MFTE Program: Summary and Considerations

City of Leavenworth | November 6, 2023

Introduction

This guide provides an overview of considerations for the proposed Multifamily Property Tax Exemption (MFTE) program, including an overview of the program framework itself, the

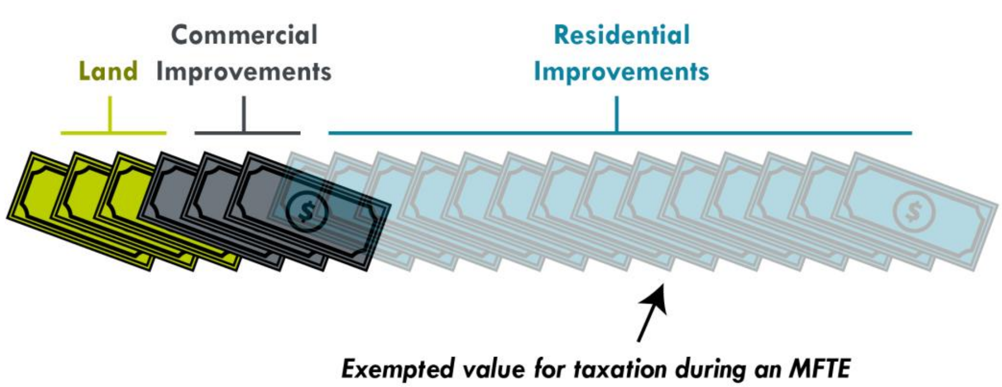
Overview of the Program

MFTE programs provide opportunities for cities and counties to encourage the development of multifamily housing. Originally, these programs were focused on economic development and the creation of new multifamily housing in larger cities. But over time, MFTEs have also become an important tool to support the development of affordable housing in cities across the state.

The core of an MFTE program is the tax exemption itself. Under the law, this applies **only to the value of all residential improvements** on a site. This <u>does not include the value of</u>:

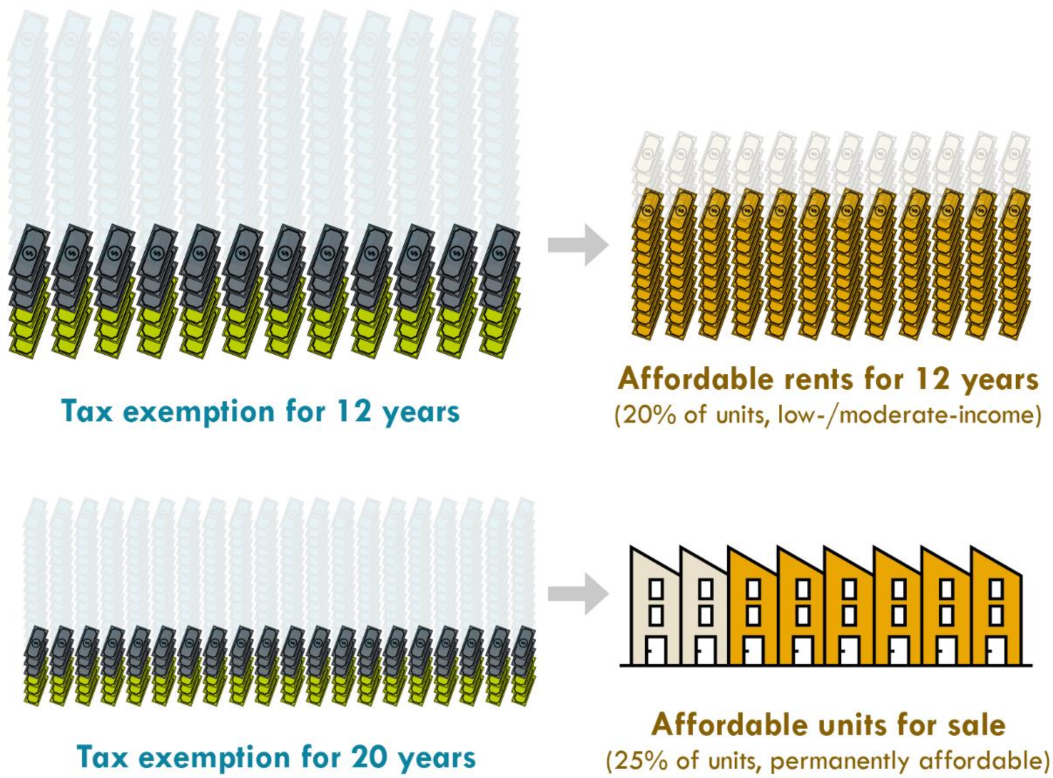
- The land itself.
- Commercial buildings on the site.
- The commercial parts of mixed-use buildings, such as ground-floor retail in a building.
- Other site improvements, personal property, etc.

