

TO: Mayor and City Council
THROUGH: Steve Powers, City Manager
FROM: Courtney Knox Busch, Strategic Initiatives Manager

SUBJECT: Middle Housing Incentives

Ward(s): All Wards
Councilor(s): All Councilors
Neighborhood(s): All Neighborhoods
Result Area(s): Welcoming and Livable Community

ISSUE:

Consider incentives to encourage development of middle housing options like townhouses, duplexes, triplexes, quadplexes, and cottage clusters.

RECOMMENDATION:

Information only.

SUMMARY:

The City of Salem is required by State law to comply with House Bill 2001 and its associated rules to allow middle housing – townhouses, duplexes, triplexes, quadplexes, and cottage clusters – on land zoned for single-family detached dwellings by June 30, 2022. The rules also require the City to consider methods to increase the affordability of middle housing through ordinances and policies, including:

- Waiving or deferring system development charges
- Adopting or amending criteria for property tax exemptions
- Assessing a construction excise tax

The City is not required to adopt any method, but consideration of them must occur by the time the City updates its zoning code to comply with HB 2001. Staff is seeking City Council direction as to whether any of the methods above should be pursued and will return to a future meeting with additional analysis on estimated costs of the incentives of interest. Staff plans to bring forward a code amendment that includes proposed changes to implement HB 2001 later this summer.

FACTS AND FINDINGS:

HB 2001 and its associated rules specifically require consideration of at least the three following methods to increase the affordability of middle housing. Staff has provided information about all three below.

System development charges

System development charges (SDCs) are one-time fees assessed on new development, new use or increase in use of a property, to address impact created by new development and cover a portion of the costs of providing certain types of public capital facilities. SDCs apply to new construction, redevelopment of an existing use and residential projects, all of which may increase the impact to City infrastructure. Oregon law 2017 ORS 223.297-223.314 provides for establishment of SDC fees for transportation, water, wastewater (sewer), stormwater, and parks and recreation facilities. In Salem, SDCs are calculated based on the type and number of dwelling units for parks, vehicle trips for transportation, water meter size for water and sewer, and impervious surface area for stormwater.

The City must consider waiving or deferring system development charges (SDCs) for middle housing, which the State defines as duplexes, triplexes, quadplexes, cottage clusters, and townhouses. SDC policies are established in Salem Revised Code Chapter 41, Administrative Rule 109-200, and a methodology adopted by Council under Resolution No. 2019-7. SDCs are calculated based on type and number of dwelling units for parks, vehicle trips for transportation, water meter size for water and sewer, and impervious surface area for stormwater. New developments have a negative impact on these infrastructure systems even when their SDCs are waived or deferred.

Currently, the City provides an SDC exemption to any rental or owner-occupied housing unit that is affordable to households with an income at or below 80 percent of the area median income. Rental housing must include a deed restriction to maintain affordability, and the developer of owner-occupied housing must demonstrate that the owners “do not have a financial incentive to sell the housing unit for profit within less than 20 years after the housing unit is completed and occupied.” The City modified this exemption in 2019 to incent development of affordable housing.

While this exemption applies to middle housing that is considered affordable, it could be extended to middle housing – or specific forms of middle housing – that is not at the affordable housing rates. The exemption would lower the cost of developing middle housing. It would not, however, guarantee that the middle housing that is created would be more affordable to the person who ultimately rented or bought the housing unit.

Current policies distinguish between single family and multi-family uses. Single family is charged at a higher rate per unit for parks and transportation. Duplexes are charged at the single-family rate, and larger complexes are charged at the multi-family rate. If the City charged duplexes at the multi-family rate, SDCs for duplexes would be reduced by roughly \$4,000 for each duplex. This type of change would apply broadly to residential properties across Salem, as duplexes will be allowed on any property that is at least 4,000 square feet in the Residential Agriculture (RA), Single Family (RS), and Multiple Family Residential-I zones once the City implements HB 2001

Property tax exemptions

A property tax exemption is a legislatively approved program that relieves qualified individuals or organizations from all or part of their property taxes. Exemptions can be either full or partial, depending on the program requirements and the extent to which the property is used in a qualifying manner. To comply with House Bill 2001, the City must consider adopting or amending criteria for a variety of property tax exemptions or freezes for middle housing.

