income housing development, and
7. Updating building codes to promote more housing growth and innovative, low cost development.

We believe that these efforts, combined with the support of the greater community, will make our region more affordable for all households and will advance quality of life throughout the region.

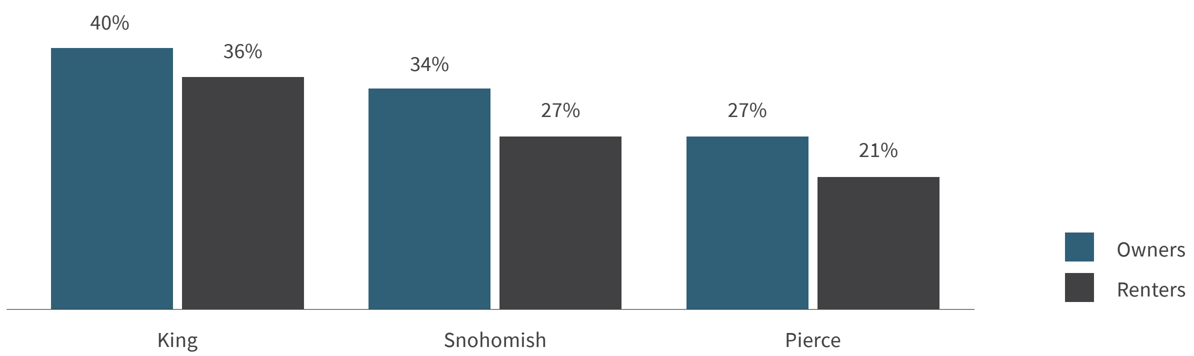
ADDITIONAL FIGURES

King County demographic, employment and housing trends



Source: US Census via American Community Survey, retrieved from American FactFinder on 1/2/2019
Bureau of Labor Statistics

Percent of middle-income households that are cost-burdened
Note: Based on Census data household income band of $50-100k per year, 2017



Source: US Census via American Community Survey, retrieved from American FactFinder on 1/2/2019

APPENDIX C

DETAILED HOUSING MODEL ASSUMPTIONS

The housing development model cited in this paper used the following assumptions to calculate monthly rent per unit before enacting any of the recommended actions to reduce cost.

Overall assumptions

- Number of units: 150
- Square feet per unit: 667
- Pre-construction timeline (months): 24
- Construction timeline (months): 24
- Sale timeline (years): 7

Equity capital assumptions

- Equity portion of capital: 35%
- Equity total: $20M
- Equity IRR: 14%
- Preferred annual return: 7.5%

Development assumptions

- Total cost to build: $58M
- Developer fee: $1M
- Financing cost: $3M
- Construction cost: $24M
- Parking construction cost: $9M
- Construction sales tax: $3M
- Land cost: $10M
- Initial feasibility cost: $1M
- Other costs: $6M

Debt capital assumptions

- Debt portion of capital: 65%
- Construction loan: $37M
- Construction loan rate: 4.5%
- Permanent loan: $38M
- Permanent loan rate: 5%

APPENDIX D

REFERENCE SOURCES

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Bureau of Labor Statistics

Curbed

Data Smart City Solutions

Education Week

Enterprise Community Partners

Lincoln Institute of Land Policy

Neighborly

New York Times

Puget Sound Regional Council

Seattle City Government

Seattle Times

Seattle's Housing Affordability and Livability Agenda (HALA)

Sightline

Sound Transit

Terner Center for Housing Innovation, UC Berkeley

Urban Institute

U.S. Census Bureau; American Community Survey

Washington State Department of Transportation

Zillow

ENDNOTES

FIGURES SOURCES AND NOTES

Figure 1: U.S. Census Bureau, American Community Survey; Bureau of Labor Statistics

Figure 2: U.S. Census Bureau, American Community Survey; Zillow.com/research/data

Figure 3: U.S. Census Bureau, American Community Survey

Figure 4: Note: Median home value and gross rent use U.S. Census Bureau reported data rather than Zillow data, due to historical data availability. Slight differences exist in reported figures.
Source: U.S. Census Bureau, American Community Survey

Figure 5: Note: Affordability ratio calculated by taking rent (plus utilities) as a percent of median household income, home value divided by median household income
Source: U.S. Census Bureau; American Community Survey; Zillow.com/research/data

