# SENATE BILL REPORT
# SB 5118

As of February 1, 2024

**Title:** An act relating to modifying the multifamily property tax exemption to promote development of long-term affordable housing.

**Brief Description:** Concerning modifying the multifamily property tax exemption to promote development of long-term affordable housing. [**Revised for 1st Substitute:** Modifying the multifamily property tax exemption to promote development of long-term affordable housing.]

**Sponsors:** Senators Kuderer, Wellman, Frame, Hunt, Keiser, Liias, Lovelett, Nobles and Randall.

**Brief History:**

**Committee Activity:** Housing: 1/13/23; 1/10/24, 1/24/24 [DPS-WM, DNP, w/oRec].
Ways & Means: 2/01/24.


**Brief Summary of First Substitute Bill**

- Updates eligibility, notification and reporting requirements for multi-family property tax exemptions.
- Includes the value of new housing constructed and corresponding land under the 12- and 20-year exemptions.
- Allows a tenant with an income-restricted unit to increase annual household income up to 150 percent of the established unit income limit without eviction or penalty at lease renewal.
- Authorizes a city or county to assign the highest penalty to the owner who caused a project to be out of compliance and a lesser or no penalty to the other owners, if a penalty applies.


## SENATE COMMITTEE ON HOUSING

**Majority Report:** That Substitute Senate Bill No. 5118 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.
Signed by Senators Kuderer, Chair; Frame, Vice Chair; Cleveland, Saldaña, Shewmake and Trudeau.

**Minority Report:** Do not pass.
Signed by Senator Braun.

**Minority Report:** That it be referred without recommendation.
Signed by Senators Fortunato, Ranking Member; Gildon, Rivers and Wilson, J..

**Staff:** Melissa Van Gorkom (786-7491)

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## SENATE COMMITTEE ON WAYS & MEANS

**Staff:** Alia Kennedy (786-7405)

**Background:** Multi-Family Property Tax Exemption. All real and personal property in the state is subject to property tax each year based on its value, unless a specific exemption is provided by law. The multi-family property tax exemption (MFTE) exempts real property associated with the construction, conversion, or rehabilitation of qualified, multiple-unit residential structures. Property owners must submit an application for the MFTE to the designated city or county. The city or county may include additional eligibility requirements for the tax exemptions. If the application is approved, the city or county must issue a conditional certificate of acceptance of tax exemption.

MFTEs authorized under the statute include:
- eight-year exemption;
- 12-year exemption if the applicant commits to renting or selling at least 20 percent of multiple-family housing units as affordable housing to low and moderate-income households. Until December 31, 2026, certain cities must also be zoned to have an average minimum density equivalent to 15 dwelling units or more per gross acre, or for cities with a population over 20,000, the area must be zoned to have an average minim density equivalent to 25 dwelling units or more per gross acre;
- 20-year exemption if applicant commits to renting at least 20 percent of dwelling units to low-income households for a term of 99 years. For this 20-year exemption, the property must be located within one mile of high capacity transit, in a city that has implemented a mandatory inclusionary zoning requirement for affordable housing for 99 years and has a population of not more than 65,000 as measured on July 25, 2021. The city must require the property owner to record a covenant or deed restriction ensuring the continuing rental of units subject to affordability requirements for a period of 99 years; and
- 20-year exemption if at least 25 percent of the units are built by or sold to a qualified nonprofit or local government that will assure permanent affordable homeownership.

Until December 31, 2031, in certain cities the area must also be zoned to have an average minimum density equivalent to 15 dwelling units or more per gross acre, or for cities with a population over 20,000, the area must be zoned to have an average minimum density equivalent to 25 dwelling units or more per gross acre.

A property that qualified for and used an 8- or 12-year exemption and is within 18 months of expiration may apply to extend the exemption for an additional 12 years if it meets minimum locally adopted requirements for affordability. To qualify, an applicant must be approved by the city or county and commit to rent or sell at least 20 percent of the housing units to low-income households.

No new MFTE applications may be approved on or after January 1, 2032, or any extensions of existing tax exemptions on or after January 1, 2046.

