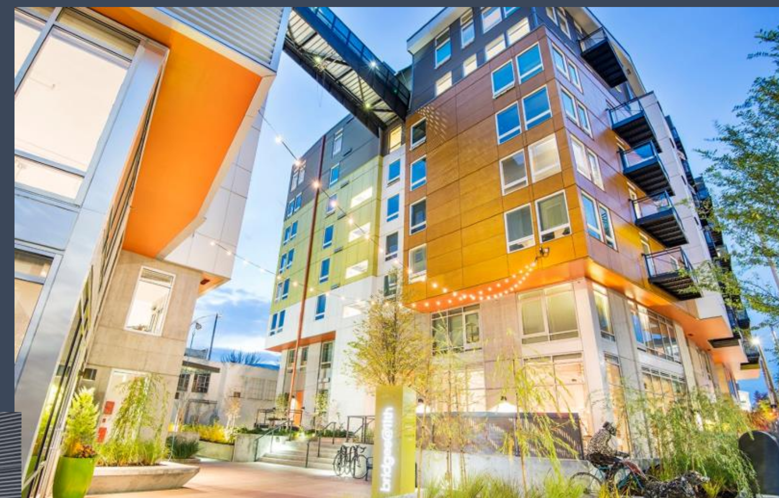
Affordable Housing and the Private Sector

SECURITY PROPERTIES

Security Properties Affordable Experience

- **Recent Multifamily Developments**
    - The Bridges @ 11th, University District, Seattle WA
        - 184 apartments, 37 affordable
    - Angeline Apartments, Columbia City, Seattle WA
        - 193 apartments, 39 affordable
- **Current Affordable Housing Portfolio**
    - 6,000 apartment units
    - Over $75 million in total LIHTC equity
    - 600 units of affordable senior housing
    - Experience with extra-low income housing
        - Down to 30% AMI

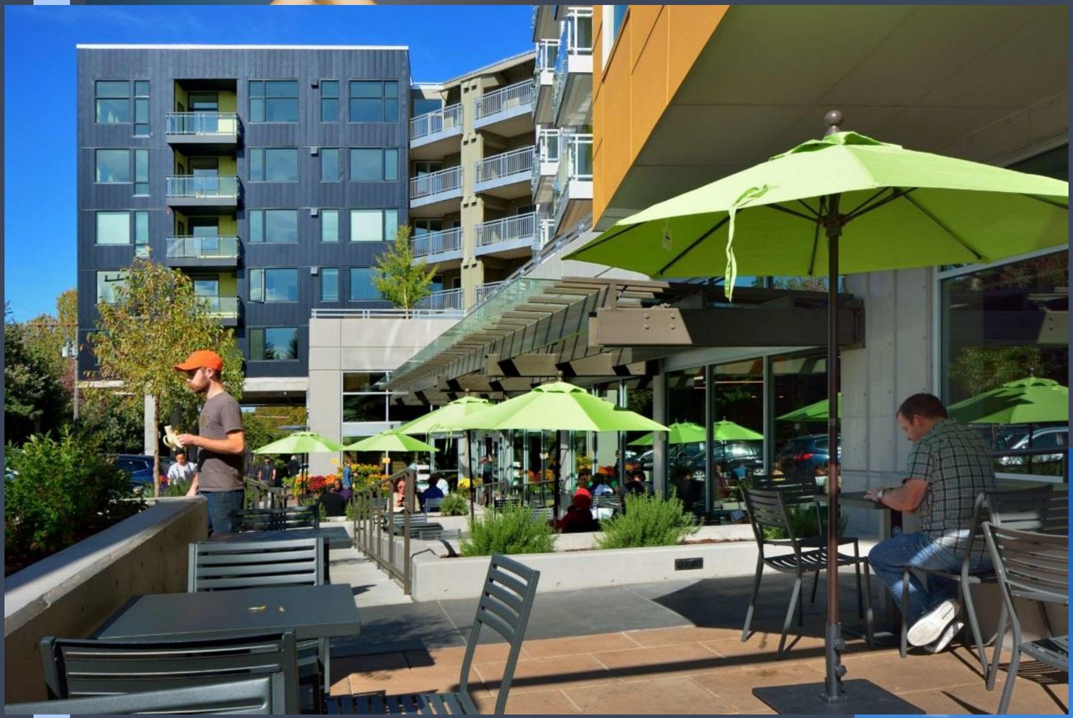
Bridges @ 11th University District



In partnership with Children's Hospital and the University of Washington

Adjacent to future University District Light Rail Station

Angeline Apartments
Columbia City



25,000 square foot
ground floor grocer

Short walk away from
Link Light Rail

Kinects Tower
South Lake Union

May 2016

July 2017

Why isn’t the Private Sector able to develop more Affordable Housing?