Figure 6: Note: Affordable payment assumes household avoids being housing cost burdened by spending less than 30% of monthly income on housing Mortgage assumptions: 30-year fixed mortgage, 14% down payment, average interest rate in 2010 & 2018, including PMI, 1.06% property tax, $900 home insurance and $150 per month in utilities. Broader region median household income used for analysis, calculated as a population weighted average of King, Pierce, and Snohomish counties.
Source: U.S. Census Bureau; American Community Survey; Zillow.com/research/data

Figure 7: Note: Affordable payment assumes household avoids being housing cost burdened by spending less than 30% of monthly income on rent plus utilities. Broader region median household income used for analysis, calculated as a population weighted average of King, Pierce, and Snohomish counties.
Source: U.S. Census Bureau; American Community Survey; Zillow.com/research/data

Figure 8: Note: Registered Nurse is example of typical middle-income job in region (other examples include: firefighter, police officer, teacher). Analysis area is comprised of Auburn, Bellevue, Federal Way, Issaquah, Kent, Kirkland, Redmond, Renton, Seattle, and Sammamish.
Source: Analysis performed by Microsoft Data Analytics team; news.microsoft.com/affordable-housing

ENDNOTES

1 Population of King, Pierce, and Snohomish counties; U.S. Census Bureau, American Community Survey

2 Bureau of Labor Statistics, Quarterly Census of Employment and Wages; U.S. Census Bureau, American Community Survey

3 Zillow, https://www.zillow.com/research/data/

4 Throughout this report, numbers may be rounded to the nearest hundred or thousand, for ease of reading; U.S. Census Bureau, American Community Survey

5 https://seattle.curbed.com/2018/1/26/16938894/seattle-area-residential-construction-2017

6 U.S. Census Bureau, American Community Survey; Zillow

7 Cities included in this analysis are Auburn, Bellevue, Federal Way, Issaquah, Kent, Kirkland, Redmond, Renton, Sammamish, and Seattle

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9 U.S. Census Bureau, American Community Survey

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15 Input from a senior executive at a local utility company; the area consists of Renton, Bellevue, Kirkland, Mercer Island and Newcastle

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20 Expert interviews

21 https://www.mitpressjournals.org/doi/suppl/10.1162/REST_a_00710/suppl_file/REST_a_00710-esupp.pdf

22 Return is composed of a commonly used preferred annual return, and the larger payout when a building is sold; Expert interviews

23 Expert interview

24 https://www.mortenson.com/~/media/files/pdfs/cost%20index%20report%20-%20seattle%20-%20q3%202018.ashx

25 https://www.seattlepi.com/business/article/Under-building-boom-construction-trades-face-12161836.php

26 http://www.globaltrademag.com/global-trade-daily/trumps-tariffs-how-will-us-construction-fare

27 See "our model" sidebar for more details

28 Housing for which the monthly rent is less than 30% of gross monthly income. In this case 60-120% of King County median household income is $53,800 - $107,600 resulting in a rent of $1,300 - $2,700.

29 Area Median Income (AMI) is the typical metric that housing affordability programs use to measure median income; it is a series of dollar figures published regionally, which vary based on household size

30 http://www.wshfc.org/admin/2017impactreport.pdf

31 http://www.seattle.gov/housing/levy/#seattlehousinglevyhistory

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Photo credit: Spectrum Development Solutions

ABOUT CHALLENGE SEATTLE

Challenge Seattle is an alliance of CEOs from 17 of the region's largest employers. Together, we are taking on the challenge of ensuring the greater Seattle area continues to thrive as one of the most vibrant, innovative, and globally competitive regions in the world. Led by former Washington State Governor Christine Gregoire, Challenge Seattle harnesses the committed leadership, unique resources, and innovative talent of its member companies to find innovative solutions and inspire collective action for the greater good.

Committed Leaders. Shared Vision. Greater Good.

Attachment 2

Middle-Income Housing Finance Model

City of Kirkland Council Study Session
June 1, 2021

Microsoft

COMMUNITY ROOTS HOUSING

PACIFICA LAW GROUP

INTROS

Partnering for Success

Microsoft

Jane Broom, Senior Director Microsoft Philanthropies

Joel Combs, Treasury Director

Jim Stanton, Senior Community Affairs Manager

COMMUNITY ROOTS HOUSING

Chris Persons, CEO

Jeremy Wilkening, VP of Real Estate Development

HEARTLAND

Deva Hasson, Principal and Investment Director

Chris Fiori, Principal and Project Director

Evan Schneider, Project Manager

PACIFICA LAW GROUP

Faith Pettis, Partner

CONTEXT:
Microsoft Affordable Housing Initiative

Microsoft Affordable Housing Initiative

- $750 million commitment to invest and catalyze affordable housing solutions. The overall Initiative supports development and preservation of affordable housing serving low-income households (up to 60% of area median income) and/or middle-income households (60% to 120% of area median income).