This applies to the entire tax parcel or parcels that are part of a development and does not apply to a portion of a project. A developer may decide to have the exemption apply to only part of a phased project, or to a project over multiple parcels that can be treated differently, but it <u>must be applied to the entire site</u>.



This exempted value results in a lower tax bill, which in turn reduces the operating costs of a building and provides some benefits for the property owner. Under an affordable program, this offsets the cost of building and retaining affordable housing. These can include either:

- Providing **affordable rents for rental housing**, or
- Requiring **permanently affordable housing for homeownership** in partnership with an affordable housing organization.



The MFTE provides a greater benefit for including affordable housing in a mixed-income project because the exemption applies to the <u>entire project</u>. Because both market and rent-restricted units are covered under the exemption, the benefit is 4–5 times what it would be if the exemption only applied to the affordable units. This means that it is a higher benefit than if it only applied to affordable housing units.

Under the state requirements, affordability requirements include:

- For **rental properties**, being affordable to low- and moderate-income households. This is calculated as being affordable for households making 80% of Area Median Income (AMI) for low-income, and 115% of AMI for moderate-income.
- For **homeownership**, this requires that the housing needs to be affordable to households making 80% of AMI. This is enforced in perpetuity through a ground lease or sale restriction.

There are other basic requirements of the program from the state as well:

- **Residential multifamily projects only.** This cannot apply to single-family homes, and it must be applied to a project that includes at least four units. Also, at least half of the project needs to be in "permanent residential use" as well, so a commercial project with a few permanent residential units wouldn't be eligible, nor would a project where a lot of people are renting units for office space and not for accommodations.
- **Displacement protection.** If there is existing housing on the site there needs to be a reason for it to be demolished, typically because it violates the Building Code, and it cannot displace current residents.
- **Permanent housing only.** As noted before, at least half of the building needs to be in "permanent residential use". It cannot be used for temporary residential uses like hotels or AirBnBs. Additionally, you cannot sublet out an affordable housing unit at a market rate.
- **Yearly income qualification.** There is regular financial reporting required for a tenant's income upon leasing or releasing to show that they qualify for the unit. This is managed by the owner and reviewed by the City.
- **Rental relocation assistance.** At the end of a 12-year exemption, the property owner must provide one month's rent as relocation assistance for the tenants that will need to pay market rent after the program expires.
- **Monitoring.** Regular monitoring of the exemption is done by the City (and not the assessor). If for some reason a property owner is out of compliance, the City needs to notify the Assessor for any action to take place.

The City does have significant leeway in making their own requirements, as long as the state requirements are met. Cities can, for example, put in tighter affordability requirements, requirements for public amenities, or other requirements.

The exemption can end in three different ways:

- **Expiration.** When the exemption expires, a rental property under the 12-year program will need to pay full property taxes again, but will be able to charge full market rents.
- **Voluntary withdrawal.** A property owner can notify the City and Assessor to stop participation in the program, and they will no longer be exempted from taxes and will no longer need to meet the MFTE requirements.
- **Cancellation.** If a property owner is out of compliance (e.g., is charging higher rents than allowed), the exemption can be cancelled by the City and they will need to pay back the exemption during the period where they were noncompliant (plus a 20% penalty).

