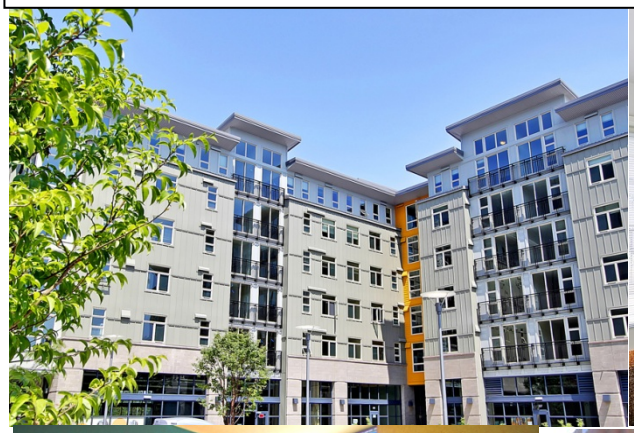
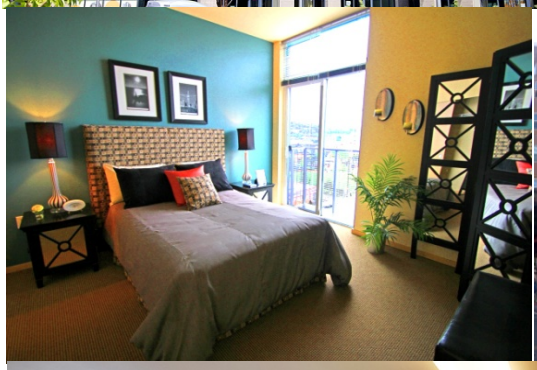
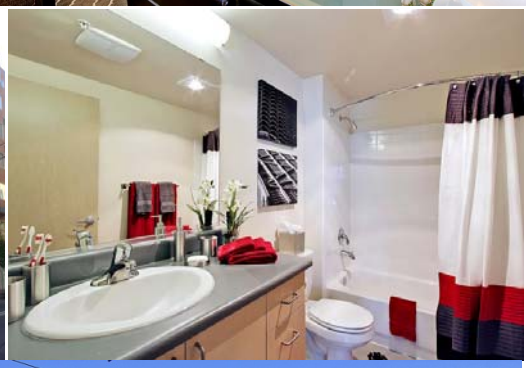
OFFICE OF CITY AUDITOR

City of Seattle Multifamily Tax Exemption Program

September 19, 2012







City of Seattle
Office of City Auditor

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City of Seattle
Office of City Auditor

September 19, 2012

City Councilmember Nick Licata
City of Seattle
Seattle, Washington 98104

Dear Councilmember Licata:

Attached is the report you requested on the Seattle Multifamily Tax Exemption Program, which is managed by the City of Seattle's Office of Housing. The primary objective of the audit was to determine whether the rental portion of the MFTE program met its goals.

The Office of Housing reviewed and provided feedback on drafts of this report. We have attached the Office of Housing's formal written response to this report in Appendix VII, and our comments on their response in Appendix VIII.

We would like to thank our intern, Shireen Deboo, for her contributions to this audit. We also appreciated the cooperation of the Office of Housing during the review process.

If you have any questions regarding this audit, please contact Virginia Garcia at (206) 684-8367, virginia.garcia@seattle.gov or me at (206) 233-1095, davidg.jones@seattle.gov.

Sincerely,

David G. Jones
City Auditor

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Introduction

At City Councilmember Nick Licata's request, the Office of City Auditor conducted a performance audit of the rental portion of the Multifamily Tax Exemption (MFTE) Program, which is managed by the City of Seattle's Office of Housing (OH).

We found that the City of Seattle (City) could improve its efforts to meet the goals stated in the MFTE ordinances that established and reauthorized the program. In addition, we offer recommendations for improving program compliance, administration and oversight. We have attached the Office of Housing's formal written response to our report in Appendix VII, and our comments on their response in Appendix VIII.

Program Background and Overview

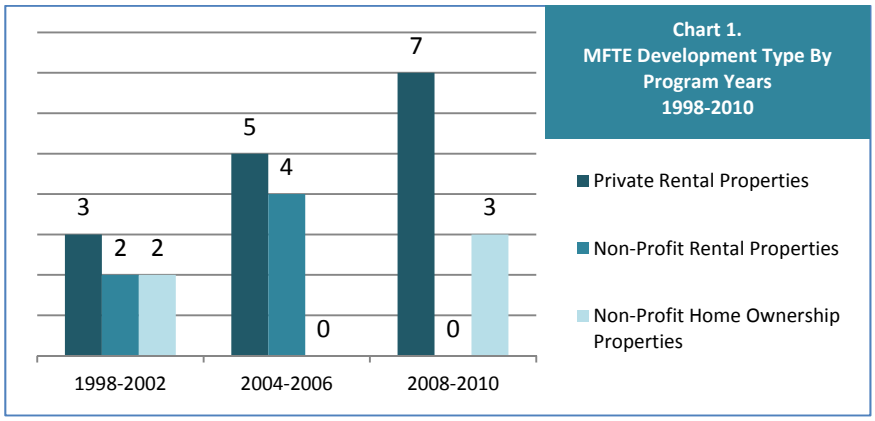
The MFTE program was created in December 1998 by Ordinance 119237 (codified in Seattle Municipal Code chapter 5.72) to provide an incentive for development and rehabilitation of both market rate and affordable rental properties and home ownership projects by granting to qualifying applicants a multi-year property tax exemption[1] on the value of residential improvements (i.e., not land or commercial areas in the building). In exchange for the tax exemption, rental property owners must rent at least twenty percent of their units to qualified tenants at a City-designated affordable rate during the time the property is receiving the tax exemption. Although properties were required to set aside at least twenty percent of their total units as affordable units, owners of eight rental properties receiving the tax exemption in 2010 promised to rent a greater percentage of affordable units.

Of the three possible types of developments that have occurred through 2010 in the MFTE program — 1) privately developed rentals, 2) rentals developed by non-profit organizations, and 3) home ownership condominiums developed by non-profit organizations — the program provided the largest number of tax exemptions to rental properties developed by private developers. As of 2010, during the program's 12 year life, 15[2] privately developed rental properties were receiving the tax exemption. Chart 1 below shows the number of properties developed by type of development and program year. As of 2010, all of the MFTE rental

[1] From the program's inception in 1999 until 2008, the tax exemption was for 10 years. In 2008, through Ordinance 122730, the City extended the tax exemption from 10 to 12 years.

[2] Two of the 15 rental properties (Welch Apartments and Charlestown Apartments) were jointly developed by private developers and non-profit organizations.

buildings were considered new construction (i.e., OH considered none of them to be rehabilitated buildings).



Source: Office of Housing and King County Department of Assessments

The 2010 tax exemption provided to the 15 privately developed rental properties totaled $1,793,177, with the City's portion of the tax exemption amounting to $573,534. The developers of these 15 properties promised the City that they would provide a total of 1,052 affordable units in exchange for the tax exemptions. This amounted to a 2010 total tax exemption of $1,705 per promised affordable unit, with the City's portion of the tax exemption being $545 per promised affordable unit[3]. Chart 2 below lists the privately developed rental properties that received the MFTE tax exemption in 2010, the number of total units in each property, and the number of affordable units the developers agreed to provide.

[3] The City does not forego this revenue. The revenue is provided through higher property taxes charged to other property owners in the City and State.

Chart 2. Privately Developed MFTE Rental Projects Receiving Tax Exemption in 2010 and Total and Affordable Units Promised		
Property	**Total Units**	**Affordable Units Promised**
Program Years 1998-2002		
1) Uwajimaya	176	46
2) Welch (private/non-profit)	90	52
3) Charlestown (private/non-profit)	7	7
Program Years 2004-2006		
4) 420 Yale	100	30
5) Alley 24	172	35
6) Weller	40	12
7) Yesler	132	27
8) Cambridge	140	140
Program Years 2008-2010		
9) 507 Northgate	161	49
10) 17th & Jackson	59	12
11) Linden 143	476	476
12) The Mural Apartments	136	28
13) Thornton Place	278	56
14) Pratt Park	244	50
15) Altamira Apartments	157	32
Total	**2368**	**1052**

Source: OH's 2010 Status Report to City Council

Since the enactment of Ordinance 119273, which created the MFTE program, the City Council has passed six ordinances modifying the program. The program's current nine goals as defined in Seattle Municipal Code 5.73.010 are to:

1. Encourage more multifamily housing opportunities.
2. Stimulate new construction and the rehabilitation of existing vacant and underutilized buildings for multifamily housing.
3. Increase the supply of multifamily housing opportunities within the City for low and moderate income households.
4. Increase the supply of multifamily housing opportunities in Urban Centers[4] that are behind in meeting their 20-year (2004 to 2024) residential growth targets, based on Department of Planning and Development (DPD) statistics.
5. Promote community development, affordable housing, and neighborhood revitalization in Residential Targeted Areas (RTAs)[5].

[4] An Urban Center is a compact identifiable district where urban residents may obtain a variety of products and services (RCW 84.14.010).

6. Preserve and protect buildings, objects, sites and neighborhoods with historic, cultural, architectural, engineering or geographic significance located within the City.
7. Encourage the creation of both rental and homeownership housing for Seattle's workers who have difficulty finding affordable housing within the City.
8. Encourage the creation of mixed-income housing that is affordable to households with a range of incomes in Residential Targeted Areas.
9. Encourage the development of multifamily housing along major transit corridors.

The MFTE policy goals identified in OH's annual MFTE 2010 Status Report to City Council were to:

- Help to make residential projects feasible in transitional urban villages with little market rate housing development, or
- Help to produce affordable units in market rate, mixed-use projects in urban centers or villages with more robust private developer interest and activity, or
- Assist with project economics for nonprofit housing that serves low and moderate wage working people but does not qualify for the State's low-income housing property tax exemption.