- Multi-pronged tracks of activity that balances the Attainable (near-term wins) and the Aspirational (long-term transformational impact)

Microsoft Affordable Housing Initiative Overview*

Microsoft

MIDDLE-INCOME FOCUS *(60-120% AMI)*	LOW & MIDDLE-INCOME FOCUS	LOW-INCOME FOCUS *(<60% AMI)*	HOMELESS FOCUS
21% *$100M* *1,365 Units*	5% *$25M*	71% *$334.3M* *5,255 Units*	3% *$10M* *600 Units*

Existing Housing Conversion/ Preservation 21% *$100M* *1,365 Units*	**URBAN HOUSING VENTURES** *Asset Purchases* *$40M* *336 Units*	**KING COUNTY HOUSING AUTHORITY** *Asset Purchases* *$60M* *1,029 Units*		
New Housing Development 5% *14.3M* *1,355 Units*	**RISE TOGETHER** *Central District, Capitol Hill, White Center* *$2.5M* *475 Units*	**PLYMOUTH HOUSING** *Permanent Supportive Housing* *$5M* *600 Units*	**ARCH & INLAND GROUP** *Together Center Permanent Affordable Housing* *$6.8M* *280 Units*	
Capital Source Expansion 72% *$350M* *4,500 Units*	**EVERGREEN IMPACT HOUSING FUND** *Impact Fund* *$75M* *1,500 Units*	**WA STATE HOUSING FINANCE COMMISSION** *Line of Credit* *$250M* *3,000 Units*	**WA STATE HOUSING FINANCE COMMISSION** *E-Land Acquisition Program* *$25M*	**MULTIPLE PARTNERS** *Tax-Exempt Bond for Middle Income Housing* *In Process*
Services & System Capacity Building 2% *$5M*	**STATE + LOCAL JURISDICTIONS** *Land Use Process & Policy Change*	**UNITED WAY OF KING COUNTY** *Eviction Prevention* *$5M*		

$469.3 M *7,220 Units* TOTAL

**As of May 2021; Additional investments and partnerships in process*

WHO:
Community Roots Housing

Community Roots Housing Overview

COMMUNITY ROOTS
HOUSING

*Photo Credit: Kevin Scott

WHY:
Affordable Housing Overview

Commonly Used Terms

Affordable:
The U.S. Department of Housing and Urban Development (HUD) deems housing to be affordable if a household spends no more than 30% of their income on housing costs (rent plus basic utilities or gross monthly owner costs).

Area median income (AMI):
Half of the households have higher incomes and half have lower income than the AMI. Public agencies use AMI to establish eligibility criteria for housing programs.

Cost-burdened households:
Households spending more than 30% of their income on housing costs.

Severely cost-burdened households:
Households spending more than 50% of their income on housing costs.

Market-rate rental housing:
Housing unit without rent or income restrictions where landlords set the rent based on what they think tenants will be willing to pay.

Subsidized housing:
Housing units, primarily rentals subsidized by local, state and federal agency(ies) restricted to households who qualify based on income.

