DATE: September 18, 2023
TO: Eric Baker, Colin Poff, Kitsap County; Mark Daniel, DCG/Watershed
FROM: Morgan Shook, Jen Cannon, Michelle Anderson, Mackenzie Visser, ECONorthwest
SUBJECT: Final Multifamily Tax Exemption Program Evaluation, Kitsap County Comp Plan Update

Section 1. Introduction, Background, & Method

Project Purpose and Background

Kitsap County has begun the process to update their Comprehensive Plan (updated previously in 2016) by the end of 2024 as a part of the periodic update process. The new plan will provide a 20-year roadmap (2024-2044) for local policies, planning and investment that is required by Washington State's Growth Management Act. Kitsap County's guiding principles focus on implementing updates that would support housing and economic development, conserve natural resources, and improve the useability and predictability of the plan.

ECONorthwest was tasked with providing key services to evaluate housing-focused Comprehensive Plan updates in support of providing greater access to more affordable housing, and more diverse housing types, needed to fill the gaps in housing demand. Due to recent program updates to the Multifamily Tax Exemption Program (MFTE), Kitsap County may now offer a MFTE Program to stimulate new affordable housing and workforce housing development in certain urban areas. This program authorizes eligible new construction or rehabilitated housing to be exempt from paying property taxes for either an 8-year, 12-year, or 20-year period of time within designated urban areas. Twelve and 20-year (programs require property owners to commit to renting a certain percentage of the housing (at least 20% and at least 25%, respectively) at a rate affordable to low- or moderate-income households. This program is enabled for projects with at least four new residential units.[1]

[1] The MFTE was first codified in 1995, per Chapter 84.14 RCW, to incentive multifamily residential development in urban centers within designated residential targeted areas, located in Washington State's largest cities. This program has been updated several times through state legislature, most recently in 2021. The program now allows a property tax exemption authorized for 8, 12, or 20 years to stimulate the construction of new, rehabilitated, or converted multi-family housing and is often used to support mixed-income housing development. The MFTE program is one of the main tools eligible local jurisdictions in Washington State can offer to stimulate affordable housing development where it is needed in urban centers. The MFTE program allows Washington State cities and counties of a certain size the ability to establish a tax exemption program to stimulate the construction of new, rehabilitated, or converted multi-family housing within designated areas. The intent of this state law is to help address the insufficient available of desirable and convenient residential units, including affordable housing units; support mixed income residential development; promote redevelopment of urban centers; and increase market rate workforce housing and affordable housing opportunities. The property tax exemptions reduce the property's assessed value which leads to a lower tax bill. Washington State Department of Commerce provides MFTE program background.

Property tax exemptions can positively impact the feasibility of housing projects and, where market-rate projects are feasible, can help cross-subsidize the affordable units. Jurisdictions should weigh the temporary loss of tax revenue against the potential attraction of new investment in target areas. Local jurisdictions should develop clear guidance for the terms under which properties are eligible for tax exemptions. These should include the income level(s) that must be served to qualify for this incentive, as well as any minimum threshold(s) for the share of units in the development that must meet affordability requirements.[3] Local jurisdictions interested in providing tax incentives for affordable housing can evaluate different program scenarios, to structure programs to more effectively advance goals.

Why is development feasibility and pro forma analysis important?

Constructing housing can be costly and risky and the costs associated with constructing affordable housing can be even more challenging. Getting funding to build new housing requires lenders and investors to be reasonably confident they will earn enough financial return to justify the risks.

Economic or market feasibility is generally assessed by comparing the expected revenues (home sales or net income from rents) against the costs of development. If a development is not feasible, it will not be built. While some of the factors that determine market feasibility are outside a jurisdiction's direct control (e.g., labor and materials costs, interest rates, market rents), local jurisdictions can provide incentives[2] (such as tax exemptions); or adjust fees, zoning, programs, and other regulations that can have a substantial impact on whether development could be feasible or not.

The project team worked with the County to identify the various scales of housing development that should be evaluated, as well as the areas for where the program could be applied within the county. ECONorthwest created a pro forma model to test the financial feasibility of development in the identified areas and assess the relative strengths and limitations of various program requirements and zoning actions to incentivize housing production. This memorandum provides background information on the method, data sources, assumptions, and explanations of the market dynamics specific to Kitsap County as well as discussing implications for pursuing various MFTE program options, incentives, and requirements.

[2] State law does not prohibit MFTE from being paired with other incentives. Bonus units, incentives such as impact fee waivers, and the integration of a more flexible development agreement approach and a menu of corresponding incentives could help offset the costs incurred from affordable housing unit requirements and could be considered to promote program usage.

[3] Some jurisdictions restrict program use to multifamily projects with over 10 units but technically multiple-unit projects with four or more units could be eligible.

Residential Target Areas Evaluated

The MFTE program can be applied to Residential Target Areas, designated by a local jurisdiction. The state defines these areas as designated areas within urban centers that are determined to lack "sufficient, desirable, and convenient" housing, including affordable housing, to meet the needs of the public.[4] The designation is determined by the relevant governing jurisdiction (either city or county), based on the potential to provide additional housing opportunities in conjunction with the risk of potential displacement of current residents. If a residential target area is designated by a county, the area must be in an urban growth area, or in an area served by a sewer or with an institute of higher education, and, in a county promoting transit supportive densities (the area should be within one-quarter mile from bus service scheduled at least every thirty minutes).[5]

The purpose of this designation is to provide tax incentives to encourage the development of additional housing, including affordable housing, in these areas. Kitsap County should consider where they want to target mixed-income residential development, where there is buildable land with infrastructure and needed services, and where the opportunity would be high (including amenities such as public transportation, grocery stores, schools, and employment).

The zoning regulations and development standards for the area where the program is applied should be structured to allow for multifamily housing development ideal under the program (particularly the density and the building height). Regulations and permitting processes encouraging housing developers to build multifamily development eligible under the MFTE program helps to ensure the program can be used.[6]

ECONorthwest worked with County staff to identify the appropriate residential target areas for evaluation. The target areas evaluated are located in the Silverdale and Kingston urban areas. These areas match the proposed Center boundaries for both Silverdale and Kingston. Exhibit 1 through Exhibit 4 (below) show the residential target areas we evaluated along with their existing zoning designations. Additional exhibits were also provided below to describe existing and proposed transit service for these areas (As shown below in **Error! Not a valid bookmark self-reference.**, the proposed MFTE program boundary encompasses an area in Silverdale that already has existing transit infrastructure throughout the area including bus routes and stops providing comprehensive access to public transit provided by Kitsap Transit. The entire area is within ¼ mile from bus lines which includes multiple stops throughout the Silverdale area mostly providing 30-minute to 1 hour frequency of service. The Long-Range Transit Plan, 2022-2042 (adopted in 2016), for Kitsap County provides a roadmap for transit service and investments over the next 20 years. This plan outlines a variety of Silverdale area transit service improvements (see Exhibit 6) such as bus frequency upgrades, new circulator routes, a new transit center for Silverdale, a new high-capacity bus rapid transit route extending from

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[4] [4] More detail at: RCW 84.14.040: https://app.leg.wa.gov/RCW/default.aspx?cite=84.14.040

[5] More detail at: RCW 84.14.040: https://app.leg.wa.gov/RCW/default.aspx?cite=84.14.040

[6] The state MFTE program rules require a minimum of housing with four or more dwelling units (source: RCW 84.14).

Silverdale to Bremerton, and various other transit improvements (such as technology, bus stop, speed and reliability upgrades). The Long-Range Transit Plan, 2022-2042, proposes to increase the frequency of bus service in the area, providing at least 30 minute frequency within one-quarter mile of the entire Silverdale area and high capacity transit with 15 minute frequency of service for the eastern portion of the Silverdale area. The long range plan phases transit improvement capital projects to be completed from 2023 to 2042. The frequency upgrades are phased to be completed between 2025 to 2041, the new local express and circulator routes are phased to be completed between 2030 to 2041, and high-capacity transit is phased to be completed between 2035 and 2041.