*Residential Targeted Area.* To qualify for a MFTE, the housing project must be located in a residential targeted areas (RTA) designated by a qualifying county or city. The RTA must be in an urban center that lacks sufficient residential housing, including affordable housing, to meet the needs of the public who would likely live in the urban center if housing were available and provide additional housing opportunity, including affordable housing, in the area. If designated by a county, the RTA must be located in an unincorporated area of the county within the Urban Growth Area (UGA) and the area must be:
- in a rural county served by a sewer system and designated by a county prior to January 1, 2013; or
- in a county that includes a campus of an institution of higher education where at least 1200 students live on campus during the academic year; and
- until July 15, 2024, in a county seeking to promote transit supportive densities and efficient land use in an area located within a designated UGA and within one-quarter mile of a corridor where bus service is scheduled at least every 30 minutes for no less than ten hours per weekday and is in service or is planned for service to begin within five years of designation.

For any multiunit housing located in an unincorporated area of a county, a property owner must commit to renting or selling at least 20 percent of the units as affordable housing units to low- and moderate-income households.

A governing authority must hold a hearing to consider RTAs and provide notice in a paper of general circulation where the proposed RTA is located 7-10 days before the hearing.

*Reporting.* All cities and counties must report annually by April 1st of each year to the Department of Commerce (Commerce) to offer certificates of tax exemptions. The report must include the:
- number of tax exemption certificates granted;
- number, size and type of units produced or to be produced, including the amount meeting the affordable housing requirements;

- total monthly rent or sale amount of each unit produced;
- annual household income and size for each of the affordable units and a summary of these figures for the city or county; and
- value of the tax exemption for each project and the total value of tax exemptions granted.

Commerce must adopt and implement a program to effectively audit or review the compliance of the program.

Cancelation of an Exemption. If the property no longer meets the requirements, the tax exemption must be canceled, and the following must occur:
- additional real property tax must be imposed on the value of the nonqualifying improvements in the amount that would normally be imposed plus a penalty of 20 percent;
- additional interest is owed upon the amounts of the additional property tax at the same rate charged on delinquent property taxes, calculated from the dates on which the additional tax would have been payable without the tax exemption; and
- additional tax, interest, and penalty are a lien on the land and attach at the time the property, or portion of the property is removed from exempt status.

**Summary of Bill (First Substitute):** Multi-Family Property Tax Exemption. If application for MFTE is approved, the city or county must send the certificate of acceptance of tax exemption to the county assessor upon issuance.

For the 12-year exemption program:
- the applicant must commit to renting 20 percent of the living units net square footage as affordable housing units to a mix of low- and moderate-income households, ensuring the number of bedrooms for the affordable units is proportional to the number of bedrooms provided at the property as market rate units;
- the authorizing authority must require the applicant to record a covenant or deed restriction which defines the affordability requirements and their duration; and
- until December 31, 2026, the project must have an average minimum density equivalent to 15 dwelling units or more per net acre, or for cities with a population over 20,000, the area must have an average minim density equivalent to 25 dwelling units or more per net acre.

For the 20-year exemption rental program:
- the applicant must commit to renting 20 percent of the living unit net square footage as affordable housing units to low-income households, and the number of bedrooms for the units is proportional to the number of bedrooms provided at the property as market rate units; and
- the project must be located within a residential targeted area that includes areas with high capacity transit, in a city that has implemented a mandatory inclusionary zoning requirement for affordable housing for 99 years.

For the 20-year exemption ownership program:

- the project must have an average minimum density equivalent to 15 dwelling units or more per net acre, or for cities with a population over 20,000, the area must be zoned to have an average minim density equivalent to 25 dwelling units or more per net acre.

To qualify for a 12-year extension for a property that qualified for and used an 8- or 12-year exemption, an applicant must commit to rent or sell at least 20 percent of the living units net square footage as affordable housing units for low-income households.

A tenant within an income-restricted unit may increase annual household income up to 150 percent of the established unit income limit without eviction or penalty at lease renewal.

Each living unit will be measured to the inside furnished surface of the exterior wall and to the inside surface of walls separating living units from other living units and common areas to calculate the net living area. For the purpose of defining bedroom parity, market rate units with three or more bedrooms will be considered equivalent to three bedroom affordable units.

The 12- and 20-year exemptions include the value of new housing constructed and corresponding land. The exemptions do not include non-housing-related improvements.

In the case of rehabilitation of existing buildings or conversion of nonresidential buildings to multiple-unit housing, the exemptions do not include the value of improvements constructed prior to the submission of the application unless such improvements are integral to the use of the building for multiple-unit housing.