There is an option for extending out the exemption, but the proposed Leavenworth program does not include this, and it would not be a consideration until exemptions in the City would be close to expiring.

What are the Benefits and Drawbacks of MFTE?

Benefits

- **High value of the incentive.** The MFTE program can provide the greatest financial support for affordable housing across the incentives available to cities, excluding direct funding of affordable housing. Programs like impact fee waivers or parking incentives can provide some benefit, but usually cannot match the benefits that the MFTE gives for development.
- **Administration.** Because the property owner is the one to collect the financial information of tenants under accepted standards, this is not required for City staff to complete. This can be a benefit in communities that do not have existing housing programs and would need to staff up to monitor these tenant qualifications.
- **Commonly used.** The MFTE program is commonly used in Washington State, and developers have had decades of experience to understand how best to include these programs in their financial assessments of feasibility.
- **Local flexibility.** MFTE programs have base requirements set by the state, but the City has a lot of leeway in setting their own requirements for the program. This is especially important when it comes to the affordability requirements, because different communities will have different needs.
- **Council oversight.** The Council is responsible for the final approval of the contract with the landowner for the exemption, which means that they can review and consider the advantages and disadvantages of special cases under the program.

Drawbacks

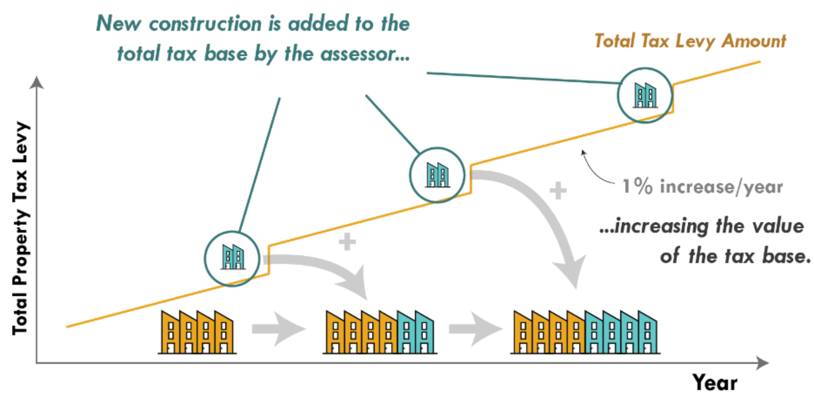
- **Limited timeframe.** For rental properties, the City is only providing the exemption for a 12-year period. This means that affordable units may become unaffordable after this period, and the City will need to plan for other affordable housing options as well.
- **Voluntary program.** Under the Leavenworth program, no developer will be required to participate. This means that a developer will at least need to believe that they can break even in a project, and if affordable housing would be too much of a cost they simply won't take an exemption.
- **Specific levels of affordability.** An incentive for market-rate developers can only go so far. Deeper levels of affordability, especially below 50% AMI, will often need other sources of subsidies to be built.
- **Finding the right affordability requirements.** In addition to not setting the affordability requirements too low to make sure that developers participate, another challenge is setting the affordability requirements too high, where the benefits to developers far outpaces the public benefits from affordable housing and the public investment would not go as far as it could.
- **Shifting of tax obligations / change in revenue.** The support provided by the MFTE program will result in financial impacts elsewhere. In most cases, this means that the tax obligations of the program will be shifted over to other property owners. Additionally, this can also mean that cities and other taxing districts will collect less revenue from taxes.

What is Tax Shift?

As mentioned, one question that can come up with MFTE is where the support from the exemption comes from. There are two options under the tax system in Washington State:

- **Foregone tax revenues** that are not collected, which reduce total revenues for a city and other taxing districts (e.g., the port, county, school district, state, etc.).
- A **shift of tax obligations** to all other payers of property taxes in these districts, where there is an increase in taxes collected to offset the losses from the exemption.