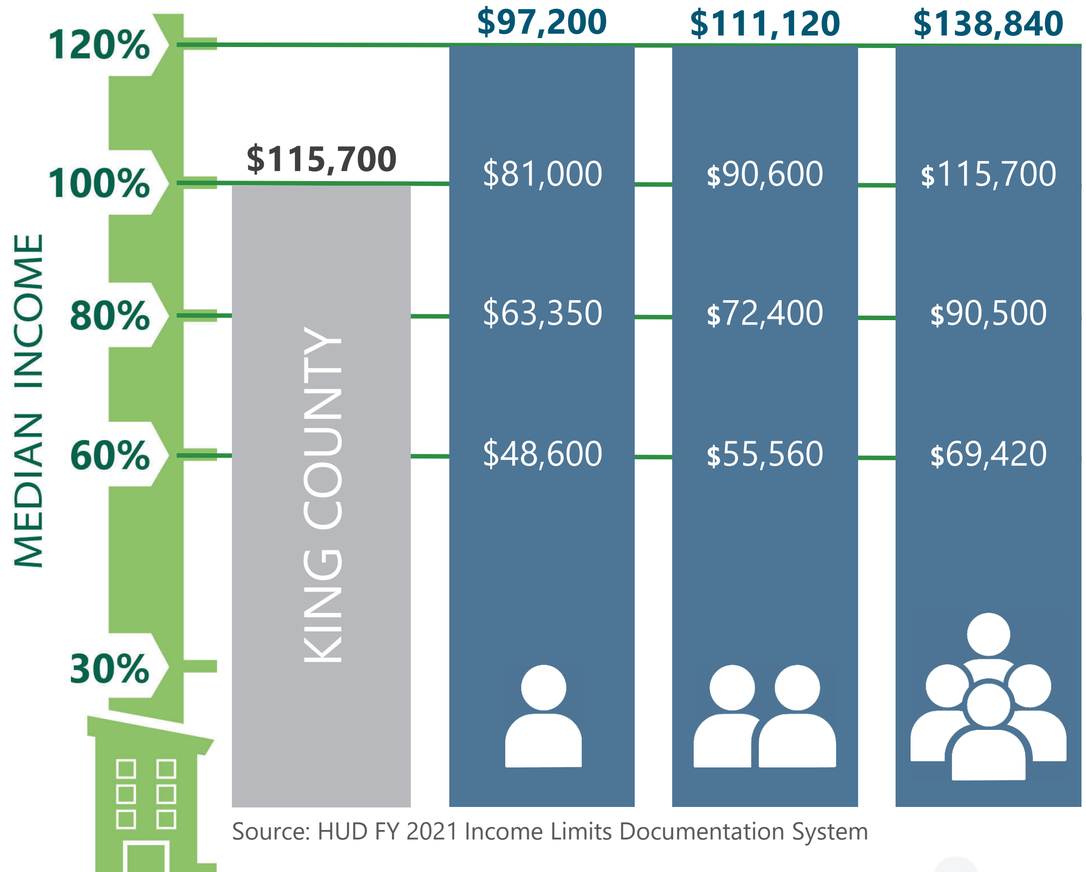
Low Income Housing Tax Credit (LIHTC):
Dollar for dollar credit against federal income tax liability that is conveyed to the owner of a qualified project. They are earned through investments in new construction or acquisition and substantial rehabilitation. The credit is earned over 15 years and claimed over 10 years. There are two types, 4% and 9%, both are allocated by the State to qualified projects based on a competitive system. 4% tax credits are paired with tax-exempt Private Activity Bonds.

Multifamily Property Tax Exemption (MFTE) Program:
The MFTE Program provides a tax exemption on new multifamily buildings in exchange for setting aside 20-25% of the homes as income- and rent-restricted.

Tax-Exempt Debt:
Tax-exempt financing is a financing tool available to eligible borrowers (government entities, PDAs, 501(c)3, Private Activity Bond-eligible projects) as a means of raising funds for capital needs. Interest rates on tax-exempt bonds are lower than interest rates on comparable taxable obligations because the interest component of the bond debt service payments is exempt from federal and sometimes state and local income taxes for the bond holder.

Area Median Income (AMI)

AMI is defined as Median Income before taxes for a specific geographical area adjusted every year for inflation.



Source: HUD FY 2021 Income Limits Documentation System

	1 PERSON	2 PEOPLE	4 PEOPLE
60% AMI			
HH Income	48,600	55,560	69,420
Mo. Rent	1,215	1,389	1,736
80% AMI			
HH Income	63,350	72,400	90,500
Mo. Rent	1,584	1,810	2,263
100% AMI			
HH Income	81,000	90,600	115,700
Mo. Rent	2,025	2,315	2,893
120% AMI			
HH Income	97,200	111,120	138,840
Mo. Rent	2,430	2,778	3,471

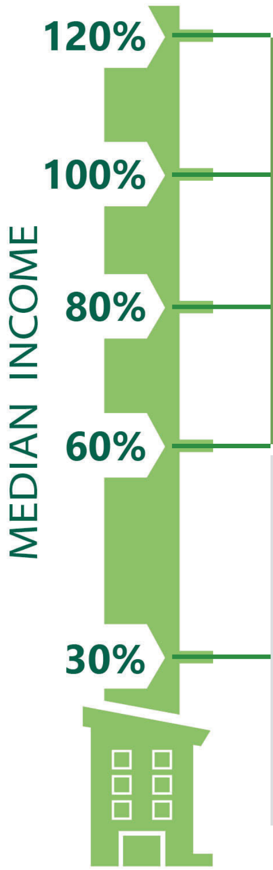
Area Median Income (AMI)

