

April 14, 2017

MEMORANDUM

To: Members of the Planning, Land Use and Zoning Committee
From: Aly Pennucci, Analyst
Subject: Incentive Zoning Audit

In May 2015,¹ Councilmember O'Brien asked the Office of City Auditor (OCA) to conduct a performance audit on the affordable housing requirements of the Incentive Zoning (IZ) program. The IZ program is a voluntary program under the Land Use Code that allows a developer to build larger buildings in exchange for providing certain public benefits, such as affordable housing, historic preservation, and open space, or making a payment in-lieu of providing those benefits. Specifically, Councilmember O'Brien requested that the OCA assess the following:

- The number and location of projects since 2006 that have elected to participate in the Incentive Zoning Program.
- Whether the affordable housing public benefit was accurately calculated and tracked over the course of the permitting process.
- Whether commitments to affordable housing benefits were adequately secured, how they were secured, and at what stage in the permitting process.

This memo provides background information, a summary of the audit and the response from the Seattle Department of Construction and Inspections (SDCI) and the Seattle Office of Housing (OH), and a discussion on next steps.

Background: *Why an Audit?*

The legislative branch is responsible for creating laws, confirming appointments for department heads, recommending and confirming appointments to certain boards and commissions, and providing oversight of the executive branch. The executive branch is responsible for carrying out the laws (and the judicial branch evaluate laws). Auditing is one of the ways the legislative branch fulfills its responsibility for oversight. Legislative review of the executive branch holds all parties accountable for transparent and efficient management of public resources.

Councilmember O'Brien requested this audit after discrepancies in the calculations of bonus floor area for a hotel development was brought to his attention; the amount of bonus floor is used to determine the required affordable housing contributions. This raised concerns about the process for review, implementation and oversight of the IZ program's affordable housing requirements and, overall, revealed a lack of transparency in the process. In addition, concerns were raised related to the decision-making and appeal process for development projects. The decision-making framework and appeal process, however, were outside the scope of this audit.

Audit Summary & Departments' Response

The OCA prepared a comprehensive report describing their findings, background on the IZ Program, a description of the methodology used for the audit, and their recommendations to address the findings (see Attachment 1). In addition, the report includes a detailed response from SDCI and OH.

¹ Though the request for an Audit was submitted in May 2015, it was understood that work on the audit would not be undertaken until 2016

In response to the findings and recommendations, SDCI and OH have acknowledged past mistakes or inconsistencies in the process and are working to address those issues. It is worth noting that projects that participated in the IZ program and were the subject of the audit represent a very small percentage of projects issued building permits between 2006 and 2016 (approximately .12%). Though this does not excuse the problems the audit revealed, it does provide some insight into the conditions that contributed to these problems given the infrequency that staff applied these requirements. More notably, this underscores that changes are necessary not only to improve the process for better implementation, monitoring and transparency for the IZ program, but are necessary for smooth implementation of the Mandatory Housing Affordability (MHA) program, where a significantly higher percentage of projects will be subject to an affordable housing requirement.

The OCA's report includes specific findings and 22 recommendations categorized into five areas: 1) Program Management Framework, 2) Internal Controls, 3) Oversight, Reporting, and Transparency, 4) Customer Service, and 5) Program Fees. For purposes of this discussion, the OCA's findings and recommendations, and the department's work plan, have been consolidated into three broader categories: A) Program Management and Internal Controls; B) Transparency, Reporting, and Customer Service; and C) Land Use Code Changes. The findings are summarized below followed by a brief description of key action steps included in the departments' workplan to address the findings and recommendations. See the full report included in Attachment 1 for more details on the OCA's findings and recommendations and Attachment 2 for the detailed workplan provided by the departments.

A. Program Management and Internal Controls

The audit revealed documentation and data discrepancies, missing contributions, late payments and inadequate systems in the application of the IZ requirements. The data discrepancies presented a challenge in identifying the projects that participated in the IZ program since 2006 and to verify the amount of extra floor area gained through IZ and the associated affordable housing requirements for individual projects. SDCI noted that the complexity of the Land Use Code requirements, and the rarity of projects subject to those requirements, contributed to these conditions.

In terms of missing contributions, the OCA identified two project that were subject to the IZ program requirements that had not fulfilled the affordable housing contribution prior to the permit being issued. One project was issued building permits in 2012 without making the required \$3.4 million affordable housing payment. After being informed by OCA about the missing payment, SDCI promptly contacted the developer and collected a \$3.76 million payment (including interest) in November 2016. This missing payment was the result of a staffing change at the end of a review process, and a lack of internal controls; these two issues have since been addressed. The second project had opted to provide affordable housing on-site. Following the findings by the OCA, the departments secured the necessary documents to ensure that the five affordable units valued at \$1.1 million, will be included in the project.

The recommendations in this area focus on a need for updated policies and procedures and stronger internal controls to improve department coordination, prevent payment and data errors, and ensure that requirements to provide affordable housing benefits are adequately secured. Key actions the departments have or will take include:

- **Process and Procedures (P&P) documentation & Memorandum of Agreement (MOA):** SDCI and OH will execute an MOA clearly documenting roles and responsibilities and the processes and procedures for each department. This is underway and expected to be finalized by the end of 2017.

- **New Permitting Software:** SDCI will launch a new permitting system (Accela) in 2017; this will allow for stronger internal controls to address errors in documentation, will prevent permits from being issued before affordable housing requirements are secured, and will facilitate better coordination between SDCI and OH. OH will be able to use Accela to track projects and confirm that affordable housing requirements have been met prior to permit issuance.
- **Oversight:** The department has already hired one supervisory level position to provide a secondary review of all projects required to make affordable housing contributions and plans to hire a project manager lead in 2017 to assist in the implementation of the MHA program and to implement the proposed improvements to the IZ program.