- ***Tax-Incentive Systems (MFTE)***
  - Private Developers pursue highest possible returns for their investors. To participate in voluntary tax incentive schemes:
    - Must be viable without incentive due to perceived regulatory risk
    - Value (+) of tax exemption must be >= Value (-) of rent loss
    - Favorable incentives make private sector participation more likely, but also cost the public treasury more in lost tax revenue

Why isn't the Private Sector able to develop more Affordable Housing?

- ***Mandatory Affordable Component / Fee-in-Lieu***
  - Governments require developments to include affordable components or pay into a fund to create affordable housing
    - This only works up to a point, as eventually the added costs are significant enough that marginal projects do not get built
  - Risk that program can backfire
    - A law might cause a higher % of new apartments to be affordable, but cause the overall production of new apartments to drop
    - This often results in a supply crunch, reducing overall affordability for middle-income residents

Why isn't the Private Sector able to develop more Affordable Housing?

- ***Municipal Fees and Impact Mitigation Charges***
  - Municipalities often charge per-unit fees for permitting and impact mitigation
  - Could reduce fees in exchange for an affordable housing covenant

Spring District Phase II
Financial Modeling Experiment

- Utility Hookup Fees ($494k) - 6%
- Mitigation/Traffic Fees ($632k) - 8%
- FAR Purchase Fees ($1.2m) - 15%

- All Eliminated ($2.3m)
  - Rent 30% below market rate
  - Studios affordable at 75% AMI
  - 1 beds affordable at 85% AMI
  - 2 beds affordable at 90% AMI

Why isn't the Private Sector able to develop more Affordable Housing?

- ***Program Exit Fees and Penalties***
  - A developer may decide that a tax exemption is worth pursuing today, but remain unsure whether it will remain so for the duration of the program (usually 8-12 years)
    - Uncertainty will cause financial partners to view the program skeptically
  - Should there be penalties for exiting the program?
    - More lenient exit penalties will make private developers more likely to participate in affordable housing programs
    - However, as the exit penalty decreases, the program's potential benefit to taxpayers is reduced

The Public Perspective

- *One way to evaluate incentive programs…*
  - What is the cost (lost revenue) and what is the benefit (affordable units produced)?
  - Assume a city can grant a $750,000 tax exemption for 12 years in exchange for 40 affordable units
    - ~$225,000 per unit cost to the public treasury
  - Can a government agency or non-profit produce units of similar quality in a similar location for less than $225,000 per unit?
    - If the answer is no, the government should consider a tax incentive scheme

Affordable Mandates and Development Viability

- ***Investors and lenders have a "minimum yield" they require to participate in a development deal***
  - Affordable Mandates reduce revenue or increase cost, meaning deals that were just barely viable before may be abandoned completely
  - ***Example Affordable Mandate Variance Analysis –***

Rent Levels	Construction Costs	Mandatory Affordable	Investment Yield	Financible?
$2.50 per square foot	$50,000,000	5%	5.80%	Yes
$2.50 per square foot	$50,000,000	10%	5.60%	Yes
$2.50 per square foot	$50,000,000	15%	5.40%	No

  - In this example, when the mandate exceeds 10% the deal is no longer viable

Supply Constraints and their Consequences

- Why should we care if luxury apartment buildings aren't built?
  - If high-income workers cannot rent a brand new, Class-A apartment they will begin renting the nicest apartments in existing buildings
  - Owners of older apartments buildings realize that they can charge higher rents due to the new pool of high-income tenants
  - Especially true with less competition from new development
- These trends drive up rents for the existing tenants in old apartment buildings and decrease overall affordability in the area
  - ***The consequences of excessive supply constraint can be observed today in San Francisco***