Exhibit 5 and Like Silverdale, the Kingston area is already served by existing transit infrastructure throughout the area including bus routes/stops providing access to public transit provided by Kitsap Transit (see **Error! Not a valid bookmark self-reference.** provided below). The entire area is mostly within ¼ mile from bus lines which includes multiple stops throughout the Kingston area providing 2 hour frequency of service. This area is served by two ferry systems – the Washington State Kingston to Edmonds ferry and the Kitsap County Fast Foot ferry extending from the Kingston ferry terminal to Downtown Seattle. The Washington State Ferry route provides service roughly every 2 hours while the fast foot ferry runs roughly ever 45 minutes. The Long-Range Transit Plan, 2022-2042 (adopted in 2016), for Kitsap County provides a roadmap for transit service and investments over the next 20 years. This plan outlines a variety of Kingston area transit service improvements (see Exhibit 6) such as bus frequency upgrades, a proposed new route and route changes, and various other transit improvements (such as technology, bus stop, speed and reliability upgrades). The Long-Range Transit Plan, 2022-2042, proposes to increase the frequency of bus service in the area, providing at least 30 minute frequency that would be accessible within one-quarter mile of almost the entire area. The long range plan phases transit improvement capital projects to be completed from 2023 to 2042. The frequency upgrades are phased to be completed between 2025 to 2041, the new local express and circulator routes are phased to be completed between 2030 to 2041, and high-capacity transit is phased to be completed between 2035 and 2041

Exhibit 6).

Exhibit 1: Silverdale MFTE Program Evaluation
Source: ECONorthwest and Kitsap County

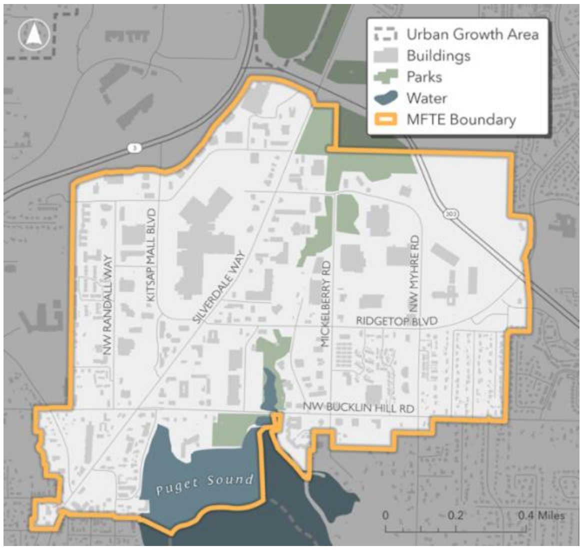


Exhibit 2: Silverdale Existing Zoning
Source: ECONorthwest and Kitsap County

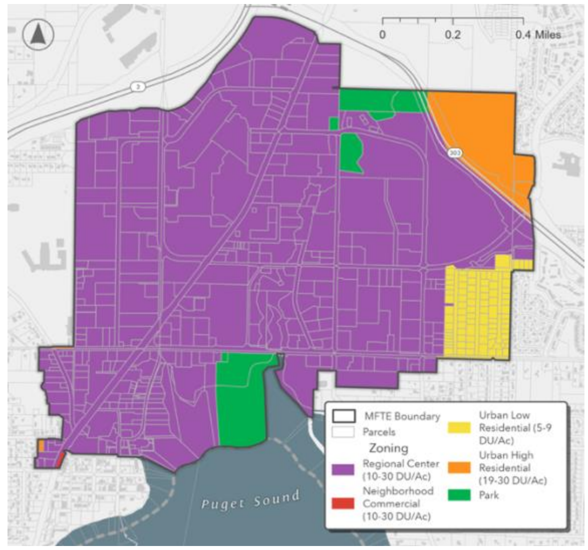
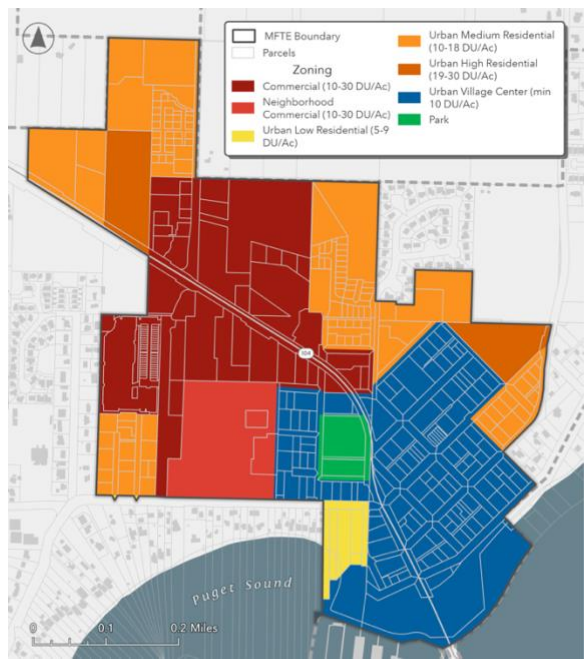


Exhibit 3: Kingston MFTE Program Evaluation
Source: ECONorthwest and Kitsap County

Exhibit 4: Kingston Existing Zoning
Source: ECONorthwest and Kitsap County



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[7] Long-Range Transit Plan, 2022-2042, Kitsap Transit (December 2022): https://www.kitsaptransit.com/uploads/pdf/planning/lrtpreport_6dec2022.pdf

[8] The project timelines are described generally. Kitsap Transit should provide specific project timing.

Exhibit 5: Silverdale Area, Existing and Proposed Transit Infrastructure
Source: ECONorthwest, Kitsap County, Kitsap Transit

