A Regional Coalition for Housing

Celebrating 30 years of bringing cities together to house East King County

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MEMORANDUM

To: ARCH Executive Board

From: Rent Policy Work Group

Date: July 3, 2023

Subject: Rent Policy Recommendation for Local Affordable Housing Programs

Background

In February of 2023, A Regional Coalition for Housing (ARCH) formed a volunteer working group to assist with developing a rent policy recommendation for local affordable housing programs. ARCH has supported member jurisdictions in East King County with the design and administration of these programs for many years, including programs that provide land use or tax incentives to market rate developments that set aside affordable units, as well as a Trust Fund program that invests funding in affordable developments. Under most program regulations, affordable rents are set each year based on the rate of change in the Area Median Income or "AMI", which is published by the U.S. Department of Housing and Urban Development (HUD).

This policy process was initiated by the ARCH Executive Board in July of 2022, following a 16.3% increase in the HUD AMI for the Seattle region that led to significant rent increases within members' affordable housing programs. The Board directed staff to conduct a robust stakeholder process, and established the following objectives for the policy:

- Reduce the trend toward increasing cost burden among renters of affordable units
- Provide greater predictability for tenants and owners
- Create regulations that support financial feasibility based on common underwriting standards among investors and lenders
- Minimize administrative burden for property managers and ARCH to oversee compliance
- Avoid unintended consequences

A wide range of stakeholder outreach was conducted in the fall of 2022, including focus groups with developers, property managers, nonprofits and tenant advocates. The work group was then formed with the purpose of aligning diverse stakeholders around a preferred ARCH recommendation and refining the proposal to address stakeholders' concerns.

Options Considered by Work Group

The following policy options were discussed by the work group, along with comments collected on each option through prior outreach. These options were presented by ARCH staff and initially identified through researching models used in other affordable housing programs. Stakeholders were also invited to generate other options, or discuss variations on these options.

1) **HUD Section 8 Limits.** Adjust rents based on changes in income limits for the HUD Section 8 program, or the Multifamily Tax Subsidy Program (MTSP) limits.
2) **Tenant-Based 3.0% Cap.** Limit individual tenant's rent increases to 3.0%, but allow unit rents to re-set to maximums based on the HUD medium income at turnover. This policy was adopted for Bellevue's MFTE program in 2021. (See Attachment B, Example Code Language.)
3) **Program-Based 4.5% Cap.** Adjust all program rent limits annually up to a cap of 4.5%. This policy was adopted for Seattle's MFTE Program 6 in 2019.
4) **Other Program Floor/Cap.** Program rent limits could be adjusted based on combining other floors or caps, such as a 2% floor or 5% cap, provided that limits would not exceed those based on the HUD median income.

Options that were not available for consideration by the stakeholders, as they were discussed in other settings and rejected, included maintaining the status quo, setting rents based on 30% of actual tenant income, and establishing an approval process for rent increases based on annual evaluation of properties' financial information against established criteria. The latter option has shown promise in other states, but would require significantly more administrative capacity to implement at the local level. The first two options were discussed by the ARCH Board after the first phase of feedback from stakeholders and determined to fall short of the established objectives for the policy, so these were not presented to the work group for consideration. Some work group members still expressed a preference for these two options, as described in Attachment C.

Initial Recommendation: Tenant-Based Cap

Among the options 1-4 above, a majority of the work group indicated the **Tenant-Based 3.0% Cap** as the preferred policy for balancing the needs of tenants and owners and creating greater overall stability and predictability within local affordable housing programs. However, while some members supported setting the cap at 3.0% cap based on alignment with Bellevue's MFTE program, as well as historic averages in CPI and AMI growth, there was no consensus on 3.0% being the right percentage cap. Further discussion of alternatives to 3.0% is described below.

Overall advantages of a tenant-based cap include:

- Tenants will have relatively stable housing costs and be able to plan ahead for their financial future, helping to limit involuntary economic displacement. This is especially true with a fixed cap, but even a graduated cap could increase stability, if the range of potential increases was limited.
- The policy could help contribute to longer tenancies and reduced expenses associated with turnover/eviction.
- Owners will be able to re-set rents as new tenants move in so that long-term unit rents still follow the HUD AMI. In addition, the policy has the effect of allowing owners to "bank capacity" or spread out annual increases/decreases at a more consistent and predictable pace. An example is shown below to illustrate this concept.