The City currently offers:

- **Non-profit low-income housing tax exemption.** The City currently offers this exemption. That tax exemption, allowed under *ORS 307.540 to 307.548: Property Tax Exemption – Nonprofit Corporation Low Income Housing*, applies to housing owned or operated by a nonprofit organization and occupied by low-income households, which are those earning up to 60 percent of the area median income. Vacant land is also eligible for two years if it is intended to be developed as low-income housing. Applicants must apply annually for the tax exemption, and a property can only receive the tax exemption for 10 years. The exemption granted by the City applies only to the City's tax levy for the property. The City may submit a request to the governing bodies of the overlapping taxing districts to agree to the exemption policy.
- **Multi-Unit Housing Tax Incentive.** The City's existing Multi-Unit Housing Tax Incentive Program (MUHTIP), enacted in 1976, provides up to 10 years of property tax abatement within a specific geographic area in downtown and central Salem. Projects must include at least two units and must contain at least one community benefit identified in Salem Revised Code 2.815.

The Program is authorized by Oregon Revised Statute (ORS) 307.600-307.691, which allows local governments to establish a program for property tax exemptions to stimulate the construction of transit-supportive multiple unit housing in the core areas of Oregon's urban centers. Unit affordability is not a requirement of this program. The basic tenets of the Program are:

- The project must include at least two dwelling units per Standards and Guidelines adopted by Resolution No. 2006-43;
- The project must be located within the "Core Area" as defined in SRC 2.800(c); and
- The project must include at least one public benefit as outlined in SRC 2.815.

Each application requesting approval is evaluated on a case by case basis by the City Council. Since 1976, seven properties have been approved by Council for this Program. The Program is set to sunset January 1, 2022. The program is set to sunset in 2022. Staff plans to recommend City Council extend the program to January 1, 2032 at an upcoming meeting.

Staff recommends exploring options to expand the a boundary of the City's existing Multi-Unit Housing Tax Incentive Program. The boundary of the existing Multi-Unit Housing Tax Incentive Program could be expanded - contiguous to the existing core area (**Attachment 1**) and adjacent to or near a fixed transit route. The expansion must be approved by two-thirds of the impacted taxing districts, which would include Marion County and the Salem-Keizer School District. If the boundary was expanded, the tax incentive could encourage middle housing in Salem's inner neighborhoods around the downtown core. These are areas that are generally well-served by transit, walkable, and close to a range of jobs and amenities. Staff can also explore adding housing affordability to criteria to receive the tax incentive.

- **Community Partners Property Tax Exemption.** The Salem Housing Authority operates a Community Partners Property Tax Exemption program to incent the inclusion of affordable units in market rate developments. This program provides a tax exemption and requires that the housing authority be designated as General Manager in a partnership agreement (5- year term and renewable) for the purposes of achieving the tax exemption (i.e., the housing authority does not become a partial owner or an active manager of the property). This tax exemption program provides for six different combinations of exemption levels, affordability levels, and unit numbers. The program could be considered for a duplex or triplex, but the annual fees (\$5,000-10,000) are designed for larger projects.

Other tax exemptions for housing development are allowed within State law. The following exemptions are not currently offered by the City of Salem:

- **Low-income rental housing tax exemption.** The City does not currently provide this property tax exemption. Under state law, *ORS 307.515 to 307.523: Property Tax Exemptions – Low-income rental housing*, this tax exemption can apply to land developed or held to be developed for low-income rental housing, for the whole property or a portion of the property. The required rent payment reflects the full value of the property tax exemption. The housing units must be constructed after the local governing body adopts the tax exemption. The property tax exemption is for up to 20 years. Private landlords and non-profits are eligible. Non-profit organizations that meet the criteria can also purchase or manage structures or units built prior to the adoption of the tax exemption.
- **Single-unit housing tax exemption.** The City does not currently provide this property tax exemption. The intent of the tax exemption is to encourage homeownership among low- and moderate-income families. Under state law, *ORS 307.651 to 307.687: Single-Unit Housing*, low- and moderate-income families can be eligible for this tax exemption for no more than 10 successive years if they purchase a home that is up to 120 percent of median sales price as determined by the local jurisdiction each year. A single unit could be a single-family structure or a single unit of a duplex, triplex, quadplex, or cottage cluster. The tax exemption cannot be applied to manufactured homes or floating homes.