B. Transparency, Reporting, and Customer Service

The audit identified a lack of information and guidance available to project applicants, contributing to limited understanding of the program requirements. In addition, the audit highlighted insufficient reporting on the programs outcomes available to the public and policy makers. To address this, recommendations focus on providing better information through expanded reporting requirements and new resources for applicants. Key actions the departments have or will take include:

- **Expanded reports:** SDCI and OH have committed to developing program metrics and providing annual reports that will be publicly available.
- **New tools for applicants:** SDCI is developing new tools for applicants to explain the permit review process and how affordable housing contributions are calculated. In addition, they are standardizing the format for documenting the affordable housing requirements in plan sets and decision documents.
- **Enhanced web page:** SDCI and OH will expand and improve the web presence for the IZ and MHA programs. The webpages will include more information about the IZ and MHA programs, including the annual reports and tools for applicants.

C. Land Use Code Changes

The audit confirmed that the Land Use Code requirements for IZ are complex and confusing, contributing to calculation discrepancies, inadequate customer service and inconsistency in implementation. The OCA made several recommendations for specific land use code changes to address this. On further review by Central Staff, we concluded that several of those changes are not necessarily required for the departments to modify certain processes. However, there is agreement that the IZ code provisions would benefit from clarification. Further, the Department of Planning and Development (now the Office of Planning and Community Development and SDCI) previously started a process in late 2013 to update the IZ requirements to create consistent, and easier to understand rules. That work was put on hold to focus on MHA implementation. The key action that the departments will take to address these recommendations is to complete the update to the IZ code provisions. This includes evaluating changes to the City's method of annually adjusting the payment fee.

Next Steps

To monitor completion of the work plan and determine if additional actions are need, Councilmembers may want to consider the following:

1. Request that SDCI work with OH and OPCD to develop a specific timeline for completing updates to the Land Use Code requirements for the IZ program in 2017.
2. Request that SDCI and OH report back to the PLUZ Committee in September and again in March 2018, or an alternative future date, on the progress made completing the actions included in work plan. This report should demonstrate how new processes, procedures and other changes have improved transparency, customer service, consistency in the application of IZ and MHA requirements and any other identified outcomes resulting from the improvements.
3. Set specific due dates for annual reporting on IZ. This could be achieved by requesting that SDCI and OH include information on the IZ program in reports they are already required to prepare, such as those required by Ordinances 125108 and 125233 related to the MHA programs. This would include a list (by address) of projects that participated in the IZ program, the amount of payments collected under the payment option, the number and location of units produced with such payments, and the number of units constructed through the performance option. This could also include reporting on any appeals made related to those projects and the outcome of those appeals. Reporting on the IZ program has been required in the past but was previously put on hold until the update to the program was completed.
4. Related to both item 1 & 2, request the development of a public facing reporting tool to highlight projects that participate in the IZ and MHA program. This would expand on the website improvements proposed in the work plan by SDCI and OH. One avenue to achieve this would be expanding the capabilities of SDCI's [Shaping Seattle](#) map application that provides the locations and detailed information on active Seattle development projects that require Design Review. An expansion of this application could include providing information about all development projects beyond those subject to design review, with details showing the calculations and contributions made to affordable housing through MHA or IZ. Note that this would require new resources to support the technology implementation and ongoing maintenance.
5. Request that, as part of the proposed quality control measures, SDCI conducts a periodic review of a sampling of projects, after construction is complete, to verify that what was built matches the plans used to calculate any required affordable housing requirements.

Other concerns outside the scope of the audit

In addition to the actions to address the findings and recommendations resulting from the audit, additional work may be warranted to address the concerns that were outside the scope of the audit (decision-making framework and appeal process). As a starting point, councilmembers may want to request that SDCI provide a comprehensive list of permitting decisions that are not subject to a public notice or appeal process and any recommendations they have on modifications to rules about noticing and appeals. This information could be used to inform future policy decisions related to land use decisions. In addition, a review of the appeal process would be needed to better understand if changes are needed.

As an example of what future changes may look like, as part of the legislation to rezone areas in Downtown and South Lake Union, the Council modified the type of decision used to approve a combined lot development. When Councilmember O'Brien requested the audit on the IZ program,

concerns about developments that utilize the combined lot development² provisions in the Land Use Code were raised. Prior to the amendment made to the legislation described above, SDCI could approve a combined lot development as a Type 1 decision. Type 1 decisions typically involve less discretion, do not typically require a public notice, and the decision cannot be appealed. Type 2 decisions typically involve more discretion, a public notice is issued, and the decision is appealable to the Hearing Examiner.

A request for a combined lot development can only be approved if it results in a significant public benefit. Though the Land Use Code includes a list of potential public benefits, determining what constitutes a “significant” public benefit requires some discretion. Because there is discretion involved in approving a combined lot development, the amendment made this decision a Type 2 decision.

Attachments:

1. Audit of Seattle’s Incentive Zoning for Affordable Housing, April 13, 2017
2. Department Work Plan

cc: Kirstan Arestad, Central Staff Director
Dan Eder, Deputy Director
Ketil Freeman, Supervising Analyst

² In certain zones, lots located on the same block may be combined to allow development capacity from one lot to be used on one or more lots on the same block. This increases the total development capacity (i.e., floor area in the building) for the receiving lot and, in some cases, will reduce the amount of floor area that the project would otherwise be required to gain through participation in the incentive zoning program.