



# **Housing our Community: Issues Influencing Housing Opportunities**

Reprinted Articles from  
*Housing Stock*  
Newsletter of  
The Housing Partnership

**Winter 2000 through Spring, 2003**

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*The following articles are reprinted from various editions (noted) of Housing Stock, the newsletter of The Housing Partnership. Since these are reprints, some of the data may not be current. The trends in housing supply, cost and markets described in the articles, however, have not reversed themselves. Contact The Housing Partnership at 425-453-5123*

## **Part I: Overview of Housing Issues**

### **Data Show Home Price Trends Continuing (Fall, 2000)**

The Washington Research Council recently updated several of the data series used in its 1998 report "Housing Affordability in the Puget Sound Metropolitan Area," which it produced for the Partnership. For the most part, the trends identified then have only gotten worse. A few of the key findings:

#### **We can't blame the Californians**

Prices continue to rise, which is no big surprise to anyone following the market. What is interesting, however, is to examine the trend over the past three business cycles. Figure 1 shows average prices in the four-county region since 1970, in both current and inflation-adjusted (constant) dollars. The home price run-up during the 1990's business cycle is not quite as dramatic as the previous two.

One explanation is what might be termed the "blood from the turnip" theory. Although average incomes have risen significantly, most middle income individuals and families have maxed out their earning potential and buying power (through double incomes, higher leverage, etc) and cannot push the market any higher.

A second explanation lies in the much lower rates of in-migration to Washington State in this business cycle. The late 1980s was the heyday of in-migration from California and the Plains states where economies were really struggling. Now, with most of the country in growth mode, the Puget Sound area has not been such a destination.

Figure 2 shows the inflation-adjusted average price chart against net in-migration to Washington State. While net in-migration has fallen dramatically from the high levels of ten years ago, home prices have continued to climb steeply. So, not only can we not blame the Californians, we cannot wait for the next recession to bail us out!

#### **Average wages don't get you into the market**

There are lots of ways to measure how much money people have to spend on housing. The most basic is wages: regular pay, plus bonuses, commissions and exercised stock options. The average wage in King County has risen dramatically in recent years, and now sits just over \$49,000 per year.

But as high as this is, it is still only enough income to afford a \$160,000 house. And as Figure 6 shows, there is very little on the market at this price.

And for the 98 percent of people not employed in the software business, the situation looks much worse. Removing software employees from the statistics, the average wage drops to under \$38,000. This is enough income to afford a \$132,000 house, which is almost non-existent in King County.

So, half of the paychecks in King County are sufficient to buy only three or four percent of the houses sold here last year.

Figure 3 shows the historic relationship between average wages (King County only) and average prices (four-county region), with the non-software wage broken out beginning in 1990 when software earnings really began to pull averages up noticeably. In 1970, the average house price was about 2.5 times the average wage. Today, for non-software employees, average prices are more than six times the average wage.

### **Job growth is booming in King County; house construction is not keeping pace**

The basic determinant of demand for housing is job growth (ya gotta pay the rent or mortgage). Figure 4 shows the trend in job growth and permits for King and Snohomish counties. For the two-county region during the current business cycle the ratio of housing production to job creation is comparable to previous cycles, at about one unit for every 1.8 jobs.

Breaking the data out by county, however, shows a much different picture. Over the past five years, in King County, one new unit has been permitted for every 3.8 jobs created in the county, while in Snohomish County that ratio is 1.2 units per job. Figure 5 shows yearly housing and job growth.

The conclusion, obvious to anyone commuting on I-5, I-405 or SR 522 near the county line, is that Snohomish County continues to absorb a large share of people who work in King County. The more King County employers rely on the Snohomish County housing market as a relief valve, the worse traffic will get.

### **The low end of the market is thin and getting thinner**

Remember the story of the guy who drowned in the pool of water that averaged an inch deep? Averages and medians just do not tell the whole story, especially in the housing market. As the Partnership's earlier research pointed out, prices level off just below the median, leaving very little available at lower prices.

In this data update we have taken a slightly different look at the structure of the market, seeing just what is available at various prices. Figure 6 shows what percent of homes are available at or below certain price points.

The two vertical lines show the level of affordability for the average wage and the median household income. The average wage can afford very little of what is available in King County (and, as pointed out above, the average non-software wage can afford even less).

The median household income, which takes dual incomes and non-wage income into account, does somewhat better, with an ability to purchase almost 30 percent of the homes on the market. This is attributable not to falling prices, but to dramatically rising incomes (around ten percent in a couple of recent years).

The huge gap between non-software wages on the one hand, and household incomes on the other, points to the necessity of dual jobs and other income sources in order to enter the housing market in King County.