2020 AMI $113,300

AMI % & ANNUAL EARNINGS (1.5 EARNINGS/HOUSEHOLD)		OCCUPATIONS		
60% & Below	$67,980	• Childcare Workers • Food Service Workers	• Cashiers/Clerks • Maintenance Workers	• Hairdressers • Security Guards
60% to 80%	$67,980 - $90,640	• Healthcare Support Workers • Social Workers • Medical Technicians and Assistants	• Food Service Supervisors • Maintenance Supervisors • Bookkeepers	• Postal Service • Construction laborers • Machinists
80% to 100%	$90,640 – $113,300	• Elementary School Teachers • Food Service Managers	• IT Support, Engineering Drafters & Technicians • Counselors	• Paralegals & Legal Assistants
100% to 120%	$113,300 – $135,960	• High School & Postsecondary Teachers • Firefighters	• Architects • Electricians	• Plumbers
120% & Above	$135,960	• Registered Nurses • Software/Web Developers	• Pharmacists • Dentists • Engineers	• Lawyers • Veterinarians • Managers Professional Services

Source: US Bureau of Labor Statistics, Occupational Employment and Wage Statistics, May 2020, Seattle-Tacoma-Bellevue MSA

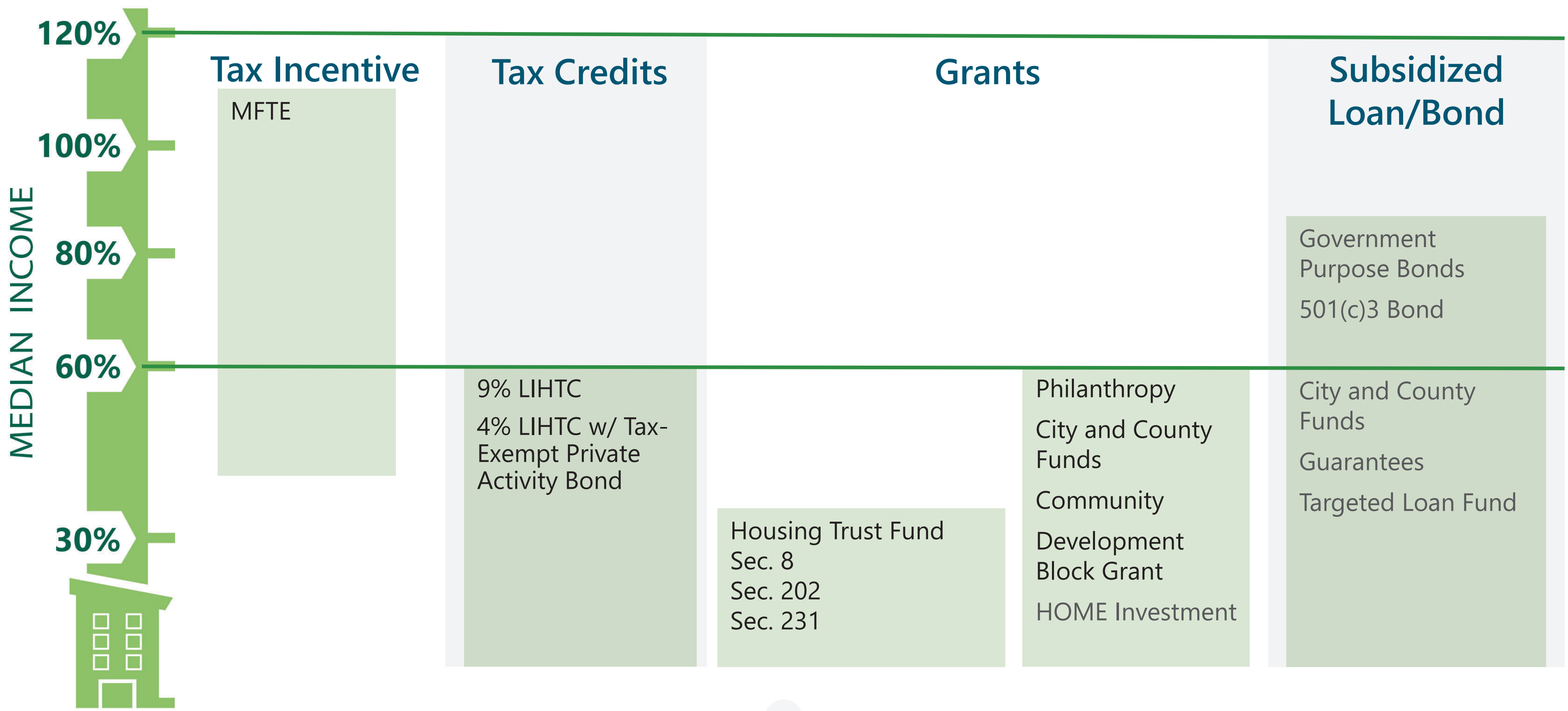
Types of Affordable Housing



Middle-Income/Workforce Rental Housing:
Housing that costs less than 30% of a household's income for a household that is between 60%-120% of AMI