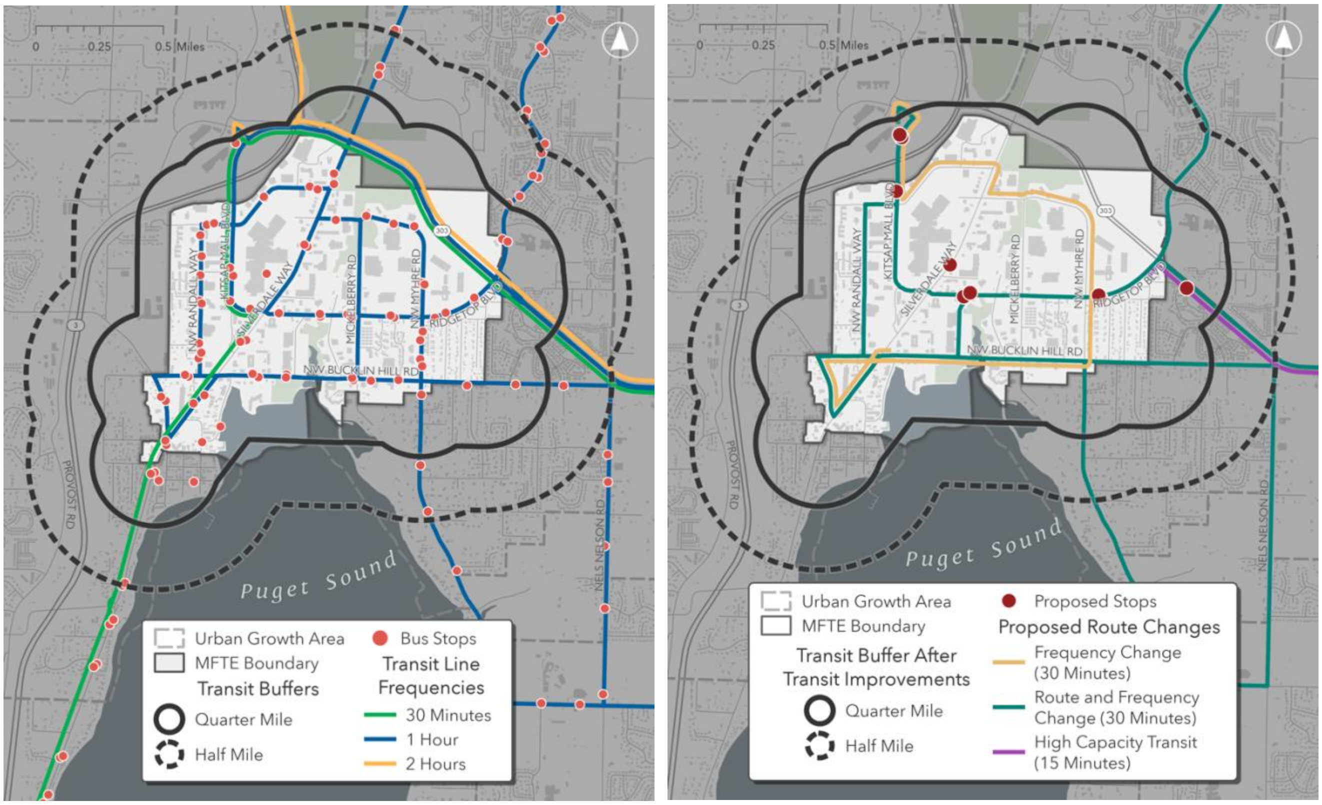

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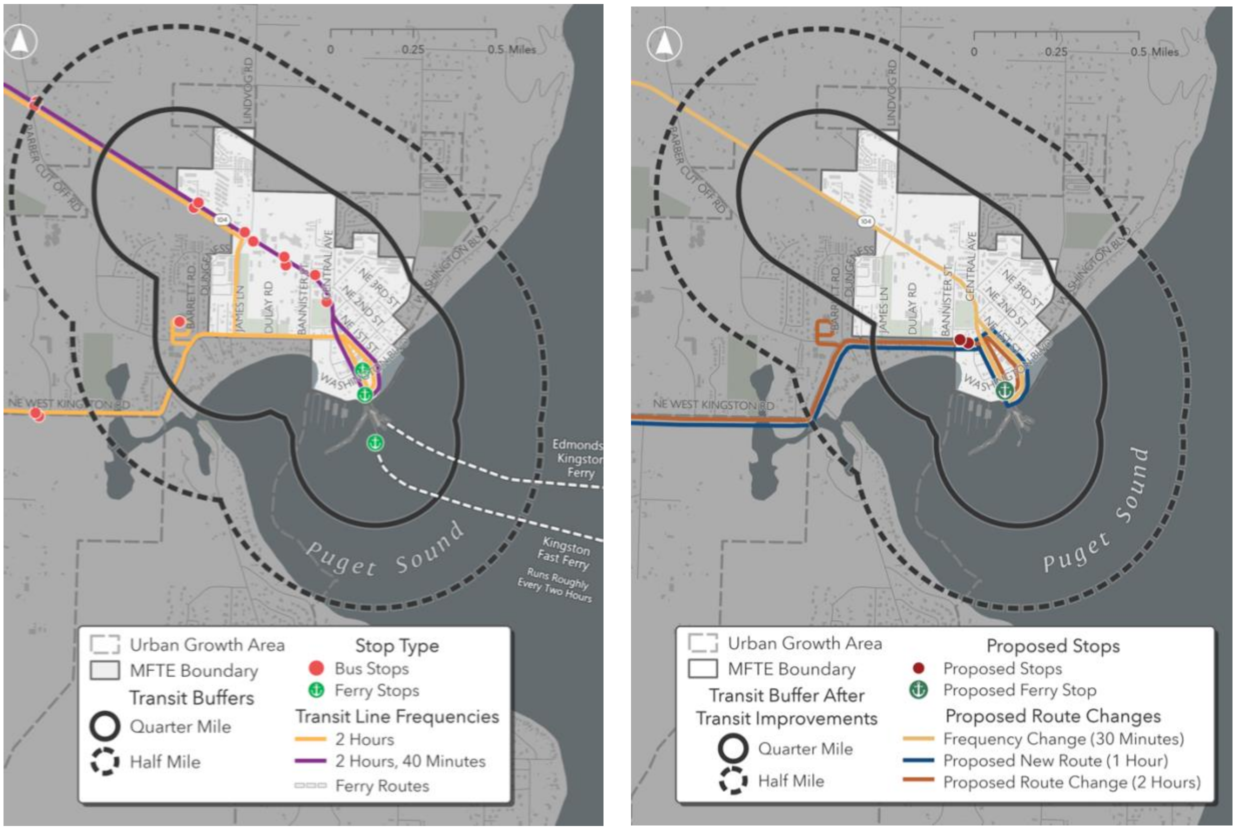
Exhibit 6: Kingston Area, Existing and Proposed Transit Infrastructure
Source: ECONorthwest, Kitsap County, Kitsap Transit



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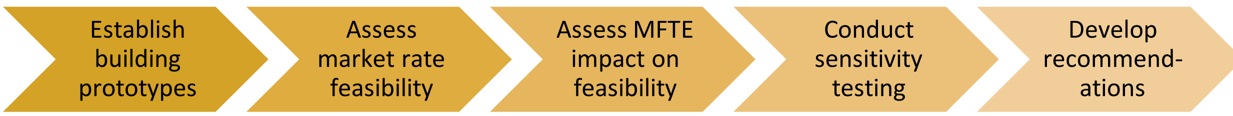
[9] The project timelines are described generally. Kitsap Transit should provide specific project timing.

How Did We Analyze the Impact of the Proposed MFTE Programs?

ECONorthwest completed an economic analysis that models a developer's decision-making process and cash flow equation, for multiple prototypical developments, or *prototypes*. The findings from this analysis can help guide Kitsap County on whether a developer will accept the proposed incentives and which incentives offer the best financial returns. Ultimately, this type of assessment will help the County understand the likelihood of developers producing multifamily housing and affordable housing under different MFTE program scenarios. Overall, our analysis followed the below structure:



ECONorthwest modeled each of the prototypes across four scenarios (including three potential program options):

- **Market rate development** (provides baseline information)
- **8-Year Program Option:** Modeled a MFTE program option that does not have an affordability program eligibility requirement for any of the housing units.
- **12-year Program Option 1:** Modeled a MFTE program option requiring that 20 percent of the total housing units be restricted to be affordable to households earning up to 115% area median income (AMI) or lower.
- **12-year Program Option 2:** Modeled a MFTE program option that requires 20 percent of the total housing units be restricted to be affordable to households earning up to 80% AMI or lower (essentially this option requires a deeper level of affordability in comparison to the first 12-year Option).

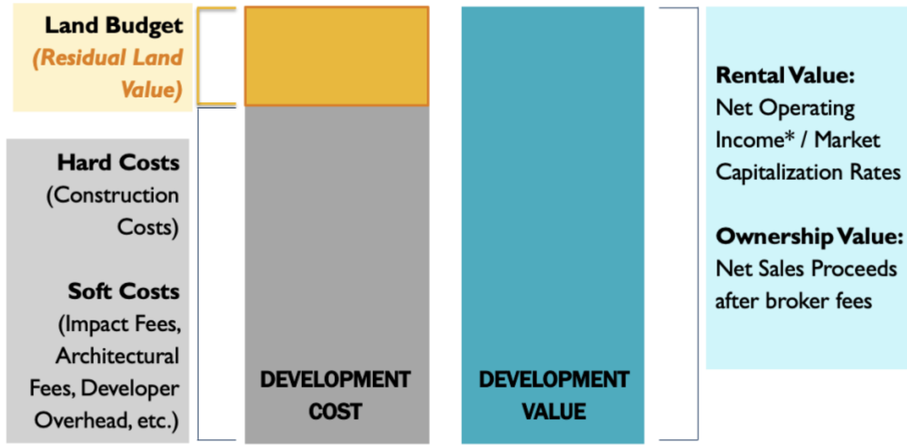
The analysis seeks to answer a set of key questions, outlined below.

- Will accessing the MFTE program create more value for developers to build more housing? Will either of the 12-Year MFTE program options create more value for developers relative to the cost of including affordable housing?
- Is there a gap in financial feasibility for various types of housing tested? If so, are the tax abatements valuable enough to fill this gap?
- How can the County calibrate its program to maximize development and public benefits such as providing more affordable housing (reductions in rent) or workforce housing needed for economic development?

How Do We Measure Development Feasibility?

To model development feasibility, we employed a pro forma model and used a residual land value (RLV) metric, which measures the land budget a developer would be left with after accounting for potential development costs and revenues.

Exhibit 7: Example of Feasible Development using Residual Land Value (RLV) Model
Source: ECONorthwest.

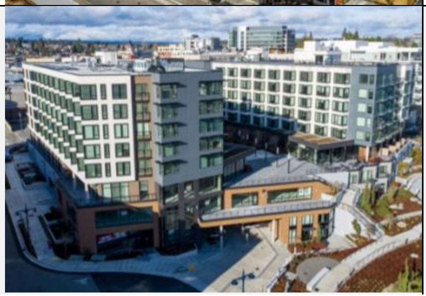


If the RLV is equal to or above land prices in the potential development area, the development is considered feasible at market rate. If the RLV is zero dollars, the development could be feasible if the land were donated for free. However, if the RLV is less than zero, the development is likely infeasible unless a developer receives additional subsidies or incentives. For the purposes of this analysis, we used Kitsap County assessor data as a proxy for land prices (see more discussion in the next section). Please note that results from this method describe a general analysis of prototypes and do not consider the many potential unique conditions that could be a factor in development feasibility (e.g., increased predevelopment costs, low land basis from longtime land ownership). For these reasons, a residual land value analyses should be thought of as a strong indicator of the relative likelihood of development, rather than an absolute measure of return to the investor or developer.