Figure 1: Average house prices in King and Snohomish Counties continue to rise  
 (Source: Puget Sound Economic Forecaster)

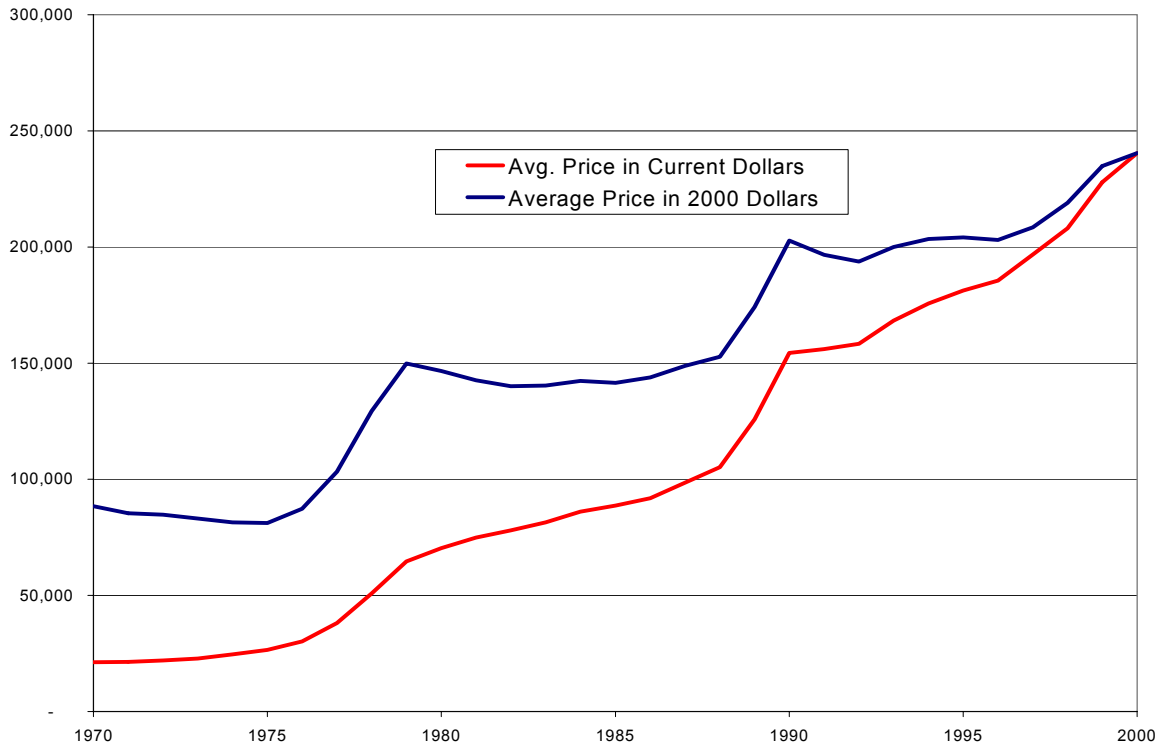


Figure 2: In-migration not tracking housing prices  
 (Sources: Puget Sound Economic Forecaster, Washington State Office of Financial Management)

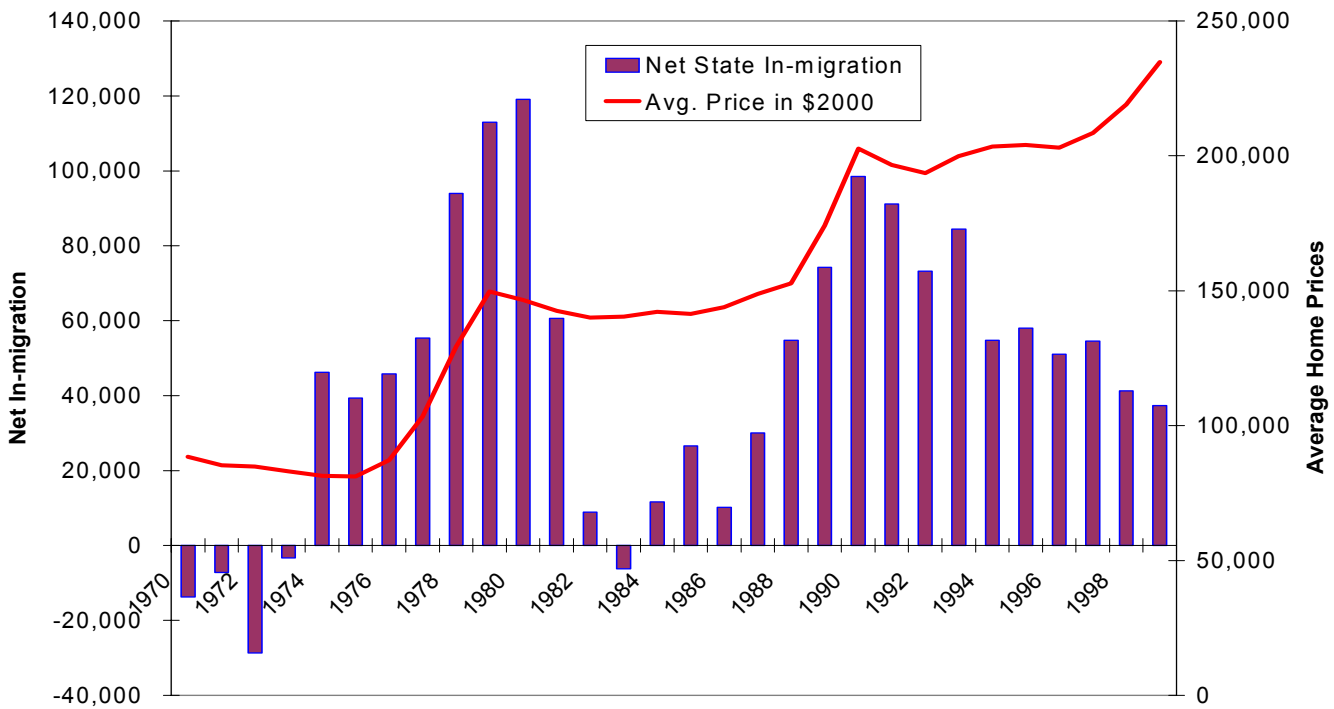


Figure 3: Price increases continue to out-pace wages

Sources: Puget Sound Economic Forecaster, Washington State Department of Employment Security)