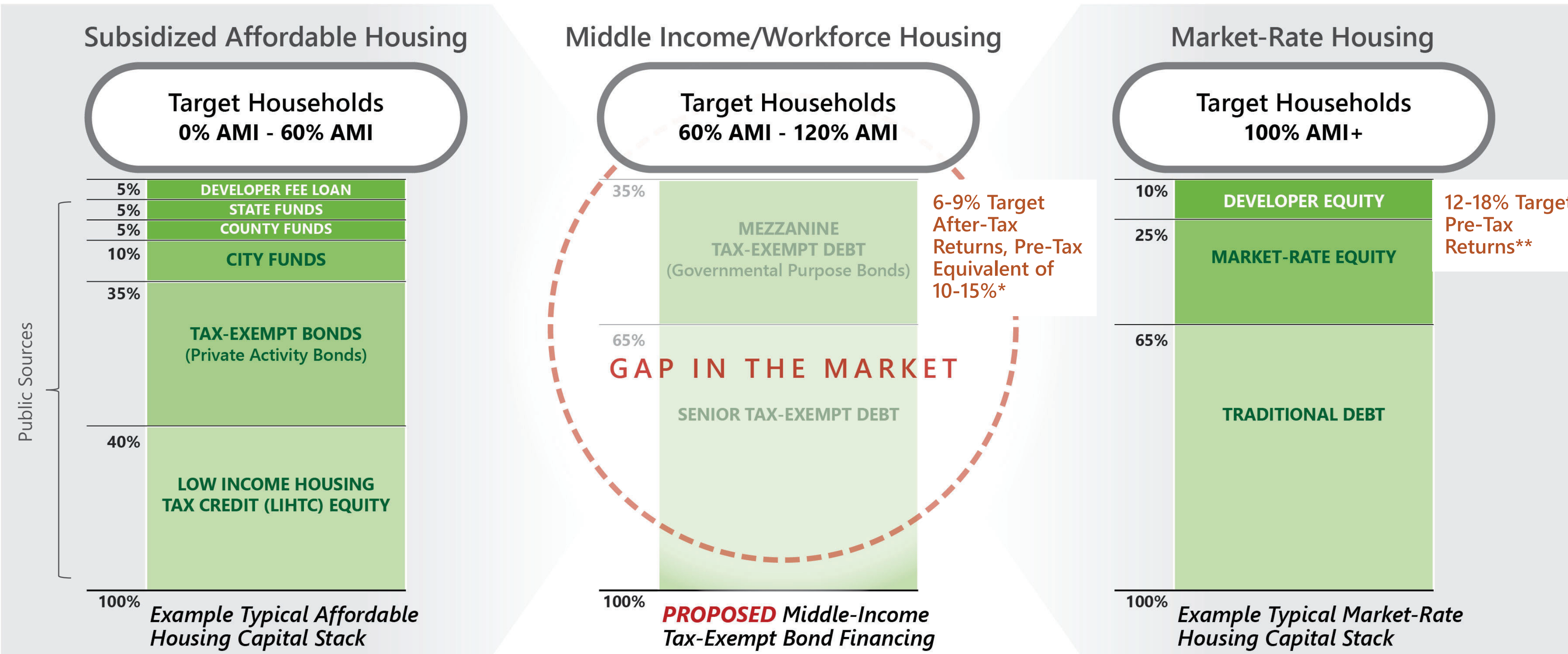
Affordable Rental Housing:
Housing that costs less than 30% of a household's income for a household that is lower than 60% of AMI (Area Median Income)

Summary of Typical Public Financing Sources For Multifamily Housing



WHY:
Why This Approach?

Why This Approach? There is a gap in both the private capital markets and traditional affordable housing resources for capital targeted to Middle-Income/ Workforce Housing



*Dependent on investor tax rates, levels of affordability, property tax exemption, and many other factors.

**Dependent on source of equity, rent levels, product type, submarket and many other factors.

Why This Approach?

