## MHA-R Payment Calculation

**How are the proposed in-lieu payment amounts calculated?**

Pursuant to the "Grand Bargain," there are two methodologies for calculating the in-lieu payment amounts: (1) a method that applies outside of Downtown and South Lake Union and (2) a method that applies inside Downtown and South Lake Union.

<u>Outside of the Downtown and South Lake Union Urban Centers</u>.

Outside of the Downtown and South Lake Union Urban Centers, in-lieu payments are proposed to be established based on costs associated with performance. Specifically, payments would be equal to the value of forgone revenue from market rate rent due to an inclusionary requirement (performance) plus a 10% surcharge to compensate the Office of Housing for transaction costs associated with developing units through the City's Notice of Funding Availability process. Generally, the fee would calculated as follows:

1. Determine characteristics, such as square footage, vacancy rate, and building efficiency for a prototypical residential unit.
2. Subtract rent affordable to a household earning 60% of area median income from market rate rent.
3. Value the forgone revenue stream using a capitalization rate (Cap Rate = Net Operating Income / Value).
4. Adjust that number by the 10% surcharge.
5. Reduce the value to a per-gross-square-foot cost based on the assumed average unit size.
6. Multiply the value of the forgone revenue stream by the performance percentage.

Key variables using this methodology are: (1) rents, (2) capitalization rate, (3) vacancy rate, and (4) median income, with the first two variables being the most sensitive.

The operative assumptions are a 5% vacancy rate, 5.25% cap rate, and rents adjusted based on CPI since July 2015, which was when the Grand Bargain was announced. For high cost areas, assumed rents are $3.04/gsf.

<u>Inside the Downtown and South Lake Union Urban Centers</u>

Inside Downtown and South Lake Union, payments would be calculated based on the cost of the current incentive zoning program. Generally, the fees would be calculated as follows for each Downtown and South Lake Union zone:

1. Determine characteristics, such as minimum and maximum Floor Area Ratio and site size for prototypical development in a given zone.
2. Multiply the current incentive zoning payment by the maximum extra residential floor area available through the incentive zoning program plus the floor area available through the increment of addition residential floor area added through MHA-R.
3. Divide that by the total residential floor area available through the base zoning, incentive zoning, and MHA-R to determine a payment amount per gross-square-foot.
4. Round that payment amount to the nearest $.25.

The Mayor is proposing payment and performance amounts that range from $5.55 - $13.75 and 2.1% - 6%, respectively. The payment amounts are derived using the current incentive zoning fee of $22.65 / square foot, which was increased from $22.35 / square foot in July to reflect an annual inflationary CPI adjustment.

**How might production under the MHA-R program change, if the Council adjusted different payment variables?**

This section explores how production might change under two scenarios:

- Scenario 1 – Using capitalized revenue methodology proposed for outside of Downtown to establish a payment of $12.80 in the Downtown and South Lake Union Urban Centers based on a 5% performance requirement.
- Scenario 2 – Same as Scenario 1 above, but assuming current market rents of $3.04/gsf, which would establish a payment of $14.20/gsf.

Using OPCD's assumptions for how growth downtown would be distributed among zones and uses, the changes under the two scenarios are summarized in the table below.

| Scenario | Downtown and SLU - Production ($ & Units) Assuming All Payment[1] |
|---|---|
| Mayor's Preliminary Proposal | $59,362,000 (773 Units)[2] |
| Scenario 1 ($12.80 / gsf) | $87,776,000 (1,097 Units) |
| Scenario 2 ($14.20 / gsf) | $97,376,000 (1,217 Units) |

[1] Unit production is derived assuming that the average per-unit City investment in an affordable unit provided through the payment option is $80,000, with the remainder of the investment coming from leveraged fund sources, such as federal tax credits.
[2] OPCD estimates that 742 units would be created through in-lieu fee payments and 31 units would be created through performance.