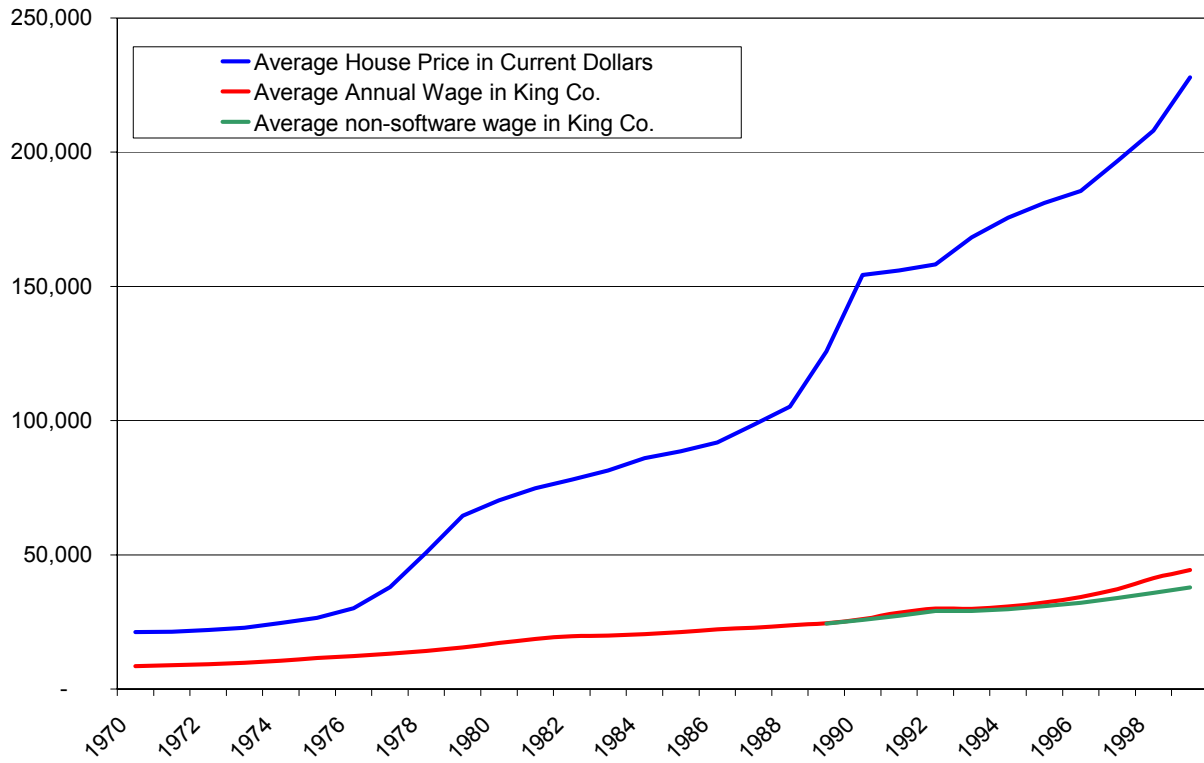


Figure 4: Home construction tracks job growth in King and Snohomish Counties combined

(Sources: Puget Sound Economic Forecaster, Washington State Department of Employment Security)

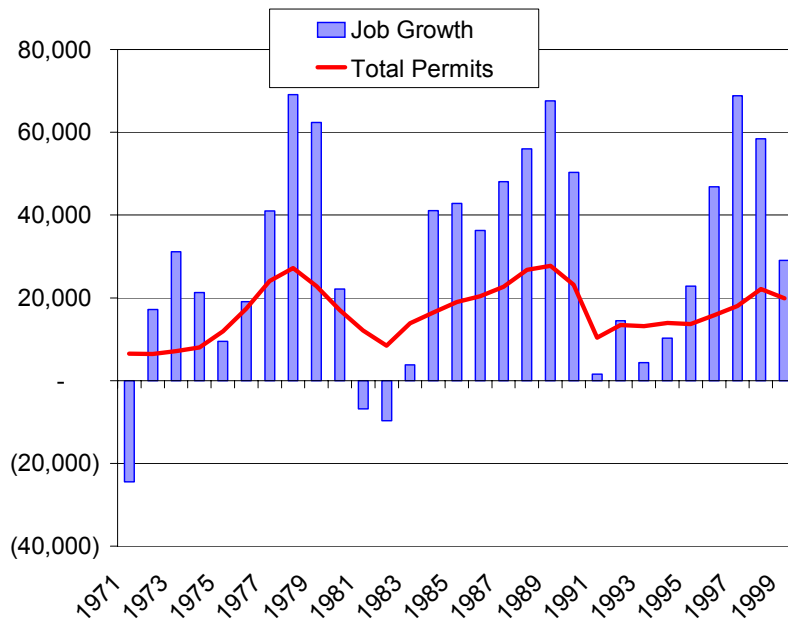


Figure 5: Snohomish County gets more than its share of housing, King County gets less.  
 (Sources: Washington State Department of Employment Security, Washington Center for Real Estate Research)