What Types of Development Were Analyzed?

To begin, ECONorthwest modeled four prototypes including 1) a pack of four townhomes, 2) a garden apartment building, 3) a wood frame apartment building, and 4) a podium apartment building. Based on local market research, we determined an appropriate scale for each prototype given recent development in Kitsap County. Prototype specifications and examples of recent comparable developments are shown in Exhibit 8 below.

Exhibit 8: Building Prototype Details
Source: ECONorthwest, CoStar, Redfin

Development Type	Recent Development Example Photo	Recent Development Example	Floors	Height	Units	Total Floor Area	Parking	Average Unit Size	Average Rent per Unit	Unit Mix
Townhomes		The Cove Townhomes, Kingston (2022)	2	22 feet	4 units	7,800 square feet	Private garage	1,450 square feet	$2,756	100% 2-bdrms
Garden Apartments		Haven Apartments, Port Orchard (2022)	3	31 feet	24 units	26,500 square feet	Surface	958 square feet	$2,267	35% 1-bdrms, 50% 2-bdrms, 15% 3-bdrms
Wood Frame Apartments		Harborside Flats, Bremerton (2021)	5	50 feet	120 units	94,300 square feet	Surface	685 square feet	$1,966	5% studios, 80% 1-bdrms, 15% 2-bdrms
Podium Apartments		Marina Square, Bremerton (2022)	7	80 feet	120 units	148,700 square feet	Struct-ured Parking	635 square feet	$2,031	5% studios, 80% 1-bdrms, 15% 2-bdrms

How does the Zoning Code Affect Multifamily Development?

ECONorthwest also audited the zones that would allow each building prototype. Because MFTE is a tool for increasing multifamily development, it is important that potential development be viable under the zoning code. Key aspects of the zoning code (density and height restrictions) are shown below for both the current and proposed zoning in Silverdale and Kingston. The proposed zoning changes outlined below generally reflect Alternative 2 that Kitsap County is evaluating for the Comprehensive Plan update.

Exhibit 9: Proposed and Current Zoning, Tested Kitsap County Zones

Source: Kitsap County. Note: The proposed zoning changes were provided below for evaluation purposes. The alternatives are subject to changes. Buildings up to 85 feet might need to meet requirements related to mixed uses, performance based development process, etc. However, these incentive structures for height increases could be modified or removed to better support MFTE and other community goals.

Zone		Current Building Height Limit	Proposed Building Height Limit	Current Housing Unit Density Limit	Proposed Housing Unit Density Limit
Kingston	**Urban Village Center**	45 feet	55 feet	No limit	No limit
Kingston	**Commercial**	35 feet	50 feet	30 units/ acre	No limit
Kingston	**Urban Medium**	45 feet	45 feet	18 units/ acre	30 units/ acre
Silverdale	**Regional Center**	65 feet	85 feet	30 units/ acre	No limit
Silverdale	**Commercial**	55 feet	85 feet	30 units/ acre	60 units/ acre
Silverdale	**Urban High**	55 feet	85 feet	30 units/ acre	60 units/ acre
Silverdale	**Urban Medium**	45 feet	45 feet	18 units/ acre	30 units/ acre

Finding: The proposed zoning code would improve the viability of multifamily development in Kitsap County; however, the zoning code could still inhibit multifamily development.

One of the strongest barriers to multifamily development is the height restriction. Exhibit 10 shows whether each development type would be allowed under the *proposed* height requirements. Current height requirements are lower and would limit the wood frame building to three zones (in Silverdale) and eliminate the podium building as an option. Exhibit 10 shows whether or not each prototype would be allowed under the proposed height requirements in each zone.

Exhibit 10: Allowed Prototypes, by Zone, based on Proposed Height Allowances
Source: Kitsap County, ECONorthwest

	Zone	Townhouse	3-Story Garden Apartment	5-Story Wood Frame	7-Story Podium
Kingston	UVC	Yes	Yes	Yes	**No**
	C	Yes	Yes	Yes	**No**
	UM	Yes	Yes	**No**	**No**
Silverdale	RC	Yes	Yes	Yes	Yes
	C	Yes	Yes	Yes	Yes
	UH	Yes	Yes	Yes	Yes
	UM	Yes	Yes	**No**	**No**

Developers can meet density restrictions (shown here as a limitation on dwelling units per acre) in two ways: by reducing the number of dwelling units on a fixed piece of land or building a fixed number of units on a larger piece of land. Hypothetically, a developer could instead reduce the building and revenue-generating area to fit smaller parcels, but some building forms aren't efficient at smaller scales. Therefore, in our analysis, we built fixed building prototypes (shown in Exhibit 8 above), and modified the land needed for each prototype based on the density limits for each zone. The resulting feasibility impacts are the same due to the density limit being scalable – the revenue-generating units scales relative to the land area.

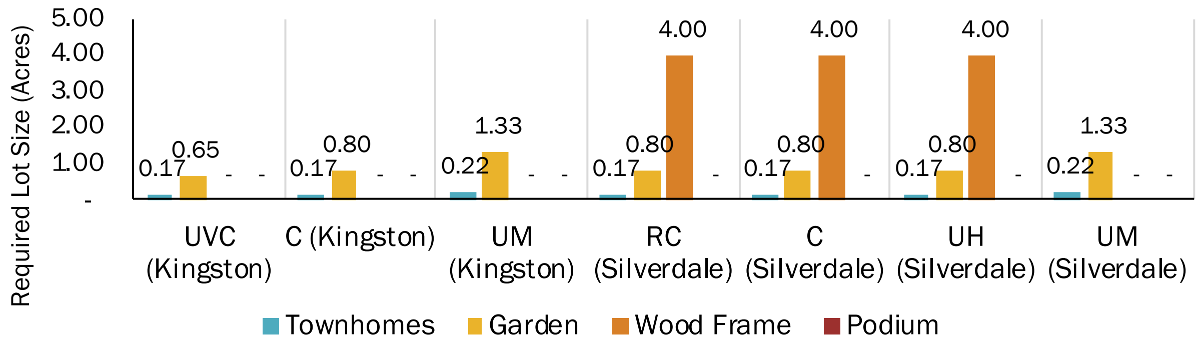
First, we calculated the minimum land each prototype would require if zoning were not a factor, considering reasonable landscaping, setbacks, parking, etc. This minimum land area is shown in Exhibit 11, as well as the associate dwelling units per acre.

Exhibit 11: Minimum Land Area and Maximum Dwelling Units Per Acre by Prototype
Source: ECONorthwest

	Townhome	3-Story Garden	5-Story Wood Frame	7-Story Podium
Land area (acres)	0.17	0.65	2.30	1.24
Dwelling units per acre if no density limit	24	37	52	97

Next, we calculated the required land area for each prototype by zone using the *current* density requirements shown in Exhibit 9. If a zone does not have a density limit, we used the land area calculated in Exhibit 11. Required lot sizes, to meet current density maximums, are shown in Exhibit 12 below.

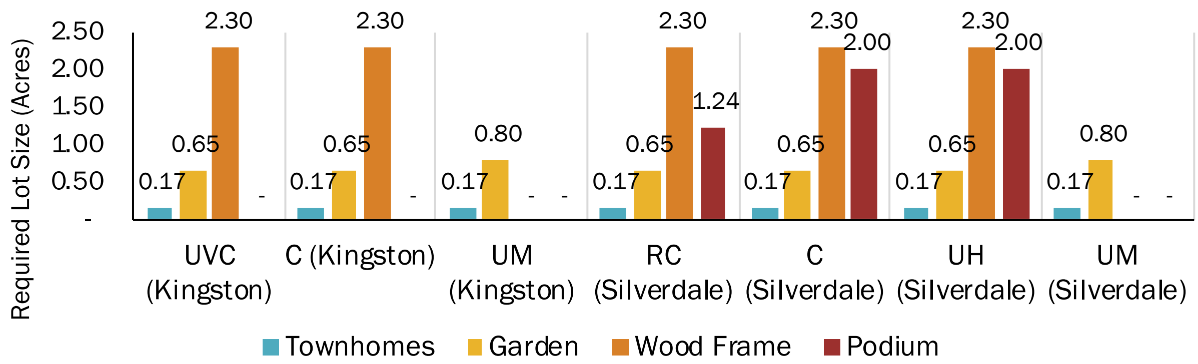
Exhibit 12: Required Land Area by Prototype by Zone (Acres) under Current Zoning[10]



We then repeated this process using the *proposed* density requirements shown in Exhibit 9. As shown in Exhibit 13 below, the proposed density and height requirements increase the range of prototypes allowed in each zone and lower the required lot size, particularly for the denser prototypes (such as wood frame and podium).