- **Property tax freeze for rehabilitated residential property.** The City does not currently provide this property tax freeze allowed by State law *ORS 308.450 to 308.481: Property Tax Freeze – Rehabilitated Residential Property*. The intent of the tax freeze is to encourage the rehabilitation of existing units in substandard condition, the conversion of transient accommodation to permanent residential units, and the conversion of nonresidential structures to permanent residential units. Properties that are eligible for the tax freeze must be rehabilitated to meet local building or housing codes and located in an area designated by a city as a “distressed area.” A city can designate up to 20 percent of the city as a distressed area; these areas must be primarily residential and be detrimental to the safety, health, and welfare of the community due to deterioration, inadequate or improper facilities, or the existence of unsafe or abandoned structures. The tax freeze can be for up to 10 years and can apply to single and multifamily units.

Construction excise tax

A construction excise tax is a tax assessed on construction permits which may be issued by cities and counties. In 2016, the Oregon State Legislature passed a bill which allows local jurisdictions to assess a construction excise tax for affordable housing.

To increase the affordability of middle housing, per House Bill 2001, the City must consider assessing a construction excise tax (CET). The State expanded local control of affordable housing policy through the passage of SB 1533 in 2016. The law, in addition to allowing for voluntary implementation of inclusionary zoning (requires or encourages new residential developments to make a certain percentage of the housing units affordable to low income residents), authorizes local governments to impose a CET on improvements to real property to fund affordable housing initiatives.

Local governments can levy a tax of up to 1 percent for residential properties and no limit on commercial properties. The tax would be based on a percentage of the permit valuation (estimated value of the construction project) for residential, commercial and industrial construction. The tax applies to new structures or additional square footage added to existing structures, including remodels that add living space. There are several mandated exemptions from the CET as well as a list of developer incentives that are allowed.

The revenue from the CET has restrictions on use based on whether the properties are residential or commercial, with 4 percent of the revenue accessible by the City to fund the administration of the program. The balance of the funds from a tax of 1 percent for residential and commercial properties could be used as displayed below:

Residential

- 50% dedicated to fund developer incentives
- 35% for city affordable housing programs and incentives

- 15% distributed to the State Housing and Community Services Dept. (HCSD) for down payment assistance

Commercial and Industrial

- 50% for city affordable housing programs and incentives
- 50% unrestricted

Cities can choose to exempt specific project types from paying a CET. Eugene, for example, exempts improvements to religious facilities, residential housing that is affordable to households earning up to 80 percent of the median income for at least 60 years, residential care facilities, and residential dwellings sold for \$250,000 or less, among other project types.

The City does not currently assess a CET on development; however, the City did consider it as part of the work of the Sustainable Services Revenue Task Force. That task force was commissioned by the City Council in the fall of 2018.

The purpose of the task force was to explore new, additional revenue sources and revenue adjustments to fees to sustain services that do not have a dedicated revenue stream. The task force reviewed 13 revenue options, one of which was a CET. The task force opted not to forward the CET to the City Council. There were various concerns voiced such as the added cost to home builders, the narrow focus of the revenue, the portion that is diverted to the State, and that the amount of revenue wasn't large enough to solve for the revenue need in the General Fund. The task force eventually recommended three other revenue options to the City Council for consideration. It is possible to exempt specific projects, such as affordable housing projects, from paying a Construction Excise Tax.

BACKGROUND:

Under House Bill 2001, Salem will be required to allow middle housing – duplexes, triplexes, quadplexes, and cottage clusters – on residential land zoned for single-family detached housing. This will include the Residential Agriculture (RA), Single-Family Residential (RS), Duplex Residential (RD), and Multiple Family Residential-I (RM-I) zones.

House Bill 2001 also requires local governments to consider incentives to encourage development of middle housing options.

Staff plans to bring forward a code amendment to implement HB 2001 this summer. Initially, staff had planned to incorporate HB 2001 into the Our Salem project; however, given the State-mandated deadline of June 2022, staff plans to advance the HB 2001-specific code amendments sooner. In the meantime, staff has created a webpage that answers [frequently asked questions](#) related to the new law and its impact on Salem.

In addition, staff has continued to implement the Salem Housing Needs Analysis (HNA) [Work Plan](#) since directed to do so by City Council in 2016. The work plan advances recommendations in the [HNA](#) to address the projected 207-acre deficit of multifamily land (2,897 dwelling units) in Salem's portion of the urban growth boundary (UGB).

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