Because the ordinance goals were adopted by ordinance, and the goals stated in OH's status report were not, this audit focused on how the ordinance goals were met for the rental portion of the MFTE program. During the course of our audit, OH issued its 2011 Status Report to the City Council that stated the program's goals were the nine goals listed in Seattle Municipal Code 5.73.010.

Scope and Methodology

The focus of our review was to determine whether the rental MFTE properties developed by private developers met the ordinance-specified program goals. Specifically, we did the following:

- Reviewed City of Seattle and Washington state law (RCW Chapter 84.14) related to the MFTE program.
- Reviewed the City of Seattle's records retention policy.

[5] Residential Targeted Areas are areas in the City of Seattle within urban villages that the City Council has designated as eligible for the MFTE program. One requirement to qualify for the program is that the property must reside within a designated Residential Targeted Area.

- Reviewed City of Seattle policy and Washington state law (RCW 42.56.230) regarding public disclosure of public records.
- Conducted research on similar programs in other jurisdictions and reviewed audits of similar programs in different jurisdictions.
- Interviewed officials from low income housing non-profit organizations.
- Interviewed multifamily developers and property managers.
- Reviewed 27 MFTE program applications including 25 submitted from private developers and 2 submitted from joint private/non-profit developers.
- Reviewed MFTE annual property certification reports that had been submitted to OH by 16 developers and/or property management firms – from the first report for Uwajimaya in 2002 to Broadway's first report for 2010. Specifically, we reviewed 47 annual property certification reports submitted by the 15 rental projects receiving the tax exemption in 2010 and 1 in 2011. We did this to determine whether the program's target population of Seattle's workers and low and moderate income households was being served, and whether the properties complied with reporting and other program requirements such as providing the appropriate number of affordable units and charging the correct rent.
- Conducted 8 property site visits and viewed both affordable and market rate units.
- Obtained and compared income and rent verification documents from 81 units in 9 MFTE properties, including rental applications, rental leases, paystubs and income tax documents against information provided in the properties' 2010 MFTE annual property certification reports.
- Reviewed Office of Housing (OH) MFTE status reports to the City Council.
- Reviewed the contents of OH's MFTE project "blue" folders, which contained documents compiled after the MFTE application was approved (i.e., the documents required to receive a certification of tax exemption).
- Reviewed MFTE agreements between the City of Seattle and the developers that state the City agrees to provide the property tax exemption after the developer constructs a project and complies with various requirements outlined in the agreement.
- Reviewed OH Director's Rules related to the MFTE program.
- Reviewed OH's statistics and Dupre + Scott[6] data by neighborhood on where MFTE developments have occurred compared to where non-MFTE multifamily housing developments have occurred since each neighborhood became eligible for the MFTE program.
- Obtained and reviewed tax exemption information from the King County Office of Assessments to determine a MFTE affordable unit cost that included the total tax exemption for all property taxes and the City's portion of the property tax exemption.

[6] Dupre + Scott is an apartment market investment research and consultant firm. They conduct research on rental market trends and development activity.

- Obtained and reviewed Department of Planning and Development (DPD) permit information related to MFTE developments.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief/Findings and Recommendations

We concluded that the City could improve its efforts to achieve the program's ordinance goals and strengthen program compliance, administration, and oversight. Below is a summary of our findings and recommendations concerning program goals, compliance, administration, and oversight.

I) Program/Policy Goals: Ordinance goals are not prioritized, most lack performance targets and timeframes, and they are not linked to program requirements.

Recommendation

1) We recommend that the City examine the relevance, attainability, and measurability of each ordinance goal governing the MFTE program and when necessary, that it modify the goals to ensure they are measurable and achievable and have performance targets and timeframes. Applicable ordinance requirements and OH Director's Rules should be linked to achieving specific goals. OH should work to achieve ordinance goals, as stated in its MFTE 2011 Status Report to the City Council, rather than the three policy goals stated in the MFTE 2010 Status Report, which may conflict with the ordinance goals (see Appendix 1 for details about conflicts in goals).

II) Development Stimulation Goal: We found it difficult to determine whether the program had achieved its goal of stimulating construction of new multifamily housing. One previous ordinance requirement that could be used to indicate whether the project was stimulating new construction was whether property owners applied for the MFTE program before applying for and/or obtaining a master use, building, or construction permit.[7] We found that

[7] Ordinance 119237 required that the application to the MFTE program be submitted before the earlier of (i) an application for a master use permit or other land use permit under SMC Title 23, and (ii) an application for a building or other construction permit under SMC Title 22.

14 of the 27 MFTE applications we reviewed for rental properties had begun the application process for construction before applying for the MFTE program so it was not clear that the MFTE program stimulated this development.

Recommendations

2) The City should consider whether stimulating construction is an appropriate MFTE program goal, which can be measured and assessed for compliance.

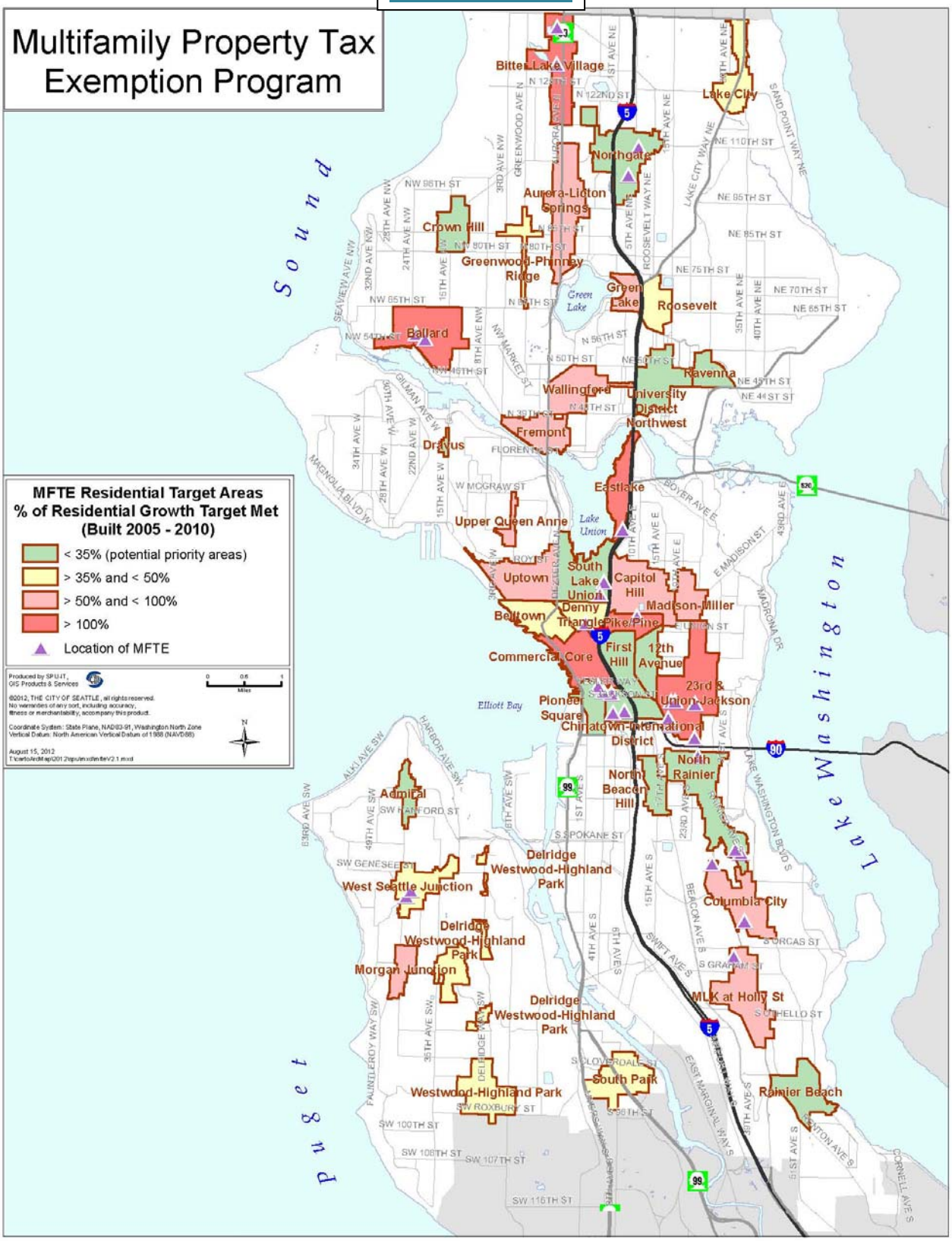
III) Goal to meet 20-Year Residential Growth Targets in Residential Targeted Areas: As of 2010, we found 9 of 39 Residential Targeted Areas without MFTE projects had achieved 35 percent or less of their 20-year (2004-2024) residential growth targets, while 4 target areas with MFTE projects had exceeded 100 percent of their growth targets. See Chart 3 below, a map of all MFTE projects that received a tax exemption in 2010.

Recommendation

3) The City should consider whether it wants to limit the number of Residential Targeted Areas where MFTE housing can be built to areas that have made little progress in meeting their residential growth targets and could benefit from housing, economic development and revitalization. For example, the City could limit the MFTE program to Residential Target Areas that have achieved 35 percent[8] or less of their residential growth target.

[8] The seven years from 2004 to 2010 are approximately thirty-five percent of the twenty-year residential growth target period (i.e., 2004-2024).

Chart 3.