Exhibit 13: Required Land Area by Prototype by Zone (Acres) under Proposed Zoning[11]

Source: ECONorthwest



A larger required lot size can have several implications for development feasibility. First, large vacant or under-development parcels are rarely available in the established urban centers (Silverdale and Kingston), and may be located farther away from existing development, infrastructure (such as stormwater and wastewater infrastructure), and amenities, which could limit the revenues a developer could achieve. Second, larger parcels are likely more expensive on a nominal basis to account for a larger land area, which could make buying land for development less attainable.

[10] If a prototype is not allowed under a zone's height restrictions no value is shown.

[11] If a prototype is not allowed under a zone's height restrictions no value is shown.

Availability of land in the areas of MFTE program evaluation

Predicting a price that a landowner would sell property for development is an imperfect science – each landowner has reasons to sell or hold their land, and there are some who are willing to develop their land without selling. For the purposes of the analysis in this report, we assumed the value of the property (i.e., the price of the land at which an owner would be willing to sell) could be observed through market values according to Kitsap County Assessor data. Therefore, this report compares the feasibility of housing development to current average market values in the relevant zones, which may present more favorable feasibility results depending on market dynamics. The average land values vary by zone.

We identified vacant and improved land according to property codes. The majority of the parcels, in the zones of interest, are considered improved – approximately 88% of the area is improved. Given the limited supply of vacant land in the zones of interest, development (or rather redevelopment) must be more financially feasible than the current use. In these cases, redevelopment will not only need to generate enough revenue to cover the costs to build and provide a return to financial partners, it will also need to generate more revenue than an existing use. The price for improved land is substantially higher than vacant land as shown in Figure 1.

Figure 1. Comparison of Market Values (per square foot of land)
Source: ECONorthwest, Kitsap County Assessor Data

	Vacant	Improved
Kingston		
Min	$4	$59
Average	$19	$99
Max	$38	$137
Silverdale		
Min	$3	$19
Average	$25	$98
Max	$52	$254

We therefore compare the feasibility results to the average value of vacant land as those sites are more likely to be feasible for redevelopment sooner. On relevant charts showing feasibility results, a dashed line is shown to represent average land value (per square foot of land) in the area analyzed. This dashed line can be viewed as a hurdle for development to exceed – the financial feasibility must be above (greater than) the dashed line.

Section 2. Results of the Evaluation

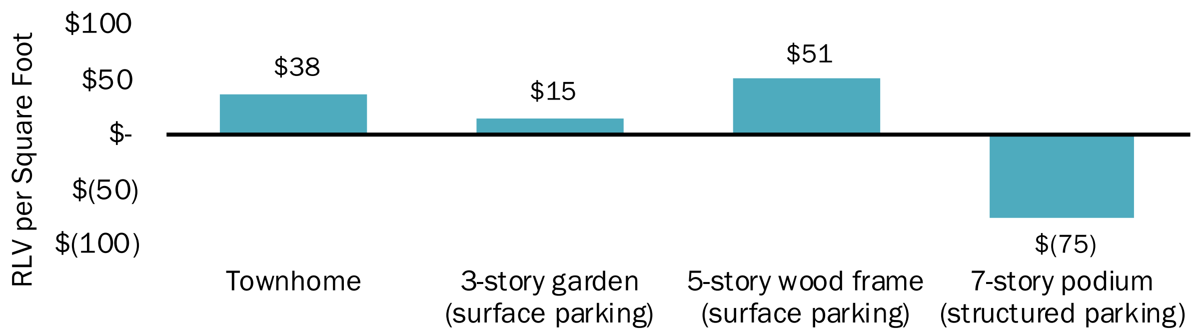
How do Prototypes Perform Under Current Market Conditions?

Once the initial building prototypes were established, ECONorthwest applied reasonable cost and revenue assumptions to evaluate baseline feasibility under current market conditions. By assessing the performance of each prototype without the MFTE programs, we are able to isolate the impact of the MFTE program options as well as identify other potential barriers to development that could limit program usage.

Finding: Not all prototypes are feasible under current market conditions.

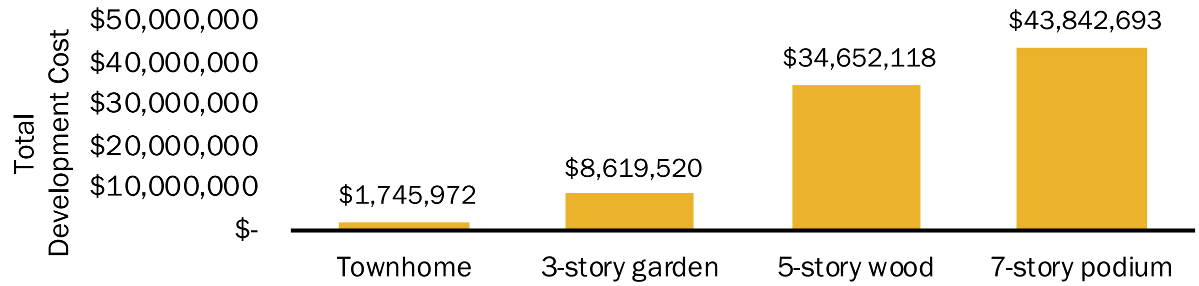
Exhibit 14 shows the residual land value (on a per square foot basis) for market rate development under current conditions for the minimum required land size.

Exhibit 14: Market Rate Development Feasibility
Source: ECONorthwest



Another consideration is total construction costs; despite being feasible on a per square foot basis on paper, larger developments will have a much higher nominal cost than smaller developments. Depending on development funding sources, developers may have difficulty sourcing adequate financing for larger projects, particularly in more rural areas. For example, a developer would need to have a loan and sufficient equity at around $43 million for a 7-story podium development with 120 units while in comparison, they would need less than $9 million to develop a 3-story garden apartment with 24 units.

Exhibit 15: Total Construction Costs by Building Type
Source: ECONorthwest



How Do the Potential MFTE Programs Affect Feasibility?

Next, using the market rate feasibility results as a baseline, we layered on costs and revenues associated with an MFTE program. For this analysis we modeled three potential MFTE program options in the Silverdale and Kingston areas:

- 8-year program, no affordability requirement.
- 12-year program, 20% of units affordable at 115% AMI.
- 12-year program, 20% of units affordable at 80% AMI.

What do Affordability Requirements Mean Under MFTE?

The Department of Housing and Urban Development (HUD) uses an area's Median Family Income (MFI) as the basis for calculating income and rent limits for affordable housing in an area. The 2023 MFI for Kitsap is $113,500 for a family of four, calculated as part of the Bremerton-Silverdale Metropolitan Statistical Area (MSA). The term MFI is often used interchangeably with area median income, or AMI. For the purposes of this report, we refer to MFI as AMI – more discussion of these details can be found in the Appendix.

Considering factors such as utility payments and unit size, we calculated affordable rent limits in the area.[12] Using the blended average unit size for each prototype, we then calculated the average rent for an affordable unit in each prototype. These rents, as well as the average market rate rents, are shown in Exhibit 16 below.[13]

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[12] Housing costs are assumed to be 30% of household income.

[13] Market rate rents were established based on regional CoStar data, recent developments, and market research in the area.

Exhibit 16: Affordable and Market Rate Rents by Prototype
Source: HUD, ECONorthwest, CoStar, Redfin

	Townhome	Garden Apartments	Wood Frame Apartments	Podium Apartments
Affordable rent for 115% AMI	$3,409	$2,443	$2,371	$2,224
Affordable rent for 80% AMI	$2,337	$1,937	$1,881	$1,764
Average market rate rent[14]	$2,756	$2,267	$1,966	$2,031

Finding: Current (2023) income limits for affordable units often exceed market rent rates in the area.

As shown above, the upper end of the affordable rents (e.g., 115% of AMI) exceed current market rate rents. This issue is caused by the bending of the relationship of median household incomes relative to housing prices (e.g., incomes are higher than housing prices), which has occurred in many regions over the course of the last couple years. One potential cause of this relationship in Kitsap County could be more workers who commute to, or remote work in, neighboring counties (particularly King County) but live in Kitsap given the proximity to nature and lower cost of living. These workers may have higher incomes than other workers in Kitsap County, raising the median income. Because these changes are likely relatively recent and these workers are more likely to own, rather than rent, the market rate rental market does not currently reflect this shift in the AMI.