The goal of Middle-Income Tax-Exempt Mezzanine Finance Model is to:

Expand the financing tools available for Middle-income Housing (60%-120% AMI) to increase supply of Middle-Income Housing by **creating a new path.**

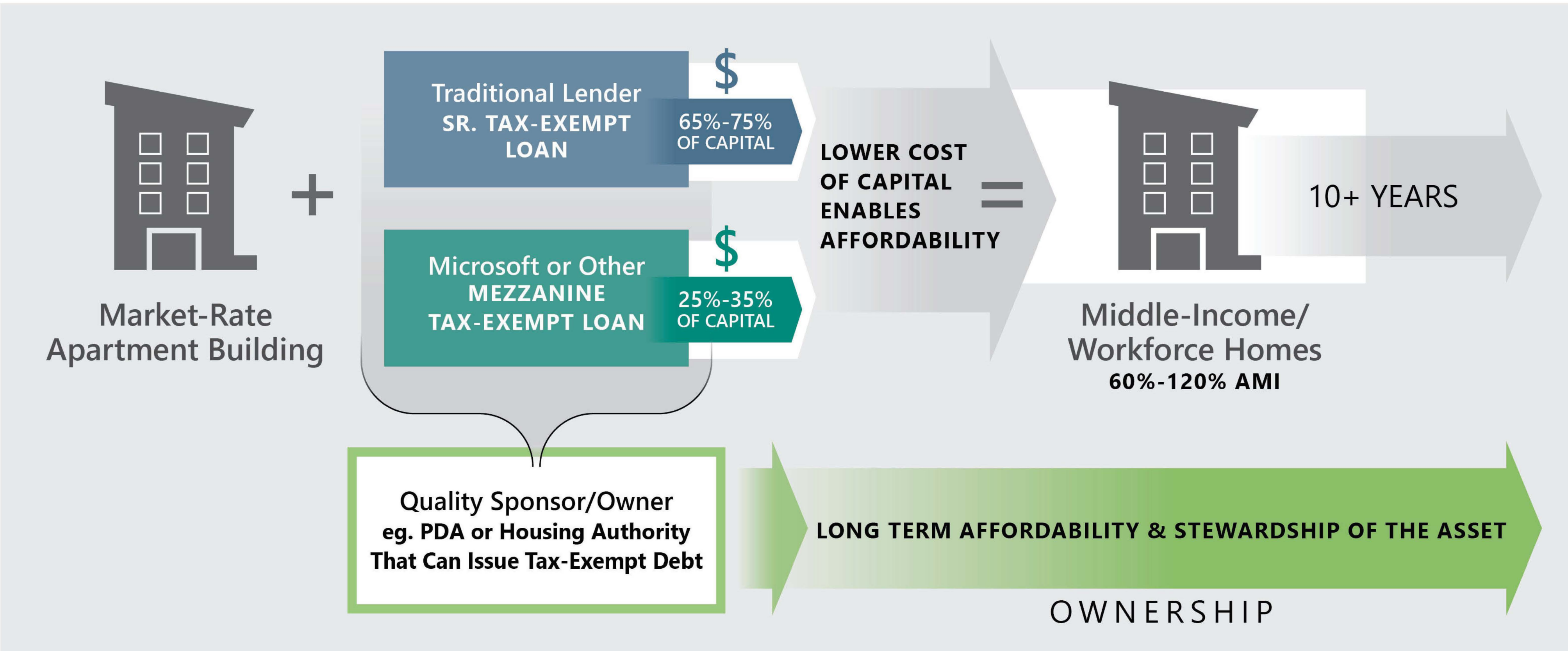
- ✓ Attracts traditional tax-exempt bond investors to invest in middle-income housing in addition to low-income housing
- ✓ Attracts investors who have not traditionally invested in the tax-exempt bond space for housing to invest by creating risk-adjusted attractive tax-exempt returns

- ✗ Relies on local, state and federal housing funding resources
- ✗ Requires federally-allocated LIHTC and the associated equity
- ✗ Competes for Private Activity Bonds, which are competitively allocated and oversubscribed
- ✗ Advantages or disadvantages non-profits or for-profits by using resources relied upon those entities

WHAT:
Middle Income Tax-Exempt Mezzanine Finance Model

Tax-Exempt Mezzanine Financing for Middle-Income Homes

A replicable financing structure to create middle-income housing (new construction and existing) that attracts traditional investors with similar returns (and less risk).