Multifamily Property Tax Exemption Program
MFTE Residential Target Areas
% of Residential Growth Target Met
(Built 2005 - 2010)
< 35% (potential priority areas)
> 35% and < 50%
> 50% and < 100%
> 100%
Location of MFTE
Bitter Lake Village
Lake City
Northgate
Aurora-Licton Springs
Crown Hill
Greenwood-Phinney Ridge
Green Lake
Roosevelt
Ballard
Ravenna
Wallingford
University District Northwest
Fremont
Dravus
Eastlake
Upper Queen Anne
South Lake Union
Uptown
Capitol Hill
Madison-Miller
Belltown
Denny Triangle
Pike/Pine
Commercial Core
First Hill
12th Avenue
23rd & Union-Jackson
Pioneer Square
Chinatown-International District
North Rainier
North Beacon Hill
Admiral
Delridge Westwood-Highland Park
West Seattle Junction
Columbia City
Morgan Junction
MLK at Holly St
South Park
Rainier Beach
Sound
Lake Washington
Puget
Elliott Bay
Lake Union
Green Lake

IV) Goal to increase the supply of multifamily housing for low and moderate income households: The MFTE program tries to meet this goal by requiring that MFTE properties set aside at least 20 percent of their rental units for low and moderate income households. To this end, each ordinance has required that qualifying households earn a certain percentage (between 60 and 90 percent depending on the ordinance year and the size of the unit) of the Area Median Income (AMI). We identified several policy issues that the City could address to help ensure that the targeted population is being served.

Recommendations

4) If the City wishes to ensure that MFTE housing is provided to low and moderate income households only, we recommend that it consider requiring tenants of MFTE affordable units to re-qualify for their housing either annually or every two years. If a tenant no longer qualifies, the ordinance could require that the property owner provide another unit to a qualifying tenant at the required rental rate.
5) We recommend that the City improve, clarify, and document tenant eligibility requirements and income verification processes to ensure that the program is meeting its goal to serve Seattle's workers and low to moderate income households who have difficulty finding affordable housing within the City as specified by Area Median Income (AMI) requirements.

V) Program Compliance: We found cases of noncompliance with MFTE program requirements. We found noncompliance with requirements related to annual property certification reports that property managers must submit to OH. We also found properties not providing the required number of affordable units, properties charging too much rent for their designated affordable units, and properties with inadequate tenant income eligibility documents. In many cases we could not verify the accuracy of information property managers provided in their annual property certification reports to OH when we compared it with tenant applications for housing and tenant-provided income eligibility documents.

Recommendations

6) OH should conduct audits of the income verification documents submitted to the properties by tenants to determine if the annual property certification reports are accurate. Alternatively, OH could collect income verification documents from the property managers in addition to the annual certification reports so that it could verify the accuracy of the tenant income information contained in the certification reports.
7) OH should clarify its Director's Rule regarding verification of tenant income to specify what documentation is expected from the prospective tenant and the circumstances in which a residential screening report provided by property management is acceptable.

8) OH should establish and document a structured process to request corrective action from properties that do not meet program requirements (e.g., submitting annual property certification reports, providing the appropriate number of affordable units to the targeted population, verifying tenant income reported by property management on annual property certification reports) or impose various types of penalties (including withdrawal of the MFTE tax exemption).

VI) Administration and Oversight: We found several areas in the administration and oversight of the program that could be improved.

Recommendations

9) The City should eliminate requirements that do not serve to advance the program's goals, and simplify others to make program administration and oversight less cumbersome. For example, the requirement that properties submit a tenant application form for affordable units does not appear to serve any purpose and some properties met this requirement by submitting the tenant application for market rate units. Another example is requiring different sized units to qualify under different affordability levels. Rather than requiring studios to be affordable at or below 65% of Area Median Income (AMI), one bedroom units at or below 75% of AMI, and 2 or more bedrooms at or below 85% of AMI, the City should consider using the same affordability level to facilitate improved compliance, reporting and oversight of this requirement.
10) OH should increase the use of automation in the application, final certificate of tax exemption, and MFTE annual property certification report processes. For example, MFTE applications and applications for final certificates of tax exemption could be submitted electronically, so applications are deemed completed only when all the required information and documentation is provided. Electronic submission would also provide the actual submittal/completion date, which be compared with the issuance date of the building permit based on DPD electronic information rather than relying on the subjective interpretation of OH staff.
11) OH should clarify and update its status reports to the City Council, and report on actual data, if it is available, rather than estimates. This should include providing actual tax exemption impacts from the King County Department of Assessments, and the actual number of qualifying tenants living in affordable units.
12) OH should include in its status reports to the City Council information on the number of affordable units that remain vacant in each MFTE property for six months or more during the reporting year.

13) OH should standardize and automate the annual property certification report form used by property managers to report compliance with program rules regarding tenants, to facilitate the accurate, timely completion of the forms. Automating annual property certification reports with information provided by OH on income and rent maximums would improve their accuracy. Automated reports using a spreadsheet would facilitate comparing maximum rent and income levels to actual rent and income levels.
14) OH should improve program oversight by conducting independent audits or reviews of the MFTE application and final certificate of tax exemption processes to determine if they were in compliance with program rules.
15) The City should consider including language in Seattle Municipal Code Chapter 5.73 requiring OH to do periodic audits of the tenant income eligibility documents.
16) The City should modify its agreements with MFTE properties to extend the time that the properties are required to retain income eligibility documents from one year to six years from termination of the tenants' rental agreements. This will ensure that the agreements with MFTE properties are consistent with State law and the City's document retention schedule and document compliance with the City's MFTE program for six years rather than one year.
17) The City should consider charging an administrative fee to MFTE property owners to cover the cost of automating reports and improving program oversight.
18) As part of the MFTE annual property certification reporting process, property managers should provide the square footage and rents of their properties' affordable and market rate units. Using this information, OH should evaluate properties for compliance with the "substantially proportional to the configuration" element of the ordinance by ensuring that affordable units are substantially the same size as market rate units and that tenants of MFTE affordable units are not being charged more on a square footage basis than market rate units. Furthermore, the "substantially proportional to the mix and configuration" requirement should be clearly defined by ordinance.
19) OH should work with the King County Department of Assessments to ensure the correct properties in Seattle are receiving the correct amount of MFTE tax exemptions.

Appendix I.
Is the MFTE Program Achieving Ordinance Goals?

The MFTE program goals listed in City ordinances are not prioritized and most lack performance targets and timeframes; furthermore, they are not linked to program requirements.

When the City created the MFTE program in 1998 through Ordinance 119371 (Seattle Municipal Code 5.72), it identified seven program goals. Since that time the City Council has approved six additional ordinances related to the MFTE program. Most of the MFTE program goals stated in the ordinances remained consistent up to 2004 (See Chart 4 below for the goals approved by each ordinance). In the four ordinances approved since 2004, the City added two goals and modified two.

In addition to the ordinance-specified goals, three policy goals were listed in the Office of Housing's (OH) 2010 status report to the City Council; in its 2011 MFTE Status Report, which was issued in March 2012 during the later phase of our audit, OH did not list these three goals; they used the 9 ordinance goals. The three goals were to:

- Help to make residential projects feasible in transitional urban villages with little market rate housing development, or
- Help to produce affordable units in market rate, mixed-use projects in urban centers or villages with more robust private developer interest and activity, or
- Assist with project economics for nonprofit housing that serves low and moderate wage working people but does not qualify for the State's low-income housing property exemption.

We found several issues with these goals:

- Although the above three policy goals are found in OH's MFTE 2010 status report and may be recognized as informal goals for the program, they have not been approved by ordinance and have no official standing.

- We found that the three MFTE status report policy goals do not appropriately summarize the goals contained in the ordinances. Specifically, we found that the second OH MFTE status report policy goal, "Help to produce affordable units in market rate, mixed-use projects in urban centers or villages with more robust private developer interest and activity," may conflict with the City's long standing residential planning goals stated in several ordinances that are focused on encouraging development in areas where the City is behind in meeting its Growth Management Act (GMA) planning goals:

1) Ordinance 119237: Accomplish GMA planning goals in accordance with the City's Comprehensive Plan,
2) Ordinance 121415: Assist in accomplishing the planning goals required under the GMA, RCW chapter 36.70A, as implemented by the City's Comprehensive Plan, by increasing the supply of multifamily housing opportunities in urban centers that are behind in meeting their 20-year residential growth targets, i.e., areas that have met 25 percent or less of their 20-year residential growth target as indicated in the January 2004 update to Appendix 1 of the March 2003 Department of Planning and Development report "Monitoring Our Progress: Seattle's Comprehensive Plan"; and
3) The current goal in Ordinance 122730: Increase the supply of multifamily housing opportunities in Urban Centers that are behind in meeting their 20-year residential growth targets based on Department of Planning and Development (DPD) statistics.

We also found issues with the ordinance goals:

- We found two ordinance goals potentially conflict with one another. Specifically, the goal to promote community development, affordable housing, and neighborhood revitalization in all 39 Residential Targeted Areas, may conflict with the goal to increase the supply of multifamily housing opportunities in Urban Centers that are behind in meeting their 20-year (2004 to 2024) residential growth targets. Some Residential Targeted Areas have exceeded their growth targets and continue to draw private development with and without the MFTE. Allowing MFTE development in areas that have met or exceeded residential growth targets may draw MFTE development from areas in need of housing to meet their residential growth targets, enhanced community development and neighborhood revitalization.

- We found that most of the ordinance goals do not have associated performance measures. Because there are no performance measures it is difficult to determine whether or when certain goals are being achieved. Until now, there has never been an audit to determine if goals are being met.

- One ordinance goal that is difficult to measure is whether the MFTE program is stimulating construction of new multifamily housing. The requirements in the ordinances that appear to have been put in place to achieve this goal have been weakened since the program's inception, and exemptions have been allowed, so projects that would have not met this requirement and may have been developed without the assistance of the MFTE now qualify for the MFTE. This issue is addressed further in Appendix II.

Because the MFTE program results in a shift of the property tax burden from the MFTE property owners to other Washington State property tax payers, OH should be clear about how it intends to achieve the program's ordinance-defined goals. Requirements, rules, performance measures and timelines should be associated with each goal so there is clarity about how and when the goals will be achieved. When necessary, OH should also institute internal controls to ensure requirements are being met.