*Residential Targeted Areas.* If designated by a county, the RTA must be located in an unincorporated area of the county within the UGA and the area must be:

- in a rural county served by a sewer system and designated by a county prior to January 1, 2013;
- in a county with a population greater than 275,000; or
- until July 15, 2026, in a county seeking to promote transit supportive densities and efficient land use in an area located within a UGA and within one-quarter mile of a corridor where bus service is scheduled at least every 30 minutes for no less than ten hours per weekday and is in service or planned for service to begin within five years of designation.

The requirement for a property owner commit to renting or selling at least 20 percent of the units as affordable housing units to low- and moderate-income households for any multiunit housing located in an unincorporated area of a county is removed.

In addition to providing notice of public hearing to consider RTAs in a paper of general circulation, the notice must be sent to the affected taxing district.

*Reporting.* The annual report to Commerce must include contracts executed, amended, or extended during the previous year. Commerce may develop rules to effectively audit or review compliance.

*Cancelation of an Exemption.* When a tax exemption is canceled, if the owner of an income restricted unit sells that unit at market rate and a penalty applies, the city or county may assign the highest penalty to the owner who caused a project to be out of compliance and a lesser or no penalty to the other owners.

<u>Definitions.</u> Definitions for the MFTE are updated.

City means any city or town, including a code city.

Conversion means either the conversion of an existing residential building, in whole or in part, or a nonresidential building, in whole or in part, to multiple-unit housing.

**EFFECT OF CHANGES MADE BY HOUSING COMMITTEE (First Substitute):**

- Updates the definition for city to include any city or town, including a code city.
- Clarifies that a conversion means the conversion, in whole or in part, of a building.
- Clarifies the definitions of low- and moderate-income household to use area median income rather than median family income.
- Provides that square footage will be the living units net square footage with each living unit measured to the inside finished surface of the exterior wall and to the inside surface of walls separating living units from other living units and common areas.
- Clarifies that the affordable housing units must be a mix of low and moderate-income households.
- Requires the authorizing authority to require the applicant record a covenant or deed restriction for the 12-year program which defines the affordability requirements and their duration.
- Provides that for the purpose of parity, market rate units with three or more bedrooms will be considered equivalent to three bedroom affordable dwelling units.
- Requires the project be within a residential target area that includes areas with high capacity transit, rather than be located within one mile of high capacity transit, to qualify for the 20-year exemption and removes the population threshold.
- Provides that the project must have an average minimum density equivalent to 15 dwelling units or more per net acre instead of requiring the area to be zoned to have an average minimum density equivalent to 15 dwelling units or more per gross acre.
- Allows annual household incomes of tenants with income-restricted units to increase up to 150 percent of the established unit income limit without eviction or penalty at lease renewal.

- Replaces the requirement that a residential targeted area designated by a county be in a county that includes a higher education campus where at least 1,200 students live during the academic year with a requirement that it be in a county with a population greater than 275,000.
- Extends the allowance for a county seeking to promote transit supportive densities and efficient land use from July 15, 2024 to July 15, 2026.
- Requires the governing authority provide notice of a hearing to consider the designation of the residential targeted area to be sent to the affected taxing district.
- Removes requirement for multiunit housing in an unincorporated area of a county to impose affordable housing requirements.
- Requires the conditional certificate of acceptance of tax exemption to be sent to the county assessor.
- Requires all cities and counties to report annually to the Department of Commerce (Commerce) on contracts executed, amended, or extended during the previous year.
- Authorizes Commerce to develop rules necessary to effectively audit or review compliance.
- Authorizes the city or county to assign the highest penalty to the owner who caused a project to be out of compliance and a lesser or no penalty to the other owners if a penalty applies.
- Makes technical changes.

**Appropriation:** None.

**Fiscal Note:** Available.

**Creates Committee/Commission/Task Force that includes Legislative members:** No.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony on Proposed Substitute (Housing) (Regular Session 2023):** PRO: Washington is experiencing a housing crisis and we need to implement all the tools we can to build as quickly as we can to provide housing. This is a different approach to the MFTE that is a work in progress. Support having a third MFTE option to help developers make more units that are affordable for longer periods. Appreciate the consideration of our comments to include the value of existing improvements as eligible for the tax exemption and providing a clear path for conversion of nonresidential buildings to multifamily residential.