Because of the requirements on assessment of property values for the tax rolls, MFTE is more likely to see a shift of tax obligations. This is because of the levy lid on property taxes. Under normal circumstances, existing tax levies can only increase by 1% per year (with some exceptions), and new construction is added in when calculating the final levy:



However, if the City exempts some property value from taxation with an MFTE, this means that the exempted taxes are shifted over to other properties that aren't exempt.

This is also applicable for other types of exemptions, such as situations where nonprofits are exempted from property taxes. As well, exempted properties may have been assessed while under construction.

However, overall the shift takes place because the same levy amount is being charged on a smaller tax base. This applies not only to the City, but also to all other taxing districts: Chelan County, schools, fire, library, hospital, etc.

Calculating the full impacts over the lifetime of the exemption at a high level of accuracy, especially for individual properties, is not possible as taxes will change year to year, and new construction will have some significant impacts on these obligations.

But to get a very general idea about what the impacts could be, it can be useful to think about what would happen if property value was suddenly exempted from the rolls in Leavenworth but the tax obligations remained?

Under the 2022 tax levy calculations, the following property taxes were applicable in the city:

Exhibit 1. 2022 Property Tax Levy Calculations (City of Leavenworth).

	District	Levy Rate	Valuation	Total Levy
010170	Chelan County	0.874396962	$16,157,112,432	$14,127,730
155001	Veteran's Relief	0.010212221	$16,157,112,432	$165,000
160001	Mental Health	0.022590670	$16,157,112,432	$365,000
656301	Fire No 3 General	0.764275132	$1,702,191,011	$1,300,942
692101	Hospital No 1 General	0.169439275	$3,746,865,548	$634,866
692110	Hospital No 1 Bond	0.170575836	$3,746,865,548	$639,125
692150	Hospital No 1 EMS	0.475907304	$3,746,865,548	$1,783,161
693031	**Leavenworth General**	**1.037196173**	**$663,829,445**	**$688,521**
644001	Regional Library	0.325366052	$16,157,112,432	$5,256,976
671101	Port General	0.207826948	$16,157,112,432	$3,357,883
654161	Cascade SD 228 General	0.936123351	$3,724,875,681	$3,486,943
654170	Cascade SD 228 Bond	1.221728134	$3,724,875,681	$4,550,785
654175	Cascade SD 228 Cap Projects	0.141888106	$3,724,875,681	$528,516
677001	Upper Valley Park & Rec General	0.091258913	$1,955,062,510	$178,417
107001	Flood Control Zone	0.048444902	$16,157,112,432	$782,730
652001	State School Refund	0.000084208		
652003	State School 2	1.030204888		
652005	State School	1.911195134		
652025	State School 2 Refund	0.000014784		
	TOTAL LEVY RATE	**9.438728991**		

In this table:

- The **levy rate** is the tax rate expressed as $ of property tax per $1,000 of value.
- The **valuation** is the total assessed value in each tax district.
- The **total levy** is the total property tax collected across the entire district, which is levied at the same rate for all property. This is calculated here for the purposes of this example as the levy rate (divided by 1,000) times the valuation.

If we're looking at a property tax exemption that removes a million dollars from the total valuation listed above, this will mean that the total levy will stay the same but will be applied over less property value. If we were to take out $5 million from a tax exemption, the levy rates could be recalculated as follows:

Exhibit 2. 2022 Property Tax Levy Scenario - $5M Exemption (City of Leavenworth).