	% HUD AMI change	% Adjusted AMI change	HUD 80% 1BR rent	Adjusted Rent
Year 0			$ 2,154	$ 2,154
Year 1	7.7%	3.0%	$ 2,320	$ 2,219
Year 2	4.8%	3.0%	$ 2,432	$ 2,285
Year 3	0.3%	3.0%	$ 2,440	$ 2,354
Year 4	-3.0%	0.6%	$ 2,368	$ 2,368
Year 5	1.4%	1.4%	$ 2,400	$ 2,400
Year 6	6.7%	3.0%	$ 2,560	$ 2,472

In year 1 and 2, the HUD AMI change is greater than 3%, creating a bank of capacity that the property can apply to its rent increases in years 3 to 5, when the HUD AMI change is less than 3%.

If the cap was set at 3.0%, it would have the benefit of aligning with regulations that have been adopted in some East King County cities that require longer notice periods for rent increases above 3.0%. Because increases would never exceed 3.0%, no extraordinary notice requirements would apply, but both tenants and owners could still plan far in advance of future increases.

It is important to balance the advantages with the disadvantages. The developers in the work group expressed concern that, while a 3.0% cap was set on the Bellevue MFTE program renewal in 2021, the 3.0% cap was based on a historic trend in the HUD AMI increases over the last 20 years, and there is risk that the low inflationary environment of the last 20 years may not persist in future years. If current high inflationary trends continue, the result may be that banked capacity cannot be utilized during the term of tenancy. Operating expenses, including in particular property taxes and insurance, could grow at a faster rate than capped affordable unit rent increases, creating a significant financial risk for the building owner over time. Accordingly, a 3.0% cap may not be a high enough cap in the future, particularly for programs such as on-site incentive zoning or inclusionary zoning covenants with significantly longer program time horizons than the 8 or 12-year term of MFTE programs.

Graduated Cap and Other Alternatives to 3.0% Cap

Accordingly, developers in the work group presented a solution that could address these concerns, with a “graduated cap” proposal. This cap would move between 3% and 9% per year, based on the difference between a resident’s current rent and the then-current AMI-adjusted rent at lease renewal. This would provide the flexibility needed to respond to potential longer term shifts in inflationary trends:

Rent increase Limits:	
Difference between resident’s current rent and applicable current HUD AMI-based program rent	Renewal rent may be Increased a maximum of:
Less than 5%	3%
Greater than 5%	4%
Greater than 10%	5%
Greater than 15%	6%
Greater than 20%	7%
Greater than 25%	8%
Greater than 30%	9%
Greater than 35%	The greater of a) 9% or b) an increase to a new rent equal to 35% below current HUD AMI-based program rent

Some work group members found this to be a creative and promising concept that allowed the cap to respond to a dynamic environment, but other comments and concerns were also expressed, including:

- The wide range of increases up to 9% does not create enough stability for renters.
- The proposal loses the benefit of predictability for tenants to plan for increases.
- The multiple tiers are complicated and likely be difficult to explain to tenants. Use of terms like “HUD AMI-Based Program Rent” will also be a confusing term to explain.
- The complexity of the policy will create increased workload for property managers and compliance staff.
- With staff turnover on the property management side, compliance could be challenging since it requires greater record-keeping and referring back to prior years’ records.
- Tying increases to AMI does mitigate longer-term concerns about operating costs, however AMI is not necessarily always linked with operating costs.
  - *Note: increases in AMI have historically outpaced CPI in the Seattle region.*

To further explore potential areas of consensus, ARCH staff collected comments from the work group on potential variations of the graduated cap, however no one specific policy emerged as the top preference for the entire group. A summary of these options and comments provided is shown below:

Alternative Proposal	**Comments**
Apply the simple 3% cap, but add the minimum floor that rises with HUD AMI (e.g., cap may never be less than 35% below HUD AMI rent).	Some preference for this proposal, but not unanimous. Developers expressed concerns it does not do enough to mitigate high inflation.
Apply a simple cap of 4% or 5%.	Some preference for this proposal, but not unanimous. Similar to the 3% cap, it is easier for mangers to implement and for residents to understand, but less risk of not keeping up with inflation. Policy could be amended to allow owners to request higher increases up to 8% or 9% if certain financial conditions are met, demonstrating that the property is performing poorly and at risk (ex: prior year operating deficits, primary DSCR below 1.05 or 1.10, etc.). If these were objective measures with a high bar for poor performance, staff impacts would be limited. Even with higher cap, may still not be enough to mitigate high inflation.
Apply a graduated cap with fewer tiers – for example, a 3%, 4% and 5% tier.	Some preference for this proposal, but not a first preference for anyone. Could have support of developers if the tiers go up to 6%, and the “floor” ensures the cap is no less than 15% of HUD AMI rent (rather than 35% in the original proposal) Similar to above, policy could be amended to allow owners to request higher increases if certain financial conditions are met.
Clarify the soft cap so it is forward looking to the following year’s rent increase (i.e., maximum increase for following year is based on the difference between the tenant’s rent and HUD rent in the current year). This gives tenants more time to plan.	No significant support for this – concern that it would be more difficult for property management to manage/implement and for residents to understand.

The work group is supportive of developing better affordable housing strategies through incentives which align all parties' interests. Given that our region is in a housing crisis and additional development is required to address housing needs at all levels of income spectrum, it is prudent to document the financial risk associated with any proposed policy. A well-calibrated program should not disincentivize new development and/or participation in the program, whether it is an optional incentive or a requirement of development. To minimize unintended consequences, developers suggested that jurisdictions considering implementation should work with local developers to ensure that any impacted program is appropriately calibrated to the unique development conditions of that locality. This may include increases in AMI levels or other modifications, similar to how Bellevue recently updated its MFTE policy, in order to achieve housing production and/or affordability targets. Other work group members expressed that any further policy development should also make sure to capture the voices and interests of renters.

Applicability

Work group members discussed that the scope of its recommendation should initially apply only to affordable units produced through local incentive programs, where affordable units are a minority of the total units in a given project and covenants are typically only required to satisfy local rules and regulations, as compared with projects that are 100% affordable and often subject to multiple federal, state and local financing regulations. For publicly financed projects, the work group supported ARCH deferring any a recommendation until such time as a coordinated policy proposal can be advanced among the relevant public agencies. If a higher cap was proposed for those projects, some work group members expressed that the number be applied to incentive projects as well.

In addition, this policy would not apply to existing projects with already executed covenants, or projects already under development and with submitted MFTE, land use or building permit applications, unless those projects elected to opt in. This policy will not apply until individual jurisdictions proceed with appropriate code updates to facilitate implementation.

Additional Policy Recommendations

Work group members acknowledge that no policy option could perfectly address the interests of all stakeholders, but some refinements can be made to ensure a more successful outcome. Specifically, the work group recommends the following:

- ARCH should create clear and accessible guidelines and compliance tools for property managers, and consider a naming convention to distinguish properties subject to the revised policy (for example, Program 2)
- The policy should be expanded to ensure that tenants have the right to renew their lease so long as they remain in compliance with their existing lease agreement. Cities

should include this in their affordable housing covenants, but make sure that owners retain their typical rights to convert properties to other uses.

- ARCH should establish appropriate regulations for annual tenant requalification.
- After three (3) years of the policy being in effect, ARCH should conduct an evaluation to identify any unintended consequences or potential improvements that need to be made. The evaluation should seek to understand:
  - Whether the policy has in fact helped promote greater housing stability among affordable housing tenants
  - Any increased administrative burden of overseeing compliance (for both properties and ARCH cities)
  - Whether properties have been able to operate with sufficient income to keep up with the growth in property expenses
  - A comparison of trends in key benchmarks, including the HUD AMI, Consumer Price Index and Social Security COLAs.
  - Participation rates in areas with voluntary programs
  - A holistic policy review at the jurisdictional level in each jurisdiction to evaluate potential incentives or code changes that could be made to encourage new development in areas with mandatory program and/or increased participation in voluntary programs. Jurisdictions implementing the cap should have a sunset date for the policy so that there is an action forcing mechanism to evaluate its success and impact on the pipeline of housing production.

  If this evaluation demonstrates any unintended consequences, ARCH should recommend a coordinated update to the policy across its member jurisdictions. Any recommended change or update would not affect projects with executed covenants.