Recommendation

1) We recommend that the City examine the relevance, attainability, and measurability of each ordinance goal governing the MFTE program and when necessary, that it modify the goals to ensure they are measurable and achievable and have performance targets and timeframes. Applicable ordinance requirements and OH Director's Rules should be linked to achieving specific goals. OH should work to achieve ordinance goals, as stated in the MFTE 2011 Status Report to the City Council, rather than the three policy goals stated in its MFTE 2010 Status Report, which may conflict with the ordinance goals (see Appendix 1 for details about conflicts in goals).

Chart 4. Summary of Ordinance Goals			
Ordinance Year	**1998 (Ord. 119237)**	**2004 (Ord. 121415)**	**2008 (Ord. 122730)**
Goal 1	**Encourage more multifamily housing opportunities**	Same as previous ordinance	Same as previous ordinance
Goal 2	**Stimulate construction of new multifamily housing and the rehabilitation of existing vacant and underutilized buildings for multifamily housing**	Same as previous ordinance	Same as previous ordinance
Goal 3	**Increase the supply of multifamily housing for low and moderate income households**	Same as previous ordinance	Same as previous ordinance
Goal 4	**Accomplish Growth Management Act (GMA) planning goals as implemented by the City's Comprehensive (Comp) Plan**	**To assist in accomplishing GMA planning goals as implemented by the City's Comprehensive Plan by increasing the supply of multifamily housing opportunities in Urban Centers that are behind in meeting their 20 year residential growth target as indicated in the January 2004 update to Appendix I of the March 2003 DPD report - Monitoring our Progress: Seattle's Comp Plan**	**To increase the supply of multifamily housing opportunities in Urban Centers that are behind in meeting their 20-year residential growth targets, based on DPD statistics**
Goal 5	**Promote community development, affordable housing and neighborhood revitalization**	**Promote community development, affordable housing and neighborhood revitalization in residential targeted areas.**	Same as previous ordinance
Goal 6	**Preserve and protect buildings, etc., with significance**	Same as previous ordinance	Same as previous ordinance
Goal 7[9]	**Encourage additional housing in areas consistent with planning for LINK Light Rail by Sound Transit**	**To encourage the creation of both rental and homeownership "workforce housing," i.e., housing affordable to households earning between 60% and 80% of median income that would not otherwise be developed by the market in residential targeted areas**	**To encourage the creation of both rental and homeownership housing for Seattle's workers who have difficulty finding affordable housing within the City**
Goal 8	NA	**To encourage the creation of mixed-income housing that is affordable to households with a range of incomes in residential targeted areas**	Same as previous ordinance
Goal 9	NA	NA	**To encourage the development of Multifamily Housing along major transit corridors**

[9] The focus of the 7th goal has changed over time from encouraging additional housing in areas planned for light rail to specific demographics.

Appendix II.
Is the MFTE Program Stimulating Development?

One MFTE program goal is to stimulate construction of new multifamily housing. A requirement in the first ordinance governing the program that appears to have been directed at this goal was that applicants submit their MFTE application to the Office of Housing (OH) before applying for a master use or other land use permit under Seattle Municipal Code (SMC) Title 23, or an application for a building or other construction permit under SMC Title 22. However, over time this requirement was revised by subsequent ordinances to provide developers with greater latitude in applying for the program. To try to gain insight into the issue of whether the MFTE program has stimulated the construction of new multifamily housing, we compared the timing of developer applications to the program to when they applied for a master use, building or construction permit. We found that 14 of the 27 MFTE applications we reviewed for rental properties had begun the application process for master use, building or construction permits before applying for the MFTE program. Therefore, it was not clear that the MFTE program stimulated this development.

Background:

One constant goal in all of the ordinances passed since the program's inception has been to stimulate the construction of new multifamily housing. From the program's inception in 1999 until 2004 the ordinances sought to ensure that the MFTE would be used to stimulate new multifamily housing development rather than subsidize development that would have occurred without the MFTE. To this end, the ordinances included permit timing requirements. The initial ordinance required that developers first apply to the MFTE program before applying for master use, land use, building or construction permits. Over time, although the goal remained the same — to stimulate new development — the requirements became less stringent and developers could apply for master use, building or construction permits before applying for the MFTE as long as none of these types of permits had been issued or construction of the project had not been completed.

Findings:

- The ordinances' requirements that promote the goal to "stimulate new construction" have been weakened over time. Ordinance 119237, (1998) indicates that applicants should not have applied for master use, land use, building, or construction permits before applying to the MFTE program. In 2004, Ordinance 121415 allowed applicants to qualify for the program if they had applied for, but not been issued a building permit. Then in 2008, in Ordinance 122730, for applicants whose "first building permit" for the project

was issued between July 22, 2007 and August 6, 2008, MFTE applications would be accepted as late as before completion of project construction. These changes made the requirement more lenient, weakening the efforts to achieve the goal of having MFTE stimulate the construction of new multifamily housing.

- Developers had applied for construction permits before applying for the MFTE program in more than half (14) of the 27 MFTE program applications we reviewed (See Chart 5 below). This indicates that the City's MFTE application process did not ensure that projects receiving preliminary approval for the MFTE were projects that would not have occurred without the MFTE. Specifically:
    - In three properties we found that the "first building permit" had been issued for construction of the foundation, the garage, or the first two stories of a building before applicants submitted their MFTE application (see Chart 5 below). OH interpreted "first building permit" to mean the first building permit for the housing portion of the structure (i.e., not the foundation, garage, or the first two stories of a building). OH allowed these projects to apply to the MFTE program because the first permit for the housing portion of the structure fell within an exemption period allowed under Ordinance 122730. The definition of "first building permit" is open to different interpretations because it is not defined in the ordinance or in SMC Title 22.
    - The developer of one project had applied for a building permit before applying to the MFTE program, but Ordinance 119237 allowed this if the applicant had applied for permits before January 1, 1999. In this case, the developer had applied for a building permit in 1998. Under the ordinance applicants who applied for permits after January 1, 1999 had to apply to the MFTE program before applying for their building or construction permits.
    - Nine other applications met permit requirements under the less stringent requirements adopted in 2004 and 2008, but we found evidence that these projects were beyond the initial stages of planning. In 2004, through Ordinance 121415, the MFTE applicants who had applied for building permits before applying for the MFTE program could qualify for the program if their building permits had not been issued. For some of these projects, the applicants applied years earlier for a building permit. For other projects, the date of the MFTE application and the issuance date of the building permit were only days apart or occurred on the same day.

- In 2008, through Ordinance 122730, when the City Council changed the program's rules to extend the tax exemption from 10 years to 12 years, it also changed the permit timing rules so that developers who submitted the MFTE applications under the old rules and had already received building or construction permits could qualify under the 12 year exemption if they submitted a new MFTE application. For one project we found a copy of their initial MFTE application that was filed under the old rules and before they received a building permit. In this case, the first MFTE application was submitted before the issuance of the building permit, but the second application was submitted after permit issuance. This was permitted by Ordinance 122730. In addition, 9 additional projects were qualified under this ordinance, because their building permit was issued between July 27, 2007 and August 6, 2008.[10] For these 9 projects it is questionable whether the MFTE had a role in stimulating their development.

It is not clear that comparing the master use, building, or construction permit application or issuance timing to when the applicant applied for the MFTE program is a viable method for determining whether the project would have occurred without the MFTE. Because there are many things that need to be in place for a developer to move forward on the project, it is unclear how much of a role the MFTE played in the decision to develop or whether the project would have been developed without the MFTE. Another indication of whether developers needed assistance to develop a multifamily rental property in a residential targeted area may be if there was multifamily rental property development that occurred in the residential targeted area without the MFTE. We examine the non-MFTE rental development activity in Appendix III.

[10] According to OH, State law (RCW 84.14.020) changed, effective July 22, 2007, and invalidated continued use of the existing City program until such time as the City could pass new legislation to bring MFTE into conformity with State law. Ordinance 122730 took effect August 6, 2008 (30 days after the Mayor's signature), which created the July 22, 2007 to August 6, 2008 exception period under SMC 5.73.050 (D)(1). The exception allowed MFTE applicants who had previously applied to the MFTE program and developers who had not previously applied to the program to apply under the new rules as their building permits had been issued within the exception period and construction had not been completed.

Chart 5. MFTE Projects with Permit Timing Issues				
Ordinance	**Requirement**	**# of rental applicants**	**In compliance, but applied for permits before applying for MFTE program**	**DPD unable to verify permit issuance date**
119237 (in effect from 1999 to 2003)	--MFTE application shall be submitted any time before the application for a master use, land use, or building/ construction permit application. (SMC 5.72.050 D) --If, as of January 1, 1999, the applicant had applied for a (building) permit, then the MFTE application may be submitted any time prior to the issuance of the building permit (SMC 5.72.050 E)	3	1	0
121415 (2004)	Application shall be submitted before the date the building permit is issued. (SMC 5.73.050D)	3	1	0
121915 (2005-2007)	Application shall be submitted before the date the first building permit is issued. (SMC 5.73.050D)	5	0	0
122730 (2008)	For owners whose first building permit was issued between July 22, 2007 and August 6, 2008 the application shall be submitted prior to completion of construction of the Project. Owners who meet the foregoing conditions and have previously submitted an application for exemption or received a Conditional Certificate of Tax Exemption may reapply for exemption prior to completion of construction of the Project (SMC 5.73.050D.1). For all others, application shall be submitted any time before, the date the first building permit under SMC Chapter 22 is issued to the Owner for the Project (SMC 5.73.050D.2).	16	12	1[11]
Total	Rental Applications	**27**	**14**	**1**

Recommendations:

2) The City should consider whether stimulating construction is an appropriate MFTE program goal, which can be measured and assessed for compliance.

[11] We found one application for which the Department of Planning and Development was unable to verify the construction permit issuance date.

Appendix III.
Are Residential Targeted Areas Achieving Planned Residential Growth Targets?