	District	Total Levy	New Valuation	New Levy Rate
010170	Chelan County	$14,127,730	$16,152,112,432	0.874667638
155001	Veteran's Relief	$165,000	$16,152,112,432	0.010215382
160001	Mental Health	$365,000	$16,152,112,432	0.022597663
656301	Fire No 3 General	$1,300,942	$1,697,191,011	0.766526721
692101	Hospital No 1 General	$634,866	$3,741,865,548	0.169665685
692110	Hospital No 1 Bond	$639,125	$3,741,865,548	0.170803765
692150	Hospital No 1 EMS	$1,783,161	$3,741,865,548	0.476543226
693031	**Leavenworth General**	**$688,521**	**$658,829,445**	**1.045067681**
644001	Regional Library	$5,256,976	$16,152,112,432	0.325466771
671101	Port General	$3,357,883	$16,152,112,432	0.207891282
654161	Cascade SD 228 General	$3,486,943	$3,719,875,681	0.937381623
654170	Cascade SD 228 Bond	$4,550,785	$3,719,875,681	1.223370297
654175	Cascade SD 228 Cap Projects	$528,516	$3,719,875,681	0.142078822
677001	Upper Valley Park & Rec General	$178,417	$1,950,062,510	0.091492903
107001	Flood Control Zone	$782,730	$16,152,112,432	0.048459899
652001	State School Refund			0.000084208
652003	State School 2			1.030204888
652005	State School			1.911195134
652025	State School 2 Refund			0.000014784
	TOTAL LEVY RATE			**9.453728370**

Shifting the same levy over less property value means that the rates would increase from 9.439 per thousand to 9.463 per thousand. For a $400,000 home, exempting $5 million in value means that a tax bill would increase from $3,775.49 to $3,781.49, or an increase of up to about $6.00.

This is not the impact of an actual exemption, as the calculations of tax levy rates are more complex and involve a different consideration of new development. Individual properties can also see their property taxes change year-to-year even without the exemption. It also gets difficult to project this into the future! However, this does provide a general order-of-magnitude estimate of what the effects might be under expected circumstances.

Finally, these effects can change significantly from year to year. If this were taken for the 2023 tax year instead, the impacts would be as defined in Exhibit 3. For a $400,000 home and a $5 million exemption in under a scenario in this year, an MFTE would result in an increase of up to $4.33. While home values and construction costs would be expected to increase from year to year, the value of the exemption and the effects on property taxes will change based on increases in property value, new construction, increases in levies, and other factors.

Exhibit 3. 2023 Property Tax Levy Scenario - $5M Exemption (City of Leavenworth).

	District	Initial Levy Rate	Total Levy	New Valuation	New Levy Rate
010170	Chelan County	0.7334053198	$14,496,165	$19,760,556,927	0.733590893
155001	Veteran's Relief	0.0086008201	$170,000	$19,760,556,927	0.008602996
160001	Mental Health	0.0189723974	$375,000	$19,760,556,927	0.018977198
656301	Fire No 3 General	0.6595493974	$1,336,767	$2,021,788,115	0.661180502
692101	Hospital No 1 General	0.1385914007	$649,181	$4,679,137,377	0.138739496
692110	Hospital No 1 Bond	0.1428539513	$669,148	$4,679,137,377	0.143006601
692150	Hospital No 1 EMS	0.3876855425	$1,815,972	$4,679,137,377	0.388099813
693031	**Leavenworth General**	**0.9158415721**	**$708,851**	**$768,989,161**	**0.921796413**
693030	Leavenworth Bond	0.0000000000	$0	$768,989,161	0.000000000
644001	Regional Library	0.2864488554	$5,661,821	$19,760,556,927	0.286521335
671101	Port General	0.1756188309	$3,471,204	$19,760,556,927	0.175663268
654161	Cascade SD 228 General	0.7839181944	$3,656,941	$4,659,952,401	0.784759317
654170	Cascade SD 228 Bond	0.9880085834	$4,609,013	$4,659,952,401	0.989068689
654175	Cascade SD 228 Cap Projects	0.1180568217	$550,729	$4,659,952,401	0.118183493
677001	Upper Valley Park & Rec General	0.0789016769	$182,997	$2,314,302,797	0.079072142
107001	Flood Control Zone	0.0408306198	$807,040	$19,760,556,927	0.040840951
652001	State School Refund	0.0000273969			0.000027397
652003	State School 2	0.8917891157			0.891789116
652005	State School	1.6674243773			1.667424377
652025	State School 2 Refund	0.0000148770			0.000014877
	TOTAL LEVY RATE	**8.036539751**			**8.047358874**