Middle-Income Tax-Exempt Mezzanine Financing Model

Multiple levels of benefits

	INVESTMENT / CONTRIBUTION	BENEFITS
RESIDENTS & COMMUNITY	• Live, work, and/or play in the community	• Quality, affordable homes in which to thrive • Diverse, vibrant sustainable community
CITY	• No additional public resource contribution required • Provides an invitation/approval of the Owner/Sponsor to operate in the community	• Increased supply of quality, affordable units • Attract, well-established, quality housing providers to operate in the community • No liability to the City and no additional support from the City required
OWNER / SPONSOR *PDA, Housing Authority*	• Provides tax-exempt debt authority to issue tax-exempt debt • Low or no initial capital investment	• Increased ability to implement their mission / mandate • Share in a portion of excess cashflows + share of asset appreciation • Option to purchase at the end of the term at a fixed price with refinance can continue to operate as middle-income housing
SENIOR LENDER *Bond Purchaser/Bank*	• Lends project traditional senior tax-exempt debt (~65-75%)	• Principal and interest payments
INVESTORS/ MEZZ LENDERS	• Lends project remaining ~25-35% of capital by purchasing a subordinate tax-exempt note.	• Reasonable, risk-adjusted returns (6-9% target after-tax returns, pre-tax equivalent of 10-15%) • Modest annual coupon + a share of asset appreciation • Additional benefit of positive community impact

What Type of Housing?

Key Criteria

Geography:
Within the City of Kirkland

Access:
Easily accessible with mass transit

Age:
No older than 10-15 years

Size:
100 or more units

Status:
Existing buildings or buildings in construction, entitlements or permitting

Aura Totem Lake

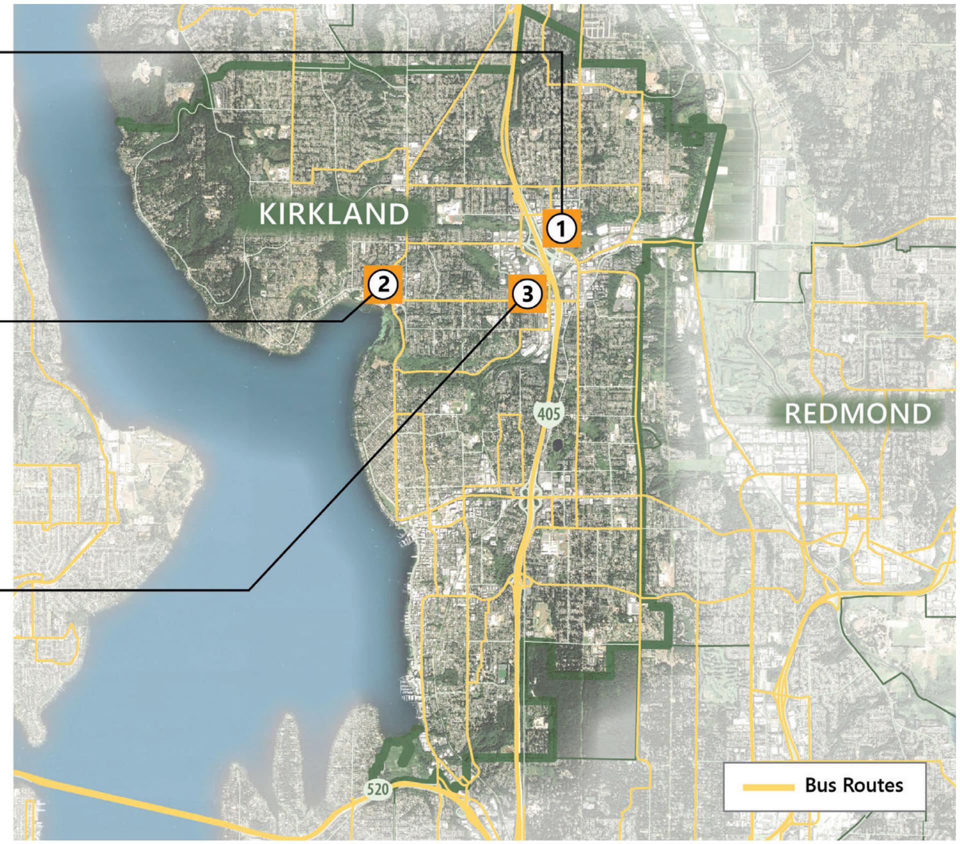
SALE DATE	April 2021
UNITS	202
YEAR BUILT	2020

Waterscape at Juanita Village

SALE DATE	May 2020
UNITS	196
YEAR BUILT	2012

Uplund

SALE DATE	October 2020
UNITS	409
YEAR BUILT	2021



QUESTIONS?