This appendix provides information on the extent to which the MFTE program has helped the City achieve its Growth Management Act 20-year residential growth targets (2004-2024), and how much new multifamily housing development has occurred in the MFTE Residential Targeted Areas without the assistance of the MFTE program. For each targeted area we obtained information on the number of apartment units built since the neighborhood became an MFTE Residential Targeted Area, and the number of apartment units that have been built in that area without the assistance of the MFTE program.

The City could potentially do a better job of achieving more of its 20-year residential growth targets if it limited or prioritized the MFTE Residential Targeted Areas to areas that are struggling to meet residential growth targets, although this could detract from achieving other program goals, such as encouraging the creation of mixed-income housing that is affordable to households with a range of incomes in Residential Targeted Areas. See Chart 7 below, which is a map that shows how Residential Targeted Areas are doing in terms of achieving residential growth targets. To create this map, we used data from the Office of Housing's (OH) *2010 Status Report to City Council* on the percentage of the growth target being met. We also used information from Dupre + Scott, a firm that conducts research on the local apartment market, to determine the extent to which multifamily rental development was occurring without the MFTE in Residential Targeted Areas. From this data, we found that:

- As of 2010, 18 of the 39 Residential Targeted Areas (46%) had achieved 50% or more of their 20-year residential growth targets.

- As of 2010, 14 of 39 (36%) Residential Targeted Areas had MFTE housing (including private developments, non-profit developments, private/non-profit developments, apartment rentals and home ownership condominium) projects.

- Four (29%) of the 14 Residential Targeted Areas with MFTE housing exceeded 100% of the City's 2024 residential growth targets.

- Four of the 14 Residential Targeted Areas with MFTEs (29%) have achieved between 50% and 100% of their growth targets with 13 years left to achieve the targets.

- Of the 8 Residential Targeted Areas with MFTE developments that have achieved 50% or higher of their 20-year growth targets, 6 had other non-MFTE multifamily housing development occur during the same period that the MFTE was offered.

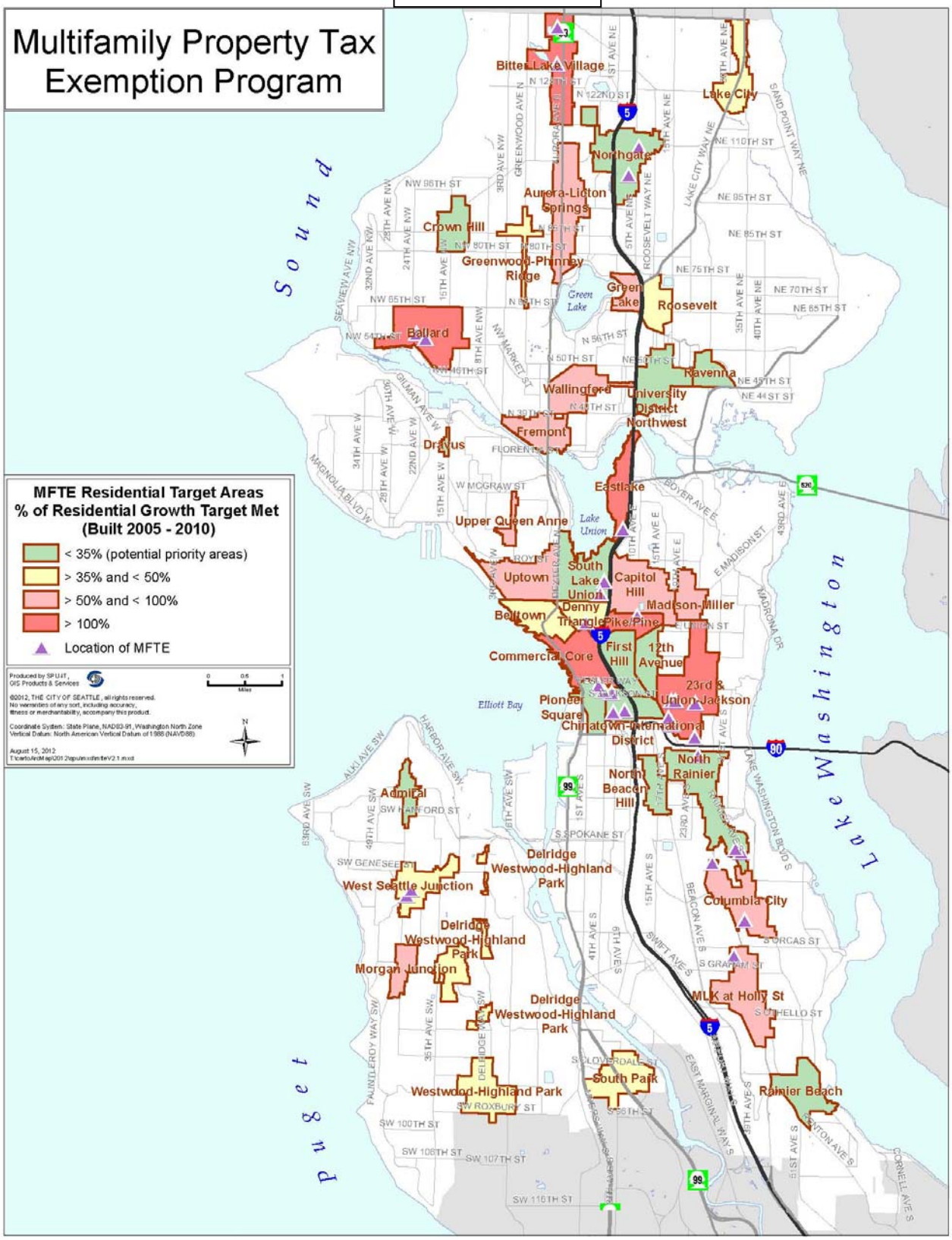
- Fourteen MFTE Residential Targeted Areas have achieved less than 35% of their 20-year growth targets as of 2010. Nine of these 14 Residential Targeted Areas have no MFTE housing located within their boundaries.

Chart 6. MFTE and Non-MFTE Development Before 2011

Number of Residential Targeted Areas (RTAs)	Number of RTAs with MFTE Development	Number of RTAs at 50% or greater of target*	Number of RTAs at 50% or greater of target without MFTEs	Number of RTAs with no MFTEs and less than 35% of target
39	**14**	**18**	**10**	**9**

*This includes four RTAs that are at 100% or greater of target.

Chart 7.


Multifamily Property Tax Exemption Program
MFTE Residential Target Areas
% of Residential Growth Target Met
(Built 2005 - 2010)
< 35% (potential priority areas)
> 35% and < 50%
> 50% and < 100%
> 100%
Location of MFTE
Bitter Lake Village
Lake City
Northgate
Aurora-Licton Springs
Crown Hill
Greenwood-Phinney Ridge
Green Lake
Roosevelt
Ballard
Ravenna
Wallingford
University District Northwest
Fremont
Dravus
Eastlake
Upper Queen Anne
Uptown
South Lake Union
Capitol Hill
Madison-Miller
Belltown
Denny Triangle
Pike/Pine
Commercial Core
First Hill
12th Avenue
23rd & Union-Jackson
Pioneer Square
Chinatown-International District
North Beacon Hill
North Rainier
Admiral
Delridge Westwood-Highland Park
West Seattle Junction
Columbia City
Morgan Junction
MLK at Holly St
South Park
Rainier Beach
Sound
Puget
Lake Washington
Elliott Bay
Lake Union
Green Lake

Recommendation:

3) The City should consider whether it wants to limit the number of Residential Targeted Areas where MFTE housing can be built to areas that have made little progress in meeting their residential growth targets and could benefit from housing, economic development and revitalization. For example, the City could limit the MFTE program to Residential Target Areas that have achieved 35 percent[12] or less of their residential growth target.

[12] The seven years from 2004 to 2010 are approximately thirty-five percent of the twenty-year residential growth target period (i.e., 2004-2024).

Appendix IV.
Policy Questions Concerning Increasing the Number of Affordable Units for the Target Population

We identified several policy issues that, if addressed, could improve the program's success in providing affordable housing to the targeted population. Because these are not compliance issues, we raise them as questions City policy makers could address.

The MFTE program tries to meet the goal of increasing the supply of multifamily housing for low and moderate income households by requiring that at least 20 percent of the rental units in MFTE properties be rented to these types of households at an affordable rent. To this end, each ordinance has required that qualifying households earn below a certain percentage (between 60 and 90 percent depending on the ordinance year and size of the unit) of the federal government's Area Median Income (AMI).

We identified the following questions that the City could address to help ensure that the targeted population is being served:

1) The assumptions found in the Office of Housing (OH) Director's Rule on maximum rent payments result in some tenants paying higher rent than is considered affordable according to the City's MFTE ordinances. This occurs because the OH Director's Rule assumes that one bedroom units will be occupied by two person households and two bedroom units will be occupied by three person households.

> ***Office of Housing Director's Rule***
>
> *...Income Eligible Occupants, together with an allowance for basic utilities that tenant pays directly and is not included in the monthly rent, may not exceed one-twelfth of 30% of the percentage of Median Income in accordance with SMC 5.73.040B. This amount shall be calculated as follows:*
>
> - *Adjust the Median Income, as defined in SMC 5.73.020, assuming a presumed average family size based on unit type. Presumed average family size shall be 1 person for a studio unit or 2 persons per*

According to the MFTE ordinances, "Affordable Rent means that the annual rent plus tenant paid utilities for the unit does not exceed thirty (30%) percent of Median Income designated by this chapter for qualifying units." Some MFTE households were paying higher than 30 percent of the AMI for rent because they were single persons renting one bedroom units or two-person households renting two bedroom units. For example, in 2010, a single person with income at 80 percent of the AMI in a one bedroom unit, as designated by the ordinance, should be paying one-twelfth of 30 percent of $47,950 (see Charts 8 and 9 below for 2010 AMI and maximum monthly rent information) or $1,199 in monthly rent. Instead, that tenant's monthly rent maximum is

$1,370, because OH assumes two people will be renting the one bedroom unit.