In addition to the areas of consensus reflected in the above recommendation, some members of the work group expressed additional comments that did not generate a clear consensus or were beyond the scope of the work group's purpose. These additional comments are shown in Attachment C to help capture the nature of the discussion.

Given the variety of comments and potential concerns, the workgroup recommends that the range of proposals generated by the work group, including a simple tenant based cap as well as alternative graduated caps, be considered with a larger variety of stakeholders.

Conclusion

Producing, operating and maintaining safe, quality housing that is affordable to people of different incomes is a shared goal of all members of this work group. The work group thanks the ARCH Executive Board for the opportunity to share risks and opportunities associated with this policy and strike the right balance between the needs of many housing stakeholders.

Attachments

A. Rent Policy Work Group Members
B. Example Code Language
C. Additional Discussion / Comments Not Included in Recommendation

Attachment A

Rent Policy Work Group Members

Name	Organization/Company
Eric Amado	Thrive Communities
Nathaniel Aquino	Housing Justice Project
Andrew Calkins	King County Housing Authority
Amy Cubbage	Imagine Housing
Angel DeAsis	Greystar
McKenzie Darr	Grand Peaks
Amy Kangas	Housing Justice Project
Brad Machat	Quarterra
Brandon Morgan	Vulcan Real Estate
Kyle Pierce	King County Housing Authority
Tram Tran-Larson	Housing Justice Project
Steve Yoon	Mill Creek Residential Trust

Attachment B

Example Code Language

BCC 4.52.095 Rent Stabilization

For the duration of any exemption authorized under this chapter, any rent increase for any existing tenant remaining in the same affordable unit, or in a similar type of affordable unit (e.g., very small dwelling unit, studio, one-bedroom, two-bedroom, etc.) within the same project, shall not exceed three percent in any given year as described herein:

> *A. When the King County median income increases by more than three percent in a given year, the project shall be permitted to increase affordable rents up to three percent that year.*
>
> *B. When King County median incomes increase by three percent or less in a given year, the project shall be permitted to increase affordable rents by (1) the amount of the corresponding increase in median income; or (2) three percent, to allow the project's affordable rents to begin to catch up with King County median income calculations after having been capped due to conditions set forth in subsection A of this section. Under no circumstance may affordable rents exceed the current King County median income calculation.*

The provisions of this subsection shall not apply to new tenants that move into affordable units, or existing tenants who move into a different type of affordable unit. In such an event, the rent and income qualifications shall be calculated based on the current, applicable King County median income at the time a lease agreement is executed. (Ord. 6582 § 14, 2021.)

Attachment C

Additional Discussion / Comments Not Included in Recommendation

The following table includes additional comments from work group members that go beyond the scope of the group's recommendation. These are intended to help capture the broader discussion.

Topic	*Comment*
Eviction protections	One work group member offered that broader eviction protections be considered. For example, landlords in properties financed with Low Income Housing Tax Credits (LIHTC) may evict tenants and refuse to renew their lease at the end of the lease term only for good cause.
Additional development incentives	One work group member suggested that cities should consider offering additional development incentives when requiring this new policy to help alleviate any concerns over potential costs.
Emergency declarations	One work group member expressed that any policy could become problematic if there is a future emergency declaration or other circumstance that leads to another moratorium on rent increases, such as the one established during the COVID-19 pandemic.
Notice of rent increases	While the current policy aligns with existing local notice requirements, some work group members expressed concern about future regulations of rent increase notices, expressing for example that a blanket 180 day notice requirement could be problematic when paired with the variable timing of HUD data releases.
Adjustment of 3.0% in executed covenants	Work group members discussed the idea of adjusting the cap in an existing property based on future economic trends, such as if long-term inflation trends were to continue. However, work group members did not achieve a consensus on what the adjustment would be based on or how it would be implemented, given the significant diversity in properties' financing and operations. Others expressed that certainty at the outset of the agreement would be the most important consideration, and a fixed rate would be easier to explain to project investors and underwriters.

Preference for options not considered.	Stakeholders wished to note a preference for options that were removed from consideration by the ARCH Board. Specifically, private developers in the work group indicated that maintaining the status quo would be preferrable to making any changes. In addition, during meetings with tenant stakeholders there was a unanimous preference for setting rents based on actual tenant incomes.