If HUD determines the affordable unit rent to be higher than market rate rent, a developer will likely charge the market rate. Thus, at the point of this analysis the affordable units are essentially market rate units and do not cause a major shift in revenue. However, it is likely that this trend will reverse in the coming years as the rental market adjusts to rising incomes in the area. At this point, a developer would likely see a drop in revenue from the affordable units in the building as market rate rents exceed affordable rents. To account for this additional risk, we raised the return on cost threshold for models with affordable units (both proposed 12-year MFTE programs).[15]

How do the Potential MFTE Program Options Perform?

Exhibit 17 shows the residual land value (on a per square foot basis) for market rate development under current conditions for the minimum required land size (agnostic of zoning).

Finding: MFTE program options can increase development feasibility.

As shown below, the 8-year program option (with no affordability requirement) has the strongest positive impact on development feasibility for all prototypes. The 12-year program with the less stringent affordability requirement (affordable at 115% of the AMI) also has a

[14] Average market rate rents were sourced from CoStar and Redfin, as well as local apartment leasing websites to compare rent rates across unit sizes, building scales, and construction types. Data was primarily gathered from units built since 2018 to reflect new construction rates.

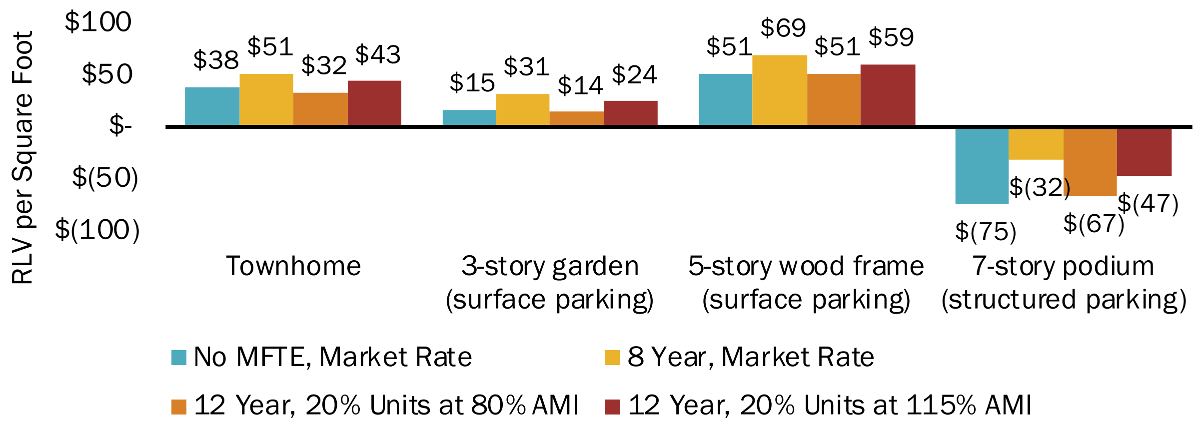
[15] The base return on cost threshold used was 5.5%; if a prototype included affordable units the threshold was 5.65%.

positive impact across all prototypes.[16] The other 12-year program (affordable at 80% of the AMI) had a slight negative impact on development feasibility for the two less dense prototypes, the townhomes and garden apartments. However, the program made no impact on development feasibility for the wood frame apartments, and a slightly positive impact on feasibility for the podium apartments.

While all tested MFTE programs had a positive impact on the podium development's feasibility, none had a strong enough impact to bring the RLV above zero, let alone to average land prices in any of the relevant zones. However, the podium prototype in particular is very sensitive to potential changes in revenues. We discuss this in more detail in a subsequent section.

Exhibit 17: Residual Land Value (RLV) per Square Foot for Minimum Lot Size Needed Agnostic of Zoning

Source: ECONorthwest



How do Results Change Across Zones?

We have excluded the podium prototype from these considerations because it is not currently feasible—a more thorough discussion of this prototype can be found in the following section.

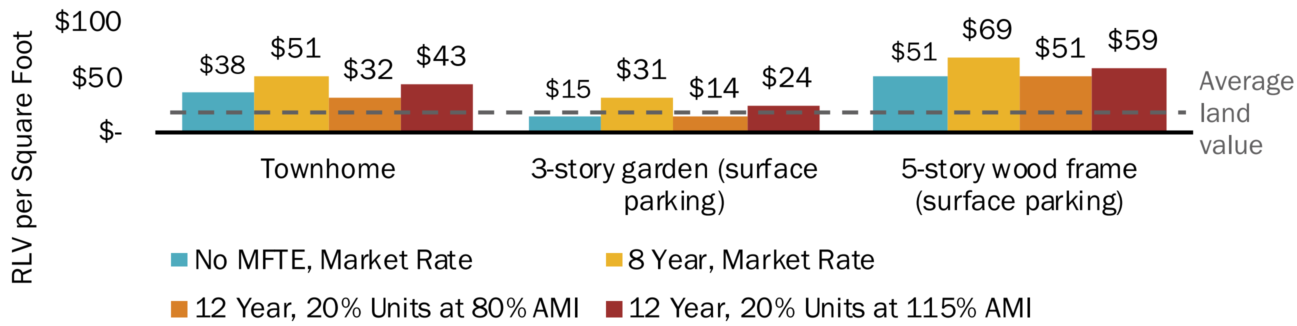
Finding: Development feasibility varies by market area.

Kingston

We modeled allowed prototypes in the densest Kingston zone (UVC) and the least dense Kingston zone (UM). The RLV results for the UVC zone are shown in Exhibit 18; please note that while the podium prototype is not allowed in any zone in Kingston under the height requirements, the RLV per square foot results for the remaining three prototypes are identical to the results shown in Exhibit 17. Because the density requirements are not affecting the required lot size in the UVC zone, the RLV per square foot remains the same.

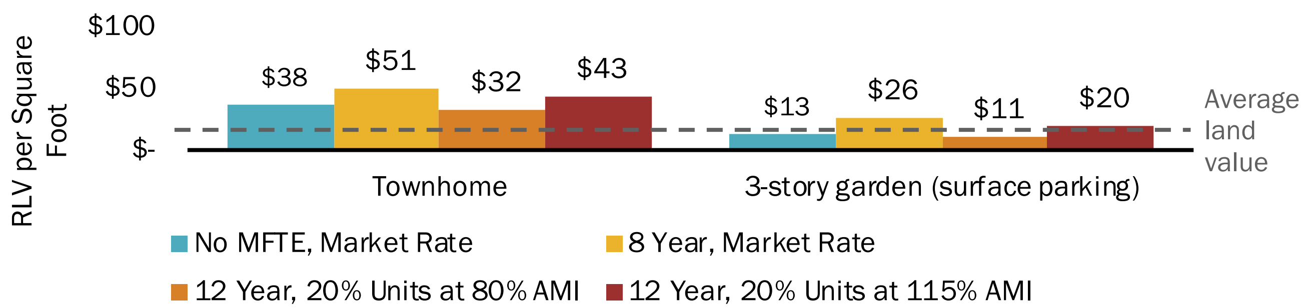
[16] In practice, 20% of units would be set aside as "affordable" (and restricted as such for the length of the program) but charged at market rate so long as it is below the affordable rate. In this scenario, a developer would receive the benefit of the tax exemption without losing any revenue from the lower rate affordable units.

Exhibit 18: Residual Land Value (RLV) per Square Foot, Kingston UVC Zone (Densest Zone)



RLV per square foot results for the Kingston UM zone are shown in Exhibit 19.[17] The modeled townhome prototype has a density of 24 dwelling units/ acre, which is allowed in all zones under the proposed zoning amendments. However, the garden apartment prototype has a density of 37 dwelling units per acre as modeled, and thus requires a larger lot size to meet the density requirement of 30 dwelling units per acre in the UM zone. As shown across Exhibit 18 and Exhibit 19, the increased land required lowers the RLV per square foot for the garden apartment as the developer's land budget would be spread across a larger area.