Chart 8. 2010 Area Annual Median Income Percentages								
Family Size	60%	65%	70%	75%	80%	85%	90%	100%
1 Person	$35,950	$38,950	$41,950	$44,950	$47,950	$50,950	$53,950	$59,900
2 Persons	$41,100	$44,500	$47,950	$51,350	$54,800	$58,200	$61,650	$68,500
3 Persons	$46,200	$50,100	$53,950	$57,800	$61,650	$65,500	$69,350	$77,050
4 Persons	$51,350	$55,650	$59,900	$64,200	$68,500	$72,750	$77,050	$85,600

Chart 9. 2010 Maximum Monthly Rent (including utilities) at Various Affordability Levels							
Unit Size	60%	65%	70%	75%	80%	85%	90%
Studio	$899	$974	$1,049	$1,124	$1,199	$1,274	$1,349
1 Bedroom	$1,028	$1,113	$1,199	$1,284	$1,370	$1,455	$1,541
2 Bedroom	$1,155	$1,253	$1,349	$1,445	$1,541	$1,638	$1,734

We found that the majority of the MFTE one bedroom affordable units were occupied by one person households, and that there were few instances in which two bedroom units were occupied by three people. This meant that these MFTE households were spending more than 30 percent of the designated affordability amount on rent. We found this to be true in 4 of 9 properties whose documents we reviewed, and on average it occurred in 24 percent of the units we reviewed. In these units, the tenants were paying an average of 45 percent of their income in rent.

Policy Question: Because some tenants are paying more than 30 percent of the City designated affordability amount on rent, should the OH Director's Rule be modified to better reflect the City Council's intent that rents be set at 30 percent of the monthly affordability level (including utilities) by assuming a more realistic tenant per bedroom occupancy rate?

2) Tenants have to qualify as meeting the MFTE affordable income criteria only "at the time of initial occupancy," i.e., on the first day of their tenancy. They never have to re-qualify for program housing even if their income level increases to a point at which it exceeds the affordable income category. We found such cases during our review of MFTE tenant income documents. There was a case in which a tenant gained a roommate and the combined incomes of both exceeded the income level defined as a low to moderate income household.

   Six of the eight property managers we interviewed stated that a tenant eligibility re-qualification process would be appropriate, manageable and/or they are currently re-

qualifying tenants. Property managers gave examples of tenants who applied with documents showing low temporary income or income as a student, but then subsequently their income rose significantly and yet they were still considered as meeting affordable income requirements (e.g., a medical school student starts earning a doctor's salary, or a new employee with an offer letter subsequently gets a large pay raise after a short trial period). Three property managers stated that a re-qualification process every two years would be manageable and preferable to an annual re-qualification process.
Policy Question: Should properties be required to re-qualify tenants on an annual or biennial basis to take such changing circumstances into account? If the tenant in an affordable unit no longer qualifies, should the property be required to offer another affordable unit for rent?

3) Some tenants of the MFTE affordable units are students who receive monetary gifts from parents. For example, one student had a letter from a bank stating that the student's father had $400,000 in the bank that could be used should the tenant fail to pay rent. In this instance, the student reported no income. The Federal Government's Low Income Housing Tax Credit Program does not allow students who are dependents of other individuals to participate in the program.
Policy Question: Should dependent students be considered qualified to live in MFTE affordable units when parents' income exceeds program income requirements?

4) Some properties allow applicants for the affordable units to use cosigners.[13] In such cases, if the cosigner's income were taken into account, the prospective tenant's income would exceed the program's income requirement. If a cosigner's income is not taken into account then the percentage of the applicant's income paid for rent tends to be significantly higher than 30 percent of income, which is regarded as an affordable amount of income to be spent on housing.
Policy Question: Should a cosigner's income be taken into account in determining eligibility for MFTE housing?

5) One tenant of an MFTE affordable unit owned a home valued at $400,000.
Policy Question: Should such tenant assets be taken into account to determine eligibility for MFTE housing?

Recommendations

[13] A cosigner is an individual who guarantees payment of the rent stated in a contractual agreement undertaken by another person by signing the contract along with that person.

4) If the City wishes to ensure that MFTE housing is provided to low and moderate income households only, we recommend that it consider requiring tenants of MFTE affordable units to re-qualify for their housing either annually or every two years. If a tenant no longer qualifies, the ordinance could require that the property owner provide another unit to a qualifying tenant at the required rental rate.

5) We recommend that the City improve, clarify, and document tenant eligibility requirements and income verification processes to ensure that the program is meeting its goal to serve Seattle's workers and low to moderate income households who have difficulty finding affordable housing within the City as specified by area median income (AMI) requirements.

Appendix V.
Some MFTE Properties Are Not in Full Compliance with Ordinance Requirements

At 13 properties we found instances of non-compliance with requirements concerning annual property certification reports provided to the Office of Housing (OH), the amount of rent charged, and tenant eligibility. We concluded that OH should improve its oversight of the program, and that the City's self-certification process used to verify tenant eligibility for MFTE affordable units is not effective. Chart 10 below summarizes the compliance issues we identified.

Chart 10. Non-Compliant MFTE Properties

Requirement (# of properties reviewed)	# of non-compliant MFTE rental properties
Submit annual property certification reports (15)	1[14]
Submit certification reports on time (15)	3
Date annual property certification report and sign certification of no building changes (15)	2
Annually rent required percentage of units at affordability level (based on certification reports only) (16)	8
Annual property certification report information matches information found in rental application, rental agreement and/or income documents used as evidence of income (9)	9

Findings:

Compliance Found in MFTE Applications

We examined 27 MFTE applications to determine their compliance with 17 requirements or criteria, including whether applicants met permit timing requirements, whether the projects were located within a designated Residential Targeted Area and met the ordinance-specified minimum number of units and square footage requirements.

- Except for a few minor instances, we found that applicants met the 17 application requirements.

[14] During our initial review of OH's MFTE files, we could not locate annual certification reports for three properties. Later, OH provided certification reports for two of the three properties. For one property the annual certification report was not yet due. For the second property, there were no dates for the missing reports that indicated when they were completed or submitted. OH was not able to locate the third property's report.

Non-compliance Found in Annual Property Certification Reports Submitted to OH
We reviewed annual property certification reports submitted to OH by the properties receiving the tax exemption to determine if the properties were meeting ordinance requirements and found the following:

- Six properties did not comply with annual property certification reporting requirements. Specifically, we found 3 reports were submitted late, one report was missing, and reports from 2 properties had no submittal dates, which meant we were unable to verify whether the reports were submitted timely.

- Eight properties did not meet their minimally required number of affordable units. Based on these results we conducted a more detailed comparison of statements in the annual property certification reports against documents provided by tenants, which is discussed in the next section.

- Although OH found instances of non-compliance during its reviews of annual property certification reports submitted by property managers, the City has never exercised its right to request reimbursement of the tax exemption when requirements were not met. Furthermore, the City does not have a process established to request reimbursement and impose penalties on non-compliant properties. OH's approach has been to work with the properties to reach compliance. However, we found instances of non-compliance despite these efforts.

- OH reviewed the annual property certification reports to ensure that the properties contained the same proportion of affordable studio, 1 bedroom and 2 bedroom units compared to the total number of those units in the entire building. We also found evidence that when properties were not providing a proportional number of market rate and affordable units by number of bedrooms, OH requested evidence of corrective action from the properties, but did not impose any penalty.

Non-compliance Found in Review of Tenant Documentation
After reviewing the annual property certification reports and finding instances of non-compliance, we compared the information contained in the 2010 annual property certification reports to rental applications, rental leases, and income verification documents for a random sample of 20% of the required affordable units in 9 rental properties (8 that received the tax exemption in 2010 and 1 in 2011) and found the following:

- OH did not verify the contents of the annual property certification reports by comparing them to source documents maintained by the property managers. OH relies on property managers to submit accurate annual property certification reports that assert their compliance with program rules. Property managers are not required to submit evidence of tenant income eligibility to OH. We found that at the time of our audit OH had never reviewed documents to determine if what was contained in the annual property certification reports was accurate.

- For 9 properties we compared their 2010 annual property certification report information with the documents used to determine a tenant's income eligibility and rent to verify whether what the properties reported could be substantiated. We reviewed tenant documentation for 81 units on the 9 properties. Specifically, we found:
    - Four units from 2 properties in which the tenant income stated in the documents exceeded the affordable income level;
    - Three units from 2 properties in which the rent charged to tenants exceeded the rent maximum;
    - Outdated, conflicting, or missing documentation to support statements contained in annual property certification reports at the 9 properties; and
    - The documents for some units did not provide valid evidence of tenants' income. In some of these instances we found property managers relied upon income information self-reported by the applicant.

  Because of these issues, we found we were not confident about the validity of the information provided in the annual property certification reports about tenant income and rent. Chart 11 below provides a breakdown of our findings.

Chart 11. Affordable Units Reviewed with Findings

	Number of Units	Number of Properties
Number of units with inconsistencies between annual property certification report, rental application, and/or income documents used as evidence of income	41	9
Number of units that exceeded income eligibility levels	4	2
Number of units that exceeded rent maximums	3	2

- Most MFTE projects have designated affordable units (as opposed to having any unit serve as an affordable unit). Some will switch a market rate unit to an affordable unit if they do not have a sufficient number of affordable units. In the Uwajimaya property, any

unit could have been an affordable unit, which helped them regularly meet their required number of affordable units.