There are also two other points to consider:

- **Greater impacts from additional exempted value.** This is an example to demonstrate one particular case, but it is easy to draw from this that exempting a lot of property value from the tax rolls could have a larger effect on local taxpayers. If you exempted $25 million for the 2022 tax year (almost 4% of the total assessed value in the city), local tax bills in this example would increase by about $31, which would be less than what would be paid to the local parks and recreation district. To understand each projects impacts, the developer is required to provide a feasibility report with their request to participate in the MFTE program. This report is intended to provide the Council information about how much is being exempted and how much tax obligations are being shifted over time.
- **There are tax impacts to more than just city residents.** Because all property taxes are exempted from the residential portion of an MFTE property, this does impact the residents of other taxing districts too. However, the larger levy amounts and total valuations in those districts means that the increases elsewhere are less significant. In the same $5 million example, an owner of a $400,000 home would be paying an additional $3.15 in taxes to the City, but $1.24 to the school district, $0.90 to the fire district, $0.43 to the hospital district, and $0.11 to the County. If that home were just outside of the boundary of the city, it would no longer pay the $3.15 increase, but the other increases for the County and special districts would still apply.

What is Affordability?

Another question that comes up with MFTE is with regards to affordability and how it is calculated. In this context, the term "AMI" or "Area Median Income" comes up often. AMI is the estimated median family income for households in a county or metro area (like Chelan and Douglas Counties), and it is based on projections from the US Department of Housing and Urban Development (HUD).

For Leavenworth, the county's AMI is calculated as **$80,500** for 2023. This is assumed to be for a family of four people, and is often adjusted in two ways:

- **Affordability levels** are often expressed as a percent of AMI: for instance, households making 50–80% of AMI are considered "low income", while those making 80–115% AMI are "moderate income".
- **Household sizes** also impact AMI, and smaller households are assumed to be making less. For example, AMI for a one-person household is assumed to be $56,350.

There are a lot of special cases in affordable housing, but a single measure is important to provide a general benchmark for affordability programs like MFTE programs. Having clear thresholds for income can be much easier than trying to make a case-by-case evaluation for each household.

There are several calculation steps to get from the $80,500 median family income to a final required maximum rent under an MFTE program:

- **Affordability level.** First, median income is often adjusted to account for lower incomes than the median. Taking 80% of AMI is often a typical threshold for "low income" households under an MFTE program. In this case, the AMI is just multiplied by 80% to get a maximum income.
- **Housing unit size.** When calculating affordable rents, we also assume that each unit will have 1.5 people per bedroom (or 1 person for a studio apartment). Because the base AMI assumes four people in the household, this income level is also adjusted up or down based on the average household size expected.
- **Expected housing costs.** We assume that households, especially lower-income households, should be paying about **30% of their income** for all housing costs. This is divided by 12 to get maximum monthly housing costs (not rent!).
- **Utilities.** As housing costs can include basic utilities, such as electricity, water, sewer, etc., these total housing costs need to be adjusted based on what a tenant would need to cover. This can differ from property to property; a unit with electric baseboard heating will have different costs than one that relies on natural gas, for instance.

Based on the AMI for the County, the **total housing costs** in 2023 for different housing unit sizes and affordability levels would be calculated as follows using these steps:

Exhibit 4. 2023 Total Affordable Housing Costs by AMI and Number of Bedrooms.

	Bedrooms				
AMI	Studio	1	2	3	4
115%	$1,620	$1,736	$2,083	$2,407	$2,685
100%	$1,409	$1,509	$1,811	$2,093	$2,335
80%	$1,127	$1,208	$1,449	$1,674	$1,868
60%	$845	$906	$1,087	$1,256	$1,401
50%	$704	$755	$906	$1,047	$1,167

Based on estimates of utility costs from the area that assume utilities are the lowest cost and the responsibility of the tenant, **maximum rents** would generally be:

Exhibit 5. 2023 Maximum Rents by AMI and Number of Bedrooms.