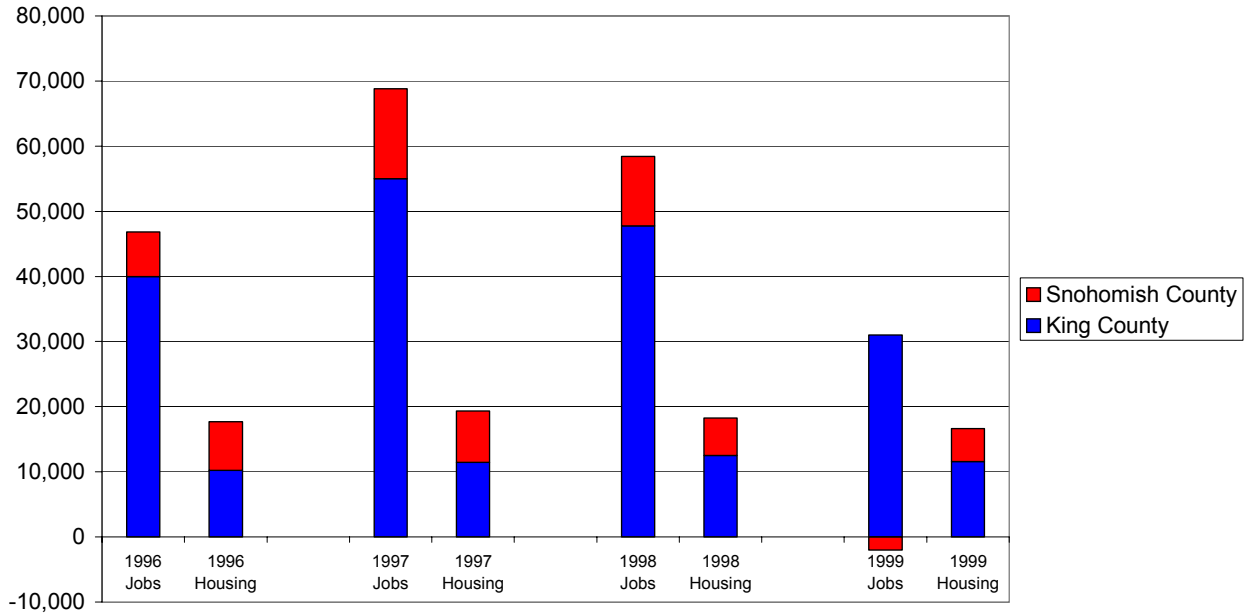
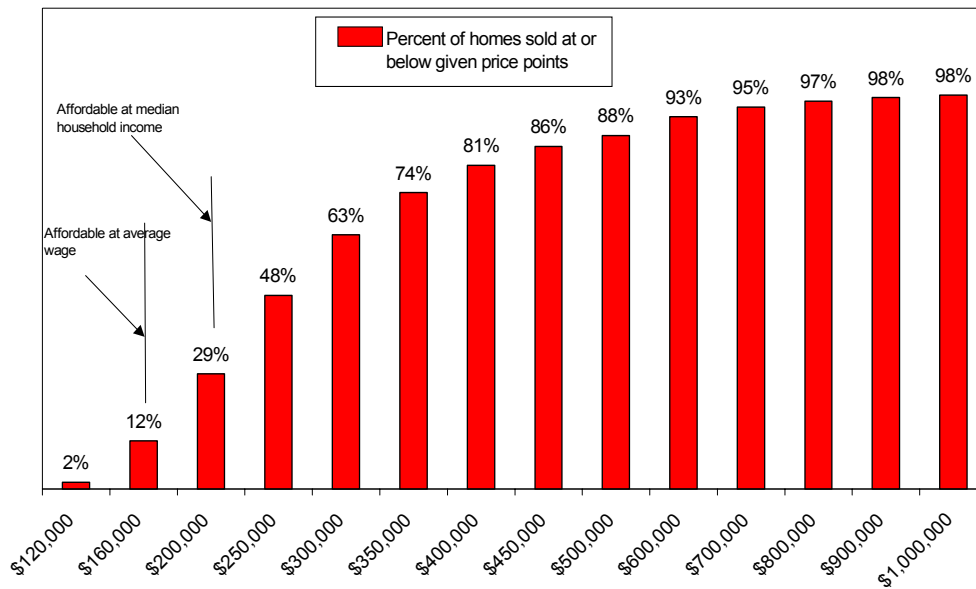


Figure 6: Few homes sold at lower end of market  
 (Source: Washington Center for Real Estate Research)



# Growth Management 10 years later

## (Fall 2001)

In a few weeks a group of public and private sector leaders will convene for the annual Puget Sound Leadership Conference which will feature a sort of 10-year report card of Washington's Growth Management Act (GMA). A lot has happened since this same conference first looked at the subject back in 1989.

Since the conference will be covering many of the same themes promoted by the Partnership, we thought it would be useful to take our own look at how the GMA has affected our region's ability to house people affordably.

Washington's Growth Management Act (GMA) is a really complicated law, which, I suppose is not surprising given the complexity of what it sets out to accomplish: influencing the millions of individual decisions that, taken together, shape how we grow.

The 13 goals which form the heart of the Act contain, on their face, enough contradictions to bring us to a grinding halt. The goals push sprawl reduction as well as property rights. They promote both citizen participation and permitting efficiency. They require environmental protections while promoting natural resource industries. Achieving artful balances is, of course, the name of the game.