OTHER: Encouraged to see that this proposal preserves the 8 and 12 year programs that have been successful and added more than 1000 rent restricted units across the state in 2021 alone. Support the changes related to conversions and believe that they will increase the likelihood that adaptive reuse projects will participate in MFTE. Extending MFTE to include existing buildings will help convert more market rate units into work force housing bringing affordable units online quickly. Do have some technical suggestions to improve the language. Would like to see the bill provide MFTE to an existing buildings that dedicates 30 percent of units to households making 80 percent AMI or less which is a higher percent of units and deeper level of affordability than what is required for the current exemption for new construction. Encourage you to provide the exemption to buildings that are not older than 15 years to ensure that market rate units being converted into affordability are new units and align with the policy of the existing 12 year exemption. Signed in other on the underlying bill but understand that the sub does retain the 12 year as an option which we support.

Concerned that the proposed 99 year program will not be used by market rate developers because our evaluation indicates that the market rate project would have better returns than if the project were to participate in the 99 year tax exemption. Ask that the Legislature review the program to ensure that there are appropriate incentives for participation.

Supportive of local jurisdictions retaining the authority to tailor the MFTE program to best meet the needs of their communities. We continue to hear that MFTE is one of the more effective solutions to continue to provide affordable housing so we support the effort.

**Persons Testifying (Housing):** PRO: Mary Hull-Drury, Washington Realtors.

OTHER: Tim Cavanaugh, Urban Housing Ventures; Marc Angelillo, Urban Housing Ventures; McKenzie Darr, NAIOP Washington; Michael Ennis, Association of Washington Business.

**Persons Signed In To Testify But Not Testifying (Housing):** No one.

**Staff Summary of Public Testimony On Proposed Substitute (Housing) (Regular Session 2024):** *The committee recommended a different version of the bill than what was heard.* PRO: The goal is to encourage a broader variety of affordable housing types, particularly multiple bedroom units. Using the unit measurement has resulted in a lot of one bedrooms and our families need more. To achieve affordability we need to address capacity, drive down the cost of housing and be able to finance it. This MFTE bill meets two of those by making these units more affordable and attract investment by making it more financeable. Housing costs have not gotten better since last year. We've had a drop in 90 percent in starts for projects of 100 units or more in the Seattle area and think that is true across the state. We need all of the options available in order to address this problem and MFTE is an important component of that. This will help more nonprofits and hybrids to build more affordable units. When you look at the cost being given up under the exemption you get a 14 to 1 return in that investment.

CON: Concerned with the shift toward square footage because buildings have to become homogeneous and I think that requirement it may have the opposite effect. For example if a building has a penthouse with 5 bedrooms this would require a 5 bedroom affordable option which matters because the revenue generated for any unit in that building helps to inform the cost of that building so by generating more revenue from one penthouse unit will help create better furnishings in other units. Request a definition be added to clarify what square footage is and think it should be the net rentable square footage because variable interpretation could have a large impact. If other spaces are included then it would reduce the opportunity for participation in the program. MFTE works when the costs pencil out.

OTHER: Support the conversion language in the bill. Allowing residential buildings to be converted allows you to take urbanized areas already built out and create more affordability in those areas. Nonresidential conversions into affordable housing is another concept we are supportive of as it would add more supply to the market. There are many provisions in the MFTE bill that are similar to another bill that will be dropped and so we would encourage you to consider whether it should be handled via MFTEs or another mechanism.

**Persons Testifying (Housing):** PRO: Senator Patty Kuderer, Prime Sponsor; Robert Pantley, Natural and Built Environments; Angela Rozmyn, Natural and Built Environments.

CON: Morgan Irwin, Association of Washington Business; McKenzie Darr, NAIOPWA.

OTHER: Briahna Murray, Urban Housing Ventures.

**Persons Signed In To Testify But Not Testifying (Housing):** No one.

**Staff Summary of Public Testimony on First Substitute (Ways & Means):** PRO: The property tax exemption program helps address the significant need for multifamily housing. The requirement that 20 percent of housing units be set aside as affordable is enough for developers to recoup costs over the exemption period. The exemption allows developers to build more units in a timely fashion. The city of Portland recently passed a new tax exemption on their multifamily projects. Studies have shown that children who grow up in mixed income communities have a 31 percent higher average salary than those who are in 100 percent low-income housing.

**Persons Testifying (Ways & Means):** PRO: Robert Pantley, Natural and Built Environments; Angela Rozmyn, Natural and Built Environments .

**Persons Signed In To Testify But Not Testifying (Ways & Means):** No one.