	Bedrooms				
AMI	Studio	1	2	3	4
115%	$1,447	$1,553	$1,885	$2,185	$2,449
100%	$1,236	$1,326	$1,613	$1,871	$2,099
80%	$954	$1,025	$1,251	$1,452	$1,632
60%	$672	$723	$889	$1,034	$1,165
50%	$531	$572	$708	$825	$931

This would change based on the individual property and how tenants would be charged for utilities, but again this provides an understanding about the general rents involved at different affordability levels.

Finally, it can be illuminating to understand who these units would be for in the community. Based on median wages in state occupational statistics for the Wenatchee MSA, we can calculate what types of jobs would be occupying these units if just one earner was present in the household, and if two earners were present. Note for comparison, “Emergency Medical Technicians” (median income $36,410) were assumed to be one of the two earners in each household.

Exhibit 6. Occupations by Affordability of Rents at Median Wage Rates (One Earner).

	Bedrooms		
AMI	Studio	1	2
115%	First-Line Supervisors of Office and Administrative Support Workers ($64,050)	Massage Therapists ($68,910)	Construction and Building Inspectors ($82,490)
100%	Entertainment and Recreation Workers Supervisors, Except Gambling Services ($56,280)	Highway Maintenance Workers ($60,040)	Public Relations Specialists ($71,930)
80%	Production, Planning, and Expediting Clerks ($44,950)	Maintenance and Repair Workers, General ($48,250)	Computer User Support Specialists ($57,910)
60%	Cashiers ($33,810)	Demonstrators and Product Promoters ($36,160)	Coating, Painting, and Spraying Machine Setters, Operators, and Tenders ($43,410)

Exhibit 7. Occupations by Affordability of Rents at Median Wage Rates (Two Earners).

	Bedrooms		
AMI	1	2	3
115%	Emergency Medical Technician + Fast Food and Counter Worker	Emergency Medical Technician + Dental Assistant	Emergency Medical Technician + Bus and Truck Mechanic
100%	(n/a)	Emergency Medical Technician + Floral Designer	Emergency Medical Technician + Mixing and Blending Machine Tender
80%	(n/a)	(n/a)	(n/a)

Note that in the second table, there are cases where a second earner working full time for median wages would always exceed the income thresholds.

It can be important here to highlight is that rent-restricted units are often more the solutions needed for one-earner households: single people living in smaller units as well as larger households with single parents or parents with one partner staying at home for child care. Two-income households typically make more than what would be needed to qualify for MFTE units.

This can lead to a common question: how do we make sure that people aren't taking advantage of the system? No system is perfect, but there are three points to consider:

- **Landlord will have income requirements to rent a unit.** MFTE units are run by private landlords that will still have their own requirements to ensure that tenants can pay their rent. They may also be held liable and could be forced to pay penalties if tenants are providing fraudulent income information without the proper documentation.
- **Income gains versus ongoing subsidies.** For younger households that may have future potential for earnings increases or part-time workers with the potential for higher earnings, accepting lower

wages to maintain a rent subsidy of a few hundred dollars a month at most is not usually an optimal long-term financial decision.

- **Significant administrative costs to the City.** Providing additional employment requirements beyond what is typically required for income verification would require substantially more oversight, likely by the City. While this is possible, the potential risks may be outweighed by the overhead for City employees to monitor participants in the program. Better approaches would involve relationships with affordable housing organizations to ensure that residents of MFTE units will have access to supporting programs as needed.

Conclusions

The MFTE program has been an effective means of providing support to achieving local housing goals for decades. The use of the tax exemption incentive can be important to tailor appropriately to local needs and ongoing oversight of the program is essential. However, the reliance on incentives for the private sector to help with meeting these needs can be effective in realizing new housing options, especially at household incomes at around 60–80% of Area Median Income.