The conference will examine our progress in managing growth by looking at just five of the 13 goals, and these five goals are the subjects of the articles in this newsletter. Each of these goals, if pursued, will have an impact on the availability and affordability of housing in our region, and the objective of the Partnership members attending the conference will be to help conference participants understand those impacts.

Managing growth is a tall order, and I don't think we should have expected to get everything right the first time. Now is a good opportunity to make the system work for us in the coming decades.

### Urban Growth Goal

*Encourage development in urban areas where adequate public facilities and services exist or can be provided in an efficient manner.*

This goal is the flip side of the GMA's second goal of containing sprawl, and has become a widely accepted principle. Although it is hard to argue with the idea of slowing the spread of cities outward and filling in underused spaces, it is turning out to be a little trickier than we thought.

We have certainly gotten off to a strong start on the sprawl containment front, with an aggressively enforced urban growth boundary, outside of which development has slowed dramatically. Encouraging infill development, as the goal states, has more of a mixed record.

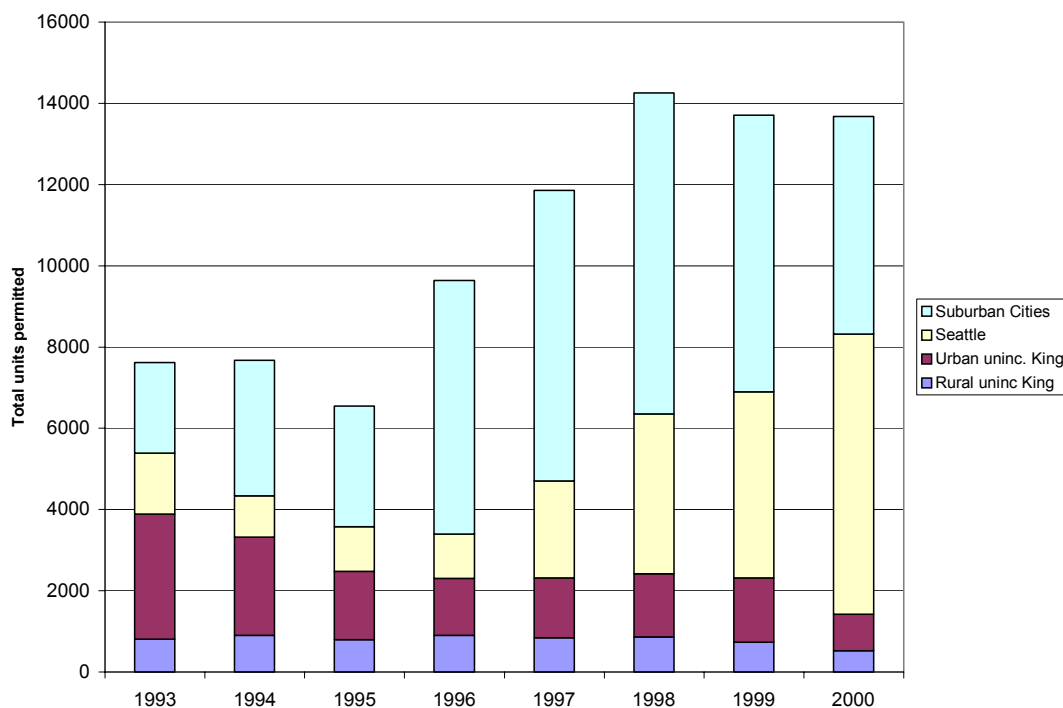
County-wide, we have begun to achieve our goal of having a quarter of all new housing built in the designated urban centers. The problem is that most of that new urban center housing is springing up in just a few of the centers, and most of the others have seen little or no housing growth in the past five years.

As GMA plans have taken shape, a number of factors have come to light that affect the ability of homebuilders to do in-fill development.

**It's Expensive.** While in-fill development may impose lower public costs, development and construction costs are usually higher than in outlying areas. Land is costly and construction is challenging on tight sites with little elbow room and no economies of scale.

**Parking drives up costs.** Multi-family buildings in urban centers will typically have underground parking, which adds considerably to unit costs. In much of the county, rents or condo prices are just not high enough to justify buildings with underground parking.

Homebuilding has been accelerating in cities, with Seattle accounting for half of all permits issued in 2000 in King County. (Source: King County Benchmark Report)



**Infrastructure is old or undersized.** Existing infrastructure -- water and sewer, roads, sidewalks -- in many areas is not adequate to accommodate new development and must be replaced. Retrofitting old systems is more disruptive and can be more costly than building brand new ones.

**Loss of open space.** Land left vacant for decades in residential areas often becomes a sort of informal community open space, which neighbors are reluctant to see developed. Strong neighborhood opposition to infill development can mean added mitigation costs and loss of units.

**Loss of parking.** In urban areas, development of parking lots can mean a loss of inexpensive or free parking for neighborhood business districts. So while new housing may bring new customers to a business district, it may also make it difficult for current customers to keep coming.

**Need for amenities.** If people are going to give up spacious houses and yards to live in a more urban setting, they need some attractions. Creating attractive, exciting neighborhoods costs money, and many communities have not stepped up to that challenge sufficiently.

But although the economics of infill development can be challenging, the market is clearly there and we have some notable successes.

The biggest difficulty is really political, especially when infill projects are outside of existing commercial areas. Our system of local government is simply not set up to encourage infill development. On the contrary, the political deck is stacked against it. The first instinct of most local elected officials is to protect their city (and citizens) from unpleasant changes such as infill development, which is often viewed negatively.