- For one MFTE property, we found that the evidence used to verify the income of prospective tenants for affordable units consisted of what is known as "residential screening reports" prepared by a private firm hired by property management. These reports provide information about a prospective tenant's employment, residential, criminal, and credit history; however, the private firm attempts to verify only the income self-reported by the tenant. The management of the MFTE property relied on these reports rather than the types of evidence cited in OH Director's Rule 5-72-003. According to this Director's Rule section 4 (Income Documentation), examples of appropriate documentation include items such as two consecutive recent pay slips, copies of tax returns from the last two years, a copy of a Social Security award letter or any other award letter (disability, pension, etc.). These types of documents are ones that would have to be provided by the prospective tenant. According to OH, a residential screening report can be used to determine a prospective tenant's income when other forms of documentation are not available. In some cases, the residential screening reports for the MFTE property noted that the tenants' income could not be verified and that property management should verify income with paystubs from the prospective tenants. Residential screening reports should not be relied upon to verify prospective tenants' incomes if other forms of documentation are available, such as paystubs from local employers.

Recommendations

6) OH should conduct audits of the income verification documents submitted to the properties by tenants to determine if the annual property certification reports are accurate. Alternatively, OH could collect income verification documents from the property managers in addition to the annual property certification reports so that it could verify the accuracy of the tenant income information contained in the certification reports.
7) OH should clarify its Director's Rule regarding verification of tenant income to specify what documentation is expected from the prospective tenant and the circumstances in which a residential screening report provided by property management is acceptable.
8) OH should establish and document a structured process to request corrective action from properties that do not meet program requirements (e.g., submitting annual property certification reports, providing the appropriate number of affordable units to the targeted population, verifying tenant income reported by property management on annual property certification reports) or impose various types of penalties (including withdrawal of the MFTE tax exemption).

Appendix VI.
MFTE Program Administration and Oversight Needs Improvement

We found that the administration and oversight of the MFTE program could be improved in certain areas. We reviewed the documents for rental properties associated with three different processes: 1) the initial MFTE application process for developers, 2) the final certificate of tax exemption that developers need to obtain, and 3) the annual property certification reports submitted by MFTE property managers to OH. In addition, we reviewed OH's MFTE Status Reports to the City Council (2003, 2007, 2010, and 2011), conducted site visits to MFTE properties, and met with King County Assessor's Office officials to determine whether the appropriate properties were receiving the tax exemption. Based on our review, we identified the following areas for improvement:

1) Review of MFTE Project Applications

OH does a comprehensive review before approving an MFTE application. With the exception of a few minor instances, we found that applicants met MFTE requirements. In 2011, the City changed the application process by eliminating the City Council from the approval process. This change was made after the State law governing the MFTE program was changed to allow jurisdictions to approve applications through an administrative process. Because this change occurred recently, we did not evaluate the merits of one process over the other. However, while this change simplified the process, the additional level of review formerly provided by the City Council and its Central Staff is now gone.

Below are findings from our review of 27 MFTE rental applications:

- The current MFTE developer application process is mostly a manual/paper process that could be improved by increased use of electronic documents. During our review of the MFTE applications we found instances in which it was unclear when OH considered the application to be completed. If MFTE applications were submitted electronically, OH could develop an application template that would require applicants to provide all required information before it would be accepted by OH. An electronic application template could also compare the date the form was received by OH with the DPD building permit issuance date so that OH staff would not have to rely on interpreting hard copy records to determine if applicants met MFTE permit timing requirements.

- OH could do a better job of maintaining documentation that provides evidence of compliance with program requirements. We encourage OH to scan copies of documents received and use electronic methods of saving applicants' paperwork.

- We found OH could improve its processes for ensuring all required documents were submitted and filed in the project folders.

- We found that the property owners' preliminary budgets, which before 2011 were required as part of the owners' MFTE project applications, did not appear to serve any useful purpose. OH has not used them to determine eligibility requirements or to determine whether projects met the program's goal to stimulate new construction.

2) Review of Properties that Received A Final Certificate of Tax Exemption

After construction of an MFTE project and before the City notifies King County that the property should receive a tax exemption, the applicant must fulfill a number of requirements. If these requirements are met, the City grants the MFTE applicant a Final Certificate of Tax Exemption. The first year of the tax exemption occurs the year following the year that the certificate is issued. Starting one year after the City files the Final Certificate of Tax Exemption with King County, property owners are required to submit to the City annual property certification reports that demonstrate compliance with tenant income and maximum rent requirements. These reports are certifications by the property owners or their representatives, such as property managers, that they are complying with program requirements.

We reviewed 21 project folders of constructed projects to determine whether applicants met the City's requirements for receiving the Final Certificate of Tax Exemption. We found that evidence in the project files intended to demonstrate compliance was inconsistent and in a few instances missing. For example, some developers submitted the required detailed statements of project expenditures, while others only provided the total project cost. We found one instance of partial completion and two of no completion of expenditure statements. In addition, the files for 15 properties did not have copies of checks for the required $150 processing fee payment to King County, although there were notations in the files for 5 properties that checks had been submitted. Finally, although properties were required to submit a copy of their market rate rental application and an affordable housing application, 9 properties' files did not contain copies of the affordable housing application and one had neither.

3) Review of MFTE Annual Property Certification Reports:

As a result of our review of the annual property certification reports submitted by the MFTE rental properties and interviews with property managers, we identified several potential issues related to the annual property certification report forms:

- Automated versions of the reports would facilitate easier and more accurate identification of discrepancies and simplify any audit work in this area.

- For some reports, the year in the annual property certification report heading did not correspond with the year of the report.

- Sometimes the information in the annual property certification reports used to document compliance with income maximums and rent maximums was incorrect.

- We found inconsistencies in how the forms were completed by property managers:

    - Some reports did not include the utilities paid by the tenants to demonstrate that the tenant paid less than 30 percent of the applicable percentage of the Area Median Income (AMI), which should include utilities. Given that the cost of utilities is part of the affordability standard established in the OH Director's Rule for the MFTE program, property managers should complete the cost of utilities field.

    - In some reports, units that were filled with qualifying tenants for six months or less were counted as affordable the entire year. Some reports included tenant information for two different tenants, only one of whom qualified, that occupied the same unit during different times of the same year. In some of these instances, the qualifying tenant only occupied the unit six months or less. In other example, the report listed one qualifying tenant occupying the unit for six months or less, but that unit was considered affordable the entire year. In these instances, it was not clear whether the units were empty the remainder of the year or occupied by non-qualifying tenants.

- One property manager was confused about how to complete the annual property certification report form and noted there are no instructions on how to complete it.

- Some property managers were confused about the program's rules, and requested training on them. Some also requested that the City provide easier access via the internet to information about the program and its rules.

- The City's MFTE agreements with property owners require that the property owners keep and allow the City access for audit purposes to the income documents tenants submit as evidence of their income for one year after the contract with the tenant has terminated. Although some properties kept pre-2010 documents of tenants who had vacated the units, they were not required to provide the City access to the documents. Consequently, we evaluated the tenant income records against the annual property certification reports for the tenants who were residing in the affordable unit at some point in 2010. We could not determine the level of compliance for pre-2010 annual property certification reports for tenants who moved out in 2009 or earlier.

- In 2011, OH made changes to the annual property certification report form, including changing the due date so that all the properties' reports were due on the same date. According to OH, this was done to facilitate the oversight and review of the reports.

4) 2010 OH Status Reports to the City Council

During the later phase of our audit, OH submitted its 2011 MFTE Status Report to the Seattle City Council, which we believe contains better information than previous reports. However, because the City Council may have relied upon the OH 2010 Status Report to City Council to make policy decisions, we wanted to note some issues with that report.

- OH reported on the number of affordable units that property owners agreed and promised to provide, including vacant units, rather than the actual number of units filled by eligible tenants at the appropriate rent. This could be interpreted to mean that every MFTE unit is filled with eligible tenants for majority of the year. Based on our review of the annual property certification reports and our sampling of tenant eligibility documents, we found that not all units were filled with eligible tenants and several affordable units were vacant the entire year. For example, two properties that promised to provide 100 percent of their units at the affordable level to eligible tenants had some tenants in affordable units that did not meet income requirements. However, these properties met the ordinance requirement to rent at least 20 percent of their units at affordable rents.

- OH does not provide information in its annual reports to the City Council on the number of affordable units that are vacant the entire year or occupied by eligible households for

less than six months. For example, in one property 47 percent of the affordable units were empty for six months or more, while in the second property, 40 percent of the affordable units were empty for six months or more. This information is important because if affordable units remain vacant for extended periods of time, this could indicate one or more of the following: affordable units are priced too high, low demand for affordable units, or insufficient marketing.

- The estimated tax impacts reported were based on outdated developer estimates rather than actual information that was available from the King County Department of Assessments. OH stated that they did not provide information on the actual tax impacts because in 2010 the King County Department of Assessments did not provide this information on-line. Attachment D to the 2011 Status Report to City Council reports actual tax impacts of exemptions for completed projects. However, in Attachment E, OH continues to provide estimated cumulative tax impacts for completed projects based on developer estimates at the time of application even when the actual exempt residential improvement value for some of the listed projects was provided in Attachment D.

5) Addressing the "Substantially Proportional to the Configuration of Total Units" Requirement

Starting in 2000, through Ordinance 120135 the City added a requirement that MFTE affordable housing units shall be substantially proportional to the configuration of the total housing units in the project. In 2004, through Ordinance 121414, the City modified the ordinance to read that the mix and configuration of MFTE affordable housing units shall be substantially proportional to the mix and configuration of the total housing units in the project. OH has interpreted this requirement to mean that the number of studio, one bedroom and two bedroom units (i.e., the mix of units) had to be proportional to the total number of studio, one bedroom, and two bedroom units in the MFTE property. OH evaluated the MFTE properties against this requirement from the information provided in the MFTE annual certification reports submitted by the properties. While we believe OH's interpretation addresses the "substantially proportional to the mix" element of this requirement, it does not address the "configuration" element of the requirement, which we interpret as pertaining to the size and shape of the unit.