Exhibit 19: Residual Land Value (RLV) per Square Foot, Kingston UM Zone (Least Dense Zone)
Source: ECONorthwest

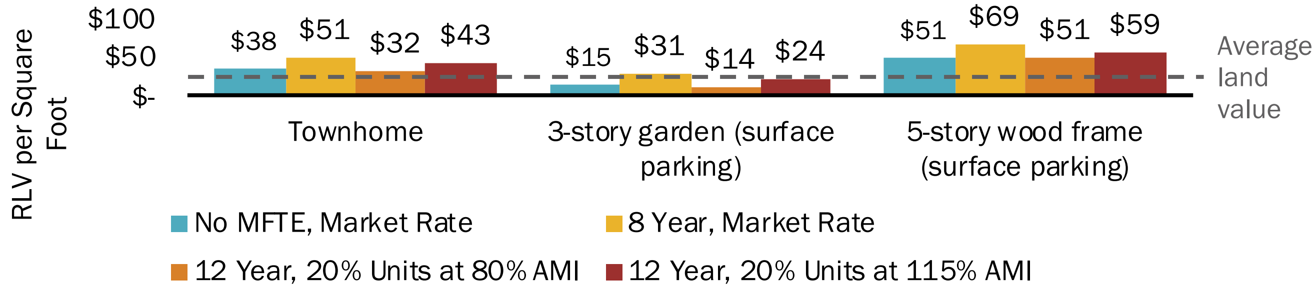


Silverdale

Exhibit 20 shows the RLV per square foot results for the densest zone in Silverdale (RC). Because this zone has the same density requirement (and thus the same required lot sizes) as the Kingston UVC zone, these values are identical to the results shown in Exhibit 17.

[17] The wood frame prototype is not allowed under the height requirements in this zone.

Exhibit 20: Residual Land Value (RLV) per Square Foot, Silverdale RC Zone (Densest Zone)
Source: ECONorthwest



Similarly, the least dense zone in Silverdale (UM), has the same relevant density requirements and results as Kingston UM zone, shown in Exhibit 19.

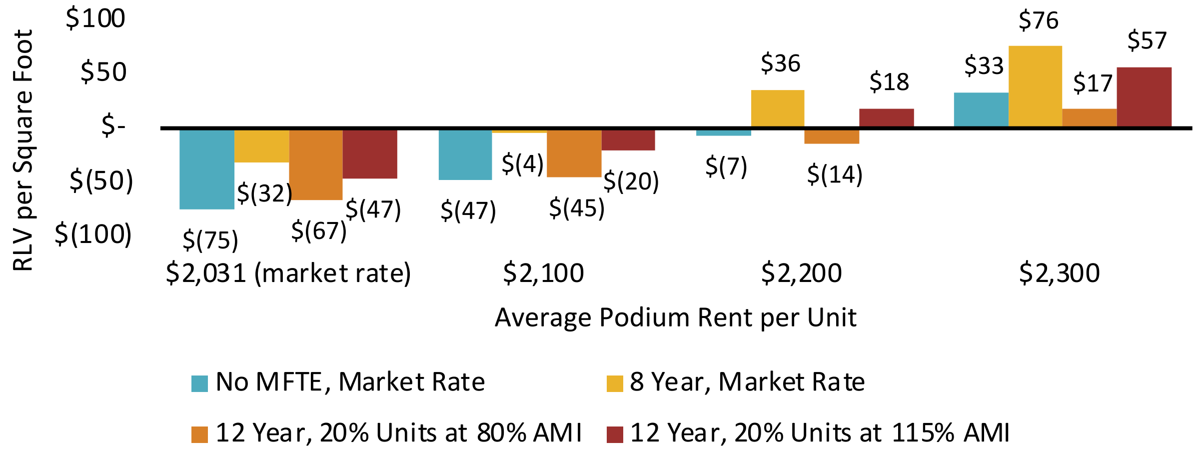
How do Results Respond to Changes in Revenues?

In addition to sensitivity testing for developer risk, we modeled adjustments in market rate rents. In particular, we tested the impact to podium development to see if it could potentially become feasible in the future should market conditions change.

Finding: Podium development feasibility is very sensitive to changes in rent revenues.

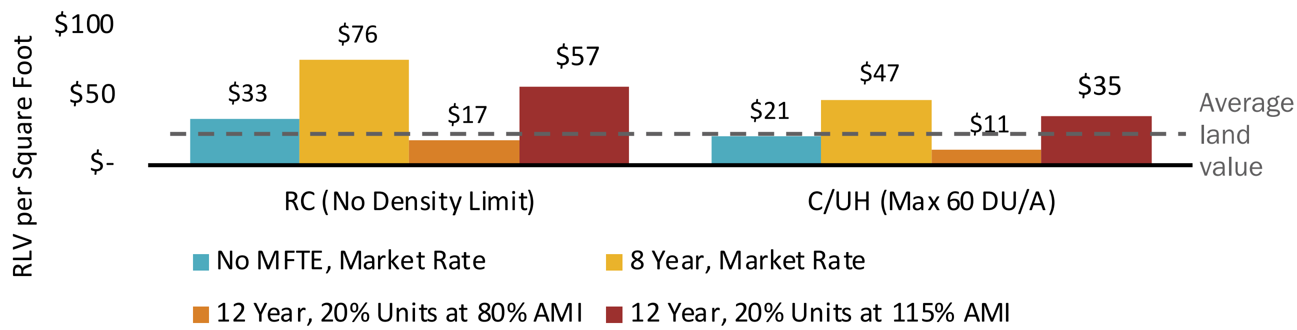
Exhibit 21 shows the RLV per square foot values for the podium prototype given changes in the average market rent per unit while holding other factors (such as construction costs) constant. Given recent increases to the area median income, it is not unlikely that Kitsap County market rate rents may also increase in the near future. As shown below, even increasing the average podium unit rent by under $300 to $2,300 is enough to produce potentially feasible RLV per square foot results, especially if layered with an MFTE program.

Exhibit 21: Podium Rent Sensitivity Testing
Source: ECONorthwest



We also analyzed the impact of different density limits in zones using the $2,300 average rent podium prototype. As shown below (for Silverdale), in the RC zone with no density limit, a developer would have a higher land budget (on a per square foot basis) than in the C and UH zones, which would require a larger piece of land for the same building.

Exhibit 22: Podium Zoning Sensitivity Testing
Source: ECONorthwest



3. Recommendations

What Should Kitsap County Consider for Implementing a Potential MFTE Program?

Based on our analysis, we arrived at the following recommendations:

Recommendation: Establish a Kitsap County MFTE Program

As established in the analysis above, all three tested MFTE program options had a positive impact on development feasibility for at least two tested prototypes; the 8-year and 12-year at 115% AMI programs had a positive impact on all tested prototypes. In addition, the 12-year program has the opportunity to introduce affordable housing units into a housing market with a rapidly rising area median income.

Although the podium prototype might not be financially feasible under today's conditions, this analysis indicates that when market conditions change, the program could help overcome a feasibility gap and therefore create an incentive for more housing supply. Particularly for podium development, the MFTE program had a strong impact on feasibility under certain market conditions (see Exhibit 21). By introducing an MFTE program, Kitsap County has an opportunity to create additional flexibility and support for denser forms of multifamily development in conjunction with proposed zoning code changes.

More specifically, we recommend the County establish the 8-year program with no affordability and the first option for the 12-year program: a 20% set-aside at 115% of AMI. Our analysis shows this first option is more financially feasible than developing without MFTE – thereby creating an incentive for a developer to participate in this voluntary program.

Additionally, we have learned through stakeholder interviews on other MFTE program projects that understanding program requirements for program options with affordability limits can be challenging. Oftentimes, the types of developers working outside of major metropolitan regions are smaller firms with limited staff capacity to research, interpret, and then financially analyze affordability requirements. If the County were to publish direct program details, in addition to the municipal code language, this could assist developers who might be interested in accessing a program option with rent limits but are deterred by the effort required to understand the program. Some cities publish the income and rent limits by AMI level and others have websites with all necessary program details and application materials. [18] Ease of compliance with program requirements is necessary too. Any compliance paperwork the County can produce would be helpful for developers concerned with the complexity of these program options.[19] This recommendation is relevant for all program options evaluated that had a rent limit tied to AMI, even if the limit is non-binding given market rents.

Recommendation: Ensure Zoning is Calibrated to Support Multifamily Development

As discussed, the zoning code should work with, not against, MFTE and multifamily development. As the County is considering and implementing its updated zoning code, it should carefully consider the impact on multifamily development. Even if a prototype is technically allowed under the height limitations, the County should ensure density maximum requirements do not limit development by requiring a developer to purchase extraneous land (see Exhibit 13). Additionally, the County should consider the impact of other zoning requirements that could effectively limit multifamily housing, such as parking requirements, setbacks, impervious coverage, or floor area ratio limits.