We will achieve the GMA's urban growth goal only when communities accept the need to accommodate infill. This is not easy, especially when a big white land use application board goes up in front of a favorite woods or field. But if we are to preserve the larger forests and fields of our region's rural areas, it must be done.

## Permits Goal

*Applications for both state and local government permits should be processed in a timely and fair manner to ensure predictability.*

If you were to ask all the homebuilders in the region for one thing that would improve the housing situation, nine out of ten would probably say something about permit processing. Permitting delays range from weeks or months for building permits, to years, and even decades for major public facilities and larger land developments.

Frustration with permitting has been building for years, and while we have made some progress, much remains to be done. A previous edition of this newsletter described four ways that permitting delays affect the cost and availability of housing:

**Tying up capital and increasing financing costs.** Homebuilding is a very capital intensive business, and the longer a project takes to get underway, the higher the cost of carrying equity investments and debt.

**Affecting construction schedules.** Contractors and workers must be scheduled well in advance, and delays put those schedules at risk. Because much of the building process is sequential, delays can ripple through the entire project.

**Increasing market uncertainty.** The longer it takes to get a project finished, the less certainty the builder has that economic conditions will be favorable when it comes time to sell or rent the new units.

**Shaking out small builders.** Homebuilding has long been dominated by relatively small builders, much to the benefit of consumers. Uncertain timing, high capital requirements and the simple need to make a living will squeeze out smaller builders.

Trying to get at the root of the problem, however, is very tricky. Some delays are caused by management problems, and those have to be addressed on an agency-by-agency basis. Other delays are caused by ambiguities in regulations and their interpretation, and must be attacked at the statutory level. To be fair, some jurisdictions have made real progress on both these fronts.

The really insidious problems tend to come from the ability of project opponents to string out endless appeals of public decisions. These delays have to be attacked by changing the processes being misused by project opponents. Unfortunately, in the past few years we have been adding more

processes than we have been taking away, and we continue to allow project opponents to file frivolous appeals that cost the developer money while doing nothing to improve the project.

While it may seem heretical -- and perhaps politically impossible -- to cut back on public involvement, we must find ways to shorten processes and hold people accountable for the high cost of frivolous legal actions.

Things we could do to improve permitting include:

**Raise SEPA thresholds.** Local governments can exempt projects of up to 20 units from SEPA requirements. With all the comprehensive planning and neighborhood planning going on under GMA, the impacts of small projects should be easy to figure out.

**Do area-wide environmental review.** Much of the analysis that would be done on a project-by-project basis under SEPA can be done for large areas all at once, making project-level review much simpler.

**Eliminate administrative appeals.** Controversial projects nearly always end up in court, so having an intermediate appeal at the administrative level just adds time and cost.

**Collect attorney's fees on failed appeals.** Although individuals are currently required to pay attorney's fees after a third failed appeal, project opponents have set up dummy non-profit corporations to evade this requirement. We need to close this loophole.

**Use project managers.** Processes are often poorly coordinated across departments, and a single manager responsible for all the permits needed for a project would improve coordination and accountability.

Finally, we need to get support at the highest level of local governments for permit process improvements. We need to have well-designed systems with reasonable standards, and to have agency personnel accountable for meeting those standards. Mid-level department personnel will respond to strong direction from their mayor and city manager. But they have to know that expeditious and fair permitting is a high priority.

At the same time, we have to recognize, support and thank the elected and appointed officials in those jurisdictions that have worked hard to improve the day-to-day operation of permitting agencies. Any kind of organizational change is difficult, and we need to applaud those who have succeeded and encourage those who still have a ways to go.

## Housing Goal

*Encourage the availability of affordable housing to all economic segments of the population of this state, promote a variety of residential densities and housing types, and encourage preservation of existing housing stock.*

Unlike the other GMA goals written about in this newsletter, the housing goal is one that government has only an indirect hand in achieving. The majority of housing is built by the private homebuilding industry according to the dynamics of the market.

And because that market is so complex, some public policies can inadvertently discourage housing construction, and those policies designed to encourage it may not have impact right away. In addition to local policies, the housing market is affected by interest rates and other broad national and regional economic factors.

Nonetheless, the availability and affordability of housing is a central measure of the success of GMA, so we do need to evaluate our progress in meeting this goal. Lets look at each of the three parts of the goal:

**Availability of affordable housing to all economic segments of the population.** As the Partnership has pointed out consistently over the past few years, we have a serious problem with the availability of market-rate housing for moderate and lower income people. The median wage in King County is enough to afford only 10 to 15 percent of the homes sold in the area. Moreover, many of the lower priced homes are located in areas of the county that are becoming inaccessible due to our transportation problems. So although a moderately-priced home may be "available," moving to that neighborhood may involve such commuting costs and sacrifice of time as to make it unattractive.

**A variety of residential densities and housing types.** There have been some encouraging steps on this front, but for the most part we are still building pretty much the same way we were ten years ago. Most of the new homes being built today are either single family detached houses or stacked-flat apartments or condos. We are just beginning to see growing interest in cottage housing and townhouses, but we need to make these mid-levels of density more widely available.

A notable exception to this lack of mid-level density is coming from the large masterplanned communities. Several of these new neighborhoods have smaller houses, smaller lots, narrower streets and alleys. By laying out a very large area, these developments can mix densities, home styles and prices in ways that smaller in-fill developments find more difficult.