During the course of our review of MFTE annual certification reports we found instances in which the mix of units (studio, one and two bedroom units) were not proportional to the total units. In these cases, we found that OH would notify the properties of the need to bring the property into compliance with this requirement. However, during our site visits, three property managers indicated that some of their MFTE affordable studio units were

smaller than market rate studio units. Specifically, during our site visits we found the following:

- OH had not conducted site visits to any of the properties to determine if they were meeting the substantially proportional requirement, and the Department of Planning and Development does not attempt to verify this during their review of submitted documents and inspection of properties.

- In three buildings (i.e., Thornton Place, Cairns, and Broadway) the square footage of some MFTE studio units was smaller than their market rate counterparts. After testing, we did not conclude that these properties were charging more per square footage for affordable units than market units. However, we are concerned that future properties may charge more per square footage for affordable units than market rate units and believe OH rules should address this element of the requirement.

6) Verifying MFTEs with King County

We reviewed information provided by the King County Department of Assessments to attempt to verify whether the list of properties and starting dates of Seattle's MFTE properties matched King County's records. We were able to verify that the 15 privately developed rental properties were receiving the MFTE in 2010. However, issues with King County property tax data resulted in the following:

- King County could not provide us with an automated summary report from their system to show which Seattle properties were receiving a MFTE and the year the exemption started. As a result, we could not verify whether properties in Seattle were receiving the MFTE when they were not entitled to it.

- King County's on-line property tax system (eReal Property) and information from OH files related to Seattle's MFTE properties did not always match. For example, OH records showed the start date of the exemption for one property as being 2005 while eReal Property showed the start date as 2004. In two other cases the parcel number for a property did not match.

- King County's manually-generated summary report of the properties receiving the City of Seattle's MFTE contained some erroneous information. For example, for two properties King County listed the incorrect beginning date for a property receiving the MFTE.

Recommendations

9) The City should eliminate requirements that do not serve to advance the program's goals, and simplify others to make program administration and oversight less cumbersome. For example, the requirement that properties submit a tenant application form for affordable units does not appear to serve any purpose and some properties met this requirement by submitting the tenant application for market rate units. Another example is requiring different sized units to qualify under different affordability levels. Rather than requiring studios to be affordable at or below 65% of Area Median Income (AMI), one bedroom units at or below 75% of AMI, and 2 or more bedrooms at or below 85% of AMI, the City should consider using the same affordability level to facilitate improved compliance, reporting and oversight of this requirement.

10) OH should increase the use of automation in the application, final certificate of tax exemption, and MFTE annual property certification report processes. For example, MFTE applications and applications for final certificates of tax exemption could be submitted electronically, so applications are deemed completed only when all the required information and documentation is provided. Electronic submission would also provide the actual submittal/completion date, which be compared with the issuance date of the building permit based on DPD electronic information rather than relying on the subjective interpretation of OH staff.

11) OH should clarify and update its status reports to the City Council, and report on actual data, if it is available, rather than estimates. This should include providing actual tax exemption impacts from the King County Department of Assessments, and the actual number of qualifying tenants living in affordable units.

12) OH should include in its status reports to the City Council information on the number of affordable units that remain vacant in each MFTE property for six months or more during the reporting year.

13) OH should standardize and automate the annual property certification report form used by property managers to report compliance with program rules regarding tenants, to facilitate the accurate, timely completion of the forms. Automating annual property certification reports with information provided by OH on income and rent maximums would improve their accuracy. Automated reports using a spreadsheet would facilitate comparing maximum rent and income levels to actual rent and income levels.

14) OH should improve program oversight by conducting independent audits or reviews of the MFTE application and final certificate of tax exemption processes to determine if they were in compliance with program rules.

15) The City should consider including language in Seattle Municipal Code Chapter 5.73 requiring OH to do periodic audits of the tenant income eligibility documents.
16) The City should modify its agreements with MFTE properties to extend the time that the properties are required to retain income eligibility documents from one year to six years from termination of the tenants' rental agreements. This will ensure that the agreements with MFTE properties are consistent with State law and the City's document retention schedule and document compliance with the City's MFTE program for six years rather than one year.
17) The City should consider charging an administrative fee to MFTE property owners to cover the cost of automating reports and improving program oversight.
18) As part of the MFTE annual property certification reporting process, property managers should provide the square footage and rents of their properties' affordable and market rate units. Using this information, OH should evaluate properties for compliance with the "substantially proportional to the configuration" element of the ordinance by ensuring that affordable units are substantially the same size as market rate units and that tenants of MFTE affordable units are not being charged more on a square footage basis than market rate units. Furthermore, the "substantially proportional to the mix and configuration" requirement should be clearly defined by ordinance.
19) OH should work with the King County Department of Assessments to ensure the correct properties in Seattle are receiving the correct amount of MFTE tax exemptions.

Appendix VII.
Office of Housing Response to Report

City of Seattle
Office of Housing

August 22, 2012

David Jones, City Auditor
Office of City Auditor
PO Box 5429
Seattle WA 98124-4729

Dear Mr. Jones:

The Office of Housing appreciates the opportunity to provide an agency response to this audit. We have worked closely with the Auditor for well over a year, and especially intensively over the past three months, to interpret a large volume of data.

The Multifamily Family Tax Exemption Program (MFTE) is one of the few tools the City has to encourage development of housing affordable to moderate-wage workers – those residents who don't qualify as low-income earners, but who are increasingly priced out of the Seattle real estate market. It does not take away from our efforts to help low-income earners. Rather, by securing the affordability of some units that would otherwise be priced at market levels, it ensures that those people who make too much to qualify for subsidized housing, but too little to afford market-rate housing, are not forced out of Seattle.

We welcome the Auditor's recommendations, especially given the MFTE program's importance. We believe that many of the recommendations will help OH strengthen the program and further its success in ensuring affordability and an active residential development market. Our goal is to run the best program possible, and many of the Auditor's 19 recommendations will help us improve the program. Of those recommendations, we believe that up to nine would likely require Council action, as their implementation would extend beyond the Executive's authority under existing Code. Three of those nine address program goals and six of the nine address rules governing the program. It appears that the remaining ten recommendations are wholly administrative in nature and could be implemented without Council action; however, significantly more complex administrative procedures could have impacts on staffing levels and fees levied on participating developers.

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An equal employment opportunity, affirmative action employer.
Accommodations for people with disabilities provided upon request.

Recommendations: Program Goals

Implementation of the first three recommendations, all of which address aspects of the program's existing Council-approved goals, would clearly require Council action. The Executive is especially interested in ensuring that the MFTE program creates meaningful public benefits in exchange for the tax exemption, and any conversation regarding the program goals should carefully consider strategies to further this outcome.

We caution that some of the Auditor's comments appear to treat the two principal thrusts of the MFTE program – stimulation of residential development in general, and provision of affordable units in particular – as either/or options rather than co-equal objectives. In particular, the Auditor's concern that allowing MFTE projects in higher-growth areas can draw development away from slower-growth areas implies that spurring development in weaker real estate markets is of higher priority. Yet often the higher-growth areas are those in which creating affordable units is most critical.

Recommendations: Program Rules

Recommendations 4, 15, 17, and elements of recommendations 5, 9, and 18 propose actions that would likely require Council action. Many have merit, though we note that some (such as annual or biennial reconfirmation of tenant eligibility) present both administrative and programmatic feasibility challenges that would need to be addressed. We note that OH cannot implement many of the recommended actions without Council direction.

Recommendations: Program Administration

A third batch of related recommendations (6, 7, 8, 10, 11, 12, 13, 14, 16, and 19) propose OH actions that would tighten administration of the program. We fully concur that program is now substantial enough to warrant more streamlined and more rigorous administrative processes. We plan to review current procedures and evaluate options for new procedures. Of particular import, in our opinion, will be the institution of periodic site visits to independently monitor compliance.

Despite our commitment to retooling elements of the program's administration, we believe that the report overstates the frequency and extent of non-compliance. Discrepancies between source documents and annual reports account for the bulk of the Auditor's compliance-oriented findings. These discrepancies signal the need for a vigorous monitoring program, but in most cases do not evidence actual non-compliance. Certain of the other cases cited by the Auditor as compliance issues (e.g., an undated annual report) are clearly problematic, but again, do not suggest that taxpayer resources were misapplied or used for anything other than their intended purpose.

That said, we acknowledge that the Auditor's findings clearly signal the need for stronger administrative practices. OH will revisit program objectives and supporting Code language; assess existing administrative rules and retool them as necessary; establish a monitoring

protocol; revamp in-house workflows (including, potentially, greater automation to the extent feasible); and establish more regular communications with the King County Assessor's Office to ensure that all parties concur on the MFTE exemption amounts and each property's status in the program.

We take these findings very seriously, and look forward to working with others within the Executive branch, as well as Councilmembers. We very much appreciated the Auditor's professional and collegial approach to this audit, and look forward to productive conversations between the Executive and Council regarding the MFTE program's fundamental goals as well as the best methods for ensuring that the City achieves those goals.

Yours truly,

Rick Hooper

Rick Hooper
Director

Appendix VIII.
Office of City Auditor Comments on Office of Housing Response to Report

We appreciate the Office of Housing's (OH) response, which can be found in Appendix VII, to our Multifamily Tax Exemption (MFTE) Program report. We would like to address two comments in OH's response.

First, OH stated that we have interpreted some of the Program's goals as either/or options rather than co-equal objectives. This audit does not draw conclusions about the relative importance of one goal over another.

Second, OH concluded that the level of non-compliance that we found is overstated. Based on a limited sample, we found non-compliance with requirements in each of the 9 properties whose documents we compared against the annual certification reports submitted by property management to OH. We believe this indicates compliance with and oversight of the Program's requirements needs to be improved, and that non-compliance may be more pervasive than we were able to document.

We believe OH should do more to better ensure that the MFTE properties are renting the minimally required percentage of affordable housing units. The MFTE program offers a substantial tax break to developers in exchange for providing affordable housing. This benefit is paid for by distributing the cost across all other property tax payers. We believe this demands the strictest level of compliance with the program's requirements, and performance measures that demonstrate that the program's goals are being achieved.