Recommendation: Carefully Calibrate Minimum Density Thresholds

When calibrating the MFTE program, there are a few aspects the County should consider. Setting minimum density or unit thresholds for program participation can help the County incentivize certain types of development through the MFTE program but should be implemented carefully.

Setting a minimum unit threshold too high could set a narrow "band" between the minimum units for program participation and the maximum density allowed in a zone. This could limit development options as developers may not be able to fit viable development within this window given the efficient development forms relative to the available parcels. Additionally, setting too many limitations to the MFTE program could limit program participation and thus multifamily development. However, the County should also consider the potential administrative cost of managing the MFTE program for smaller developments relative to their public benefit.

First, we recommend the County not set a minimum density or minimum number of units for the 12-year program, in order to incentivize affordable housing units (at any scale) in the County. Second, if the County desires to set a minimum unit threshold to incentivize denser development via the 8-year program, we recommend not much higher than 10 units. Because townhomes have demonstrated development feasibility and relatively lower financing required, it is likely that they would make up much of the multifamily development built via MFTE, particularly for the 8-year program with no affordability requirement. By setting a

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[18] The City of Seattle has a helpful MFTE webpage with an income limits chart: www.seattle.gov/housing/property-managers/income-and-rent-limits. The City of Portland has detailed tables, identifying the rent and income limits by AMI, which are released each year. www.portland.gov/sites/default/files/2022/2022%20AMI%20Rents%20PHB.pdf

[19] The City of Seattle's compliance form.

minimum density or unit threshold above typical townhome development, the County could potentially incentivize denser garden or wood frame apartments.

The County could also consider implementing multiple target areas within Silverdale and Kingston, such that there are only thresholds in higher density zones, and no (or at least lower) minimum thresholds in lower density zones. This could strategically incentivize relatively denser developments in the higher density zones – ensuring that it is more financially feasible to build multifamily development (with the MFTE program) than townhome development without and could therefore help target townhome development in the lower density zones.

Recommendation: Monitor Program Use and Track Participation

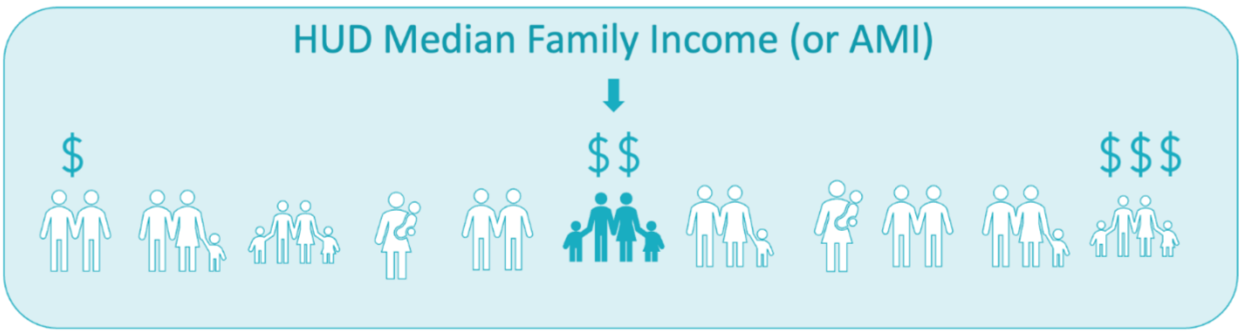
Market conditions can change rapidly, so regular monitoring and evaluation can help ensure the MFTE program is supporting the County's housing goals. We recommend conducting additional program evaluation and feasibility analysis every 3 to 5 years to help improve program performance and test out ways to amend and recalibrate the program. In particular, because the Area Median Income and the cost of development has risen substantially in recent years, market rate feasibility is likely to continue to fluctuate in the future. Additionally, feasibility analysis can and should occur more regularly if there is either no participation or substantial participation in the program to ensure it is calibrated correctly.

At a minimum, the County could track program progress by providing annual reporting on the total number of housing units and their affordability level (AMI level) built under the program, the number of projects and applicants and their location, and a description of different projects using the MFTE program (e.g., project funding, types of housing construction, number of bedrooms in units, etc.). In addition, the County could track requests for information and pre-app meetings for the MFTE program and they could consider interviewing participants to identify improvements.

Appendix

How does the MFTE Program define what is an affordable housing unit?

Several of the MFTE options require developers to set aside a certain percentage (such as 20 percent) of housing units for different Area Median Income levels. Area Median Income (AMI) is the median household income in a given region, or rather, the household that would sit in the middle of a line-up of all households with the lowest income household at the starting point and the highest income household at the ending point.[20]



The AMI used in this evaluation is based on the U.S Housing and Urban Development (HUD) Median Family Income (MFI). Every year, the HUD produces an MFI to determine affordability thresholds for a given metro area. Affordable housing projects' income limits, rent limits, loans, and other characteristics are the basis for this MFI.[21] The HUD MFI is based on a family of four people, and then different income levels are established as percentages of that four-family MFI. From that point, HUD calculates the income limits for other family sizes in each income level.

Although the latest legislation allows jurisdictions to define their own median income, we recommend the income limits should use HUD's MFI for Kitsap County (most recent year) rather than a more localized AMI to ensure that the proposed MFTE options can be easily integrated with other affordable housing programs offering subsidies and support.

20 King, Sean. 2021. "What is AMI and why does it matter"? Habitat for Humanity of Pinellas & West Pasco Counties.

[21] See this note from HUD about AMI vs MFI. "HUD estimates Median Family Income (MFI) annually for each metropolitan area and non-metropolitan county. The metropolitan area definitions are the same ones HUD uses for Fair Market Rents (except where statute requires a different configuration). HUD calculates Income Limits as a function of the area's Median Family Income (MFI). The basis for HUD's median family incomes is data from the American Community Survey, table B19113 - Median Family Income In The Past 12 Months. The term Area Median Income is the term used more generally in the industry. If the term Area Median Income (AMI) is used in an unqualified manner, this reference is synonymous with HUD's MFI. However, if the term AMI is qualified in some way - generally percentages of AMI, or AMI adjusted for family size, then this is a reference to HUD's income limits, which are calculated as percentages of median incomes and include adjustments for families of different sizes." Source: HUD. 2018. "FY 2018 Income Limits Frequently Asked Questions."

- HUD source of AMI information: https://www.huduser.gov/portal/datasets/il/il2022/2022summary.odn).
- Additional information from the state on AMI: https://deptofcommerce.app.box.com/s/3n0csxweewozq3r7jymzr2o9lokr915c

Is the MFTE Program used to encourage home ownership?

Developers using the MFTE Program tend to build rental housing since the property tax abatements provide financial incentives during the abatement time period (such as 8 or 12 years), when property taxes are paid. If a housing developer sold the housing units, there is no guarantee that they would receive the benefit of the property tax reduction through a higher sales price.

In a rental, the owner rents the units to tenants and the tenants do not pay the property taxes directly. Instead, the owner pays the taxes on all the units and the market rent of the property must be sizeable enough to cover that cost along with other operating expenses. This means that the owner/developer receives the benefit of the taxes being reduced from the property tax reduction, which increases the financial feasibility of the development. With residential ownership units, however, the developer immediately sells the units to new owners who then pay the property tax bill on their individual unit each year.

It is possible the abatement could benefit the home buyer, but that typically doesn't make the development more financially feasible. The size of a loan that a buyer qualifies for is based on multiple housing cost factors including property taxes, home insurance, and Home Ownership Association fees (if applicable). When property taxes are lowered, a bank typically won't be willing to underwrite a larger loan. Loans are typically for 30 years, so unless the abatement is permanent, they won't consider it when underwriting the buyer's ability to pay for the unit. This means that the value of the tax abatement doesn't increase the price that a buyer can pay for a unit, and therefore doesn't increase the feasibility of the development. However, even if it could increase the amount the buyer can pay for a unit, a tax abatement program is typically accompanied by requirements for restricting sales prices to various levels of affordability. This means that even if an abatement means a bank would increase the loan amount so that a buyer could pay more for the unit, the policy creates a ceiling on what they are allowed to pay, so the benefit isn't passed on to a developer to cover costs of building the unit. With a sales price ceiling, the tax abatement benefits the buyer of the unit only but doesn't impact the purchase price or cost to build.