**Preservation of existing housing stock.** We seem to be doing quite well on this part of the goal, and in some areas, maybe too well. The existing housing stock in many close-in neighborhoods is being purchased for higher and higher prices as mid- and upper-income buyers look for shorter commutes. While this certainly does enhance the condition of neighborhoods, it does eliminate much of the lower cost housing stock.

A major concern has been the preservation of existing low income rental housing, especially Section Eight buildings with expiring contracts. A number of not-for-profit housing agencies have been able to purchase these buildings and preserve them for lower income residents.

Ultimately, the housing goal is really dependent on our success in achieving many of the other GMA goals. Transportation improvements will open new areas to development. Improved permitting will bring housing to market faster. A successful urban center strategy will lure empty-nesters out of their large homes and make those homes available to younger families. And so on.

In the face of all the uncertainty of how to achieve this housing goal, we need to support local governments as they attempt different approaches. We also need to balance the desire for good planning with the realities of consumer preferences within a highly complex market.

## **Transportation Goal**

*Encourage efficient multimodal transportation systems that are based on regional priorities and coordinated with county and city comprehensive plans.*

To say we have a long way to go on this goal would be an understatement. Transportation remains the biggest unresolved growth issue we face, and with the lack of new funding, transportation improvements get pushed further and further into the future.

We all feel the irritation of traffic congestion today, but it also has a major impact on the region's housing supply and affordability. The good news is that if we deal effectively with housing strategies, we can make difference in future growth of traffic.

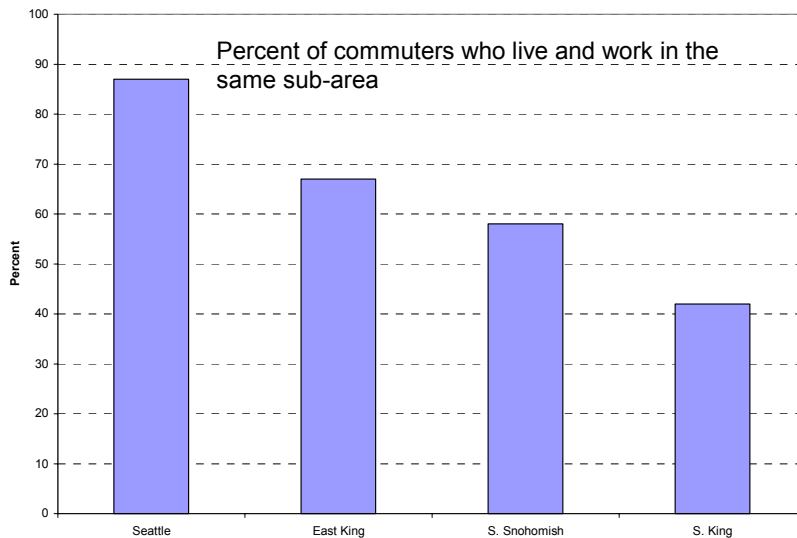
An overwhelmed transportation system affects housing in several ways.

**The value of proximity.** The parts of King County with the greatest price appreciation in the past decade are all within a reasonable commute of downtown Seattle and the Bellevue-Redmond axis. To avoid losing precious hours through long commutes, those who can afford it are moving closer in, bidding up prices in formerly unfashionable neighborhoods. Close-in neighborhoods that used to be affordable, especially to those who do not own cars, are becoming less so. This forces people with low and moderate incomes to move further out, adding commuting expenses.

**Affordable areas being cut off.** Reasonably-priced housing can be found in the southern parts of King County, but commutes to the faster-growing job centers have become so slow that living in those areas becomes less of an option. A large part of the residential development capacity in King County is effectively cut off from the main job centers by freeway choke points.

**Concurrency putting land off limits.** While homebuilding is limited in some areas simply by the market, other areas are legally off limits due to transportation concurrency. As traffic speeds fall below a certain threshold, local jurisdictions halt development. So some of the land within the Urban Growth Boundary that is theoretically available for homebuilding cannot be developed.

Most commuters begin and end their day in the same sub-area.  
(Source: Puget Sound Regional Council)



It is unlikely that within the next decade we will see significant capacity improvements on our major freeways. Our only real choice in the near-term is to improve the balance of jobs and housing within sub-areas that offer tolerable commutes. Some people will, through circumstances or choice, end up commuting long distances, but most people should have the option of living within a reasonable commute distance.

Recent data from the Puget Sound Regional Council shows that most people do, in fact, commute within their sub-areas. Two thirds of commuters living on the Eastside stay there during the workday.

58 percent of South Snohomish County commuters stay north of the county line. A whopping 87 percent of Seattle commuters stay within the city. Only 42 percent of South King County commuters work there, but another 17 percent commute to Tacoma, which is still a reasonable trip.

So as we continue to struggle to make progress with our transportation goals on the supply side, we can make a difference on the demand side by building more housing nearer the fast-growing job centers.

Within such a strategy, the biggest positive impact on transportation will come from building housing in urban centers. Some residents will be able to walk or ride a bike to work, and since transit service is best between centers, a commuter living in one center and working in another will find transit convenient.

If we cannot make traffic congestion go away, at least we can give people as many options as possible to avoid it.

## Public Facilities and Services Goal

*Ensure that those public facilities and services necessary to support development shall be adequate to serve the development at the time the development is available for occupancy and use without decreasing current service levels below locally established minimum standards.*

The preceding 39 words boil down to one word that strikes fear into the hearts of local officials and developers alike: concurrency.

The GMA was adopted, in large part, out of frustration that residential growth was getting way ahead of local communities' ability to serve it. Rural roads and water systems were overwhelmed by urban-level densities, and generations of kids were spending their school years in portable classrooms.

Thus was established the principle of concurrency: make sure the infrastructure is in place before the demand arrives.

Nice idea, but very hard to put into practice. A quick look at King County's transportation concurrency map shows lots of areas shaded in red, meaning they cannot be developed due to traffic congestion. Not very many areas on the map are shaded green, meaning they are fully open to development.

Our failure to get out in front of the growth curve mostly boils down to money, or the lack thereof. State financial assistance has not kept pace with needs, and local governments have a limited ability to raise revenue themselves. In the faster growing areas nearly every penny raised will go toward catching up with existing deficiencies rather than adding capacity needed for future growth.

Making concurrency work is going to require revenue from four sources, all of which are constrained.

**State revenue.** The State funds highways and provides money to local governments for transportation and school construction. Both of these sources of funding are falling short and the state needs to increase them. Recent events in the legislature make it hard to be optimistic, however.

**Local general revenue.** The past few years have generally been good for local government revenue and many jurisdictions put part of that windfall into infrastructure. The good times are coming to an end, however. Pressure from taxpayers is leading many governments to keep property tax rates down, and a slowing in the economy will affect sales tax collections.

**Local bonds and levies.** Local infrastructure is traditionally funded with locally-issued debt or special property tax levies. Bonds and levies will continue to be used, but taxpayer pressure, combined with the popular notion that "growth should pay for itself" will make it politically difficult to meet future growth needs with these sources.

**Impact and mitigation fees.** Many local governments have adopted impact fees for roads, schools, parks and other growth-related capital needs. Since these ultimately get passed on to the purchaser of the property, there is a practical limit to how high they can get, and state law requires that they be fair and proportional.

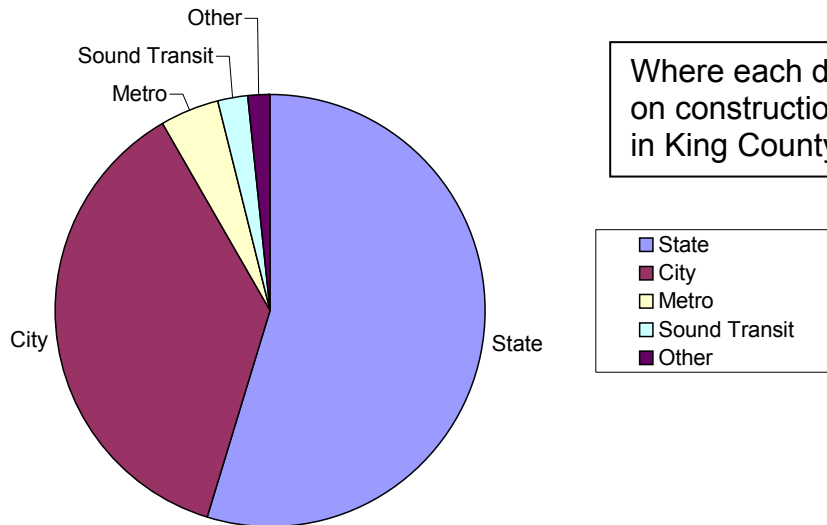
Funding the public facilities and infrastructure needed for growth becomes a political balancing act. On the one hand, many current taxpayers feel overburdened already and see no reason to pay for projects that will serve growth they did not ask for. On the other hand, most new infrastructure does have benefits that accrue to the community as a whole, so the burden should not fall just on new residents.

The solutions to all this are not very complicated, just politically frightening. It is extremely hard to score political points by spending current taxpayers' money for the benefit of future residents. But that is just what concurrency demands.

One of the few ways out of this dilemma is to use tax increment financing, which uses future tax revenues from new construction to pay for infrastructure needed to get that construction underway. This tool has not been available in Washington State due to adverse court rulings and a couple of failed ballot measures. Maybe it is time to try again.

One way or another, we need to find the money to turn those red areas on the map back into green.

The majority of sales tax collected on home construction goes to the state general fund.  
(Source: Washington Research Council)



Where each dollar of sales tax collected on construction of a new home in a city in King County goes.

# What's the deal with apartment rents?

## (Spring, 2002)

Over the past few years, apartment owners and tenants in the Puget Sound region have seen some wild swings in rents. When rents are flat, building owners get nervous, and when rents climb sharply, tenants and their advocates revolt. Following are some of the dynamics that drive this important business.

### **Many owners, different goals.**

The apartment industry is very diverse and fragmented, made up of thousands of individuals and businesses. The size of their investments range from an individual accessory apartment to thousands of units. Each owner operates within a unique set of goals and constraints which, in turn, feed into decisions on how to set rents. A small investor carrying no debt on an older building may prefer to keep rents below the market to minimize turnover. Highly leveraged investors must keep rents up to service debt and/or provide a return on equity.

Big rent shocks in a building often occur when the building has been sold by an owner who liked to keep rents low, to a new owner who wants to maximize rents, or who must charge the highest rents possible to satisfy lenders. The highly competitive nature of most rental markets makes it unlikely that a new owner will be able to raise rents much beyond the rents prevailing in the neighborhood, but this is cold comfort to anyone suddenly facing a substantial rent increase.

### **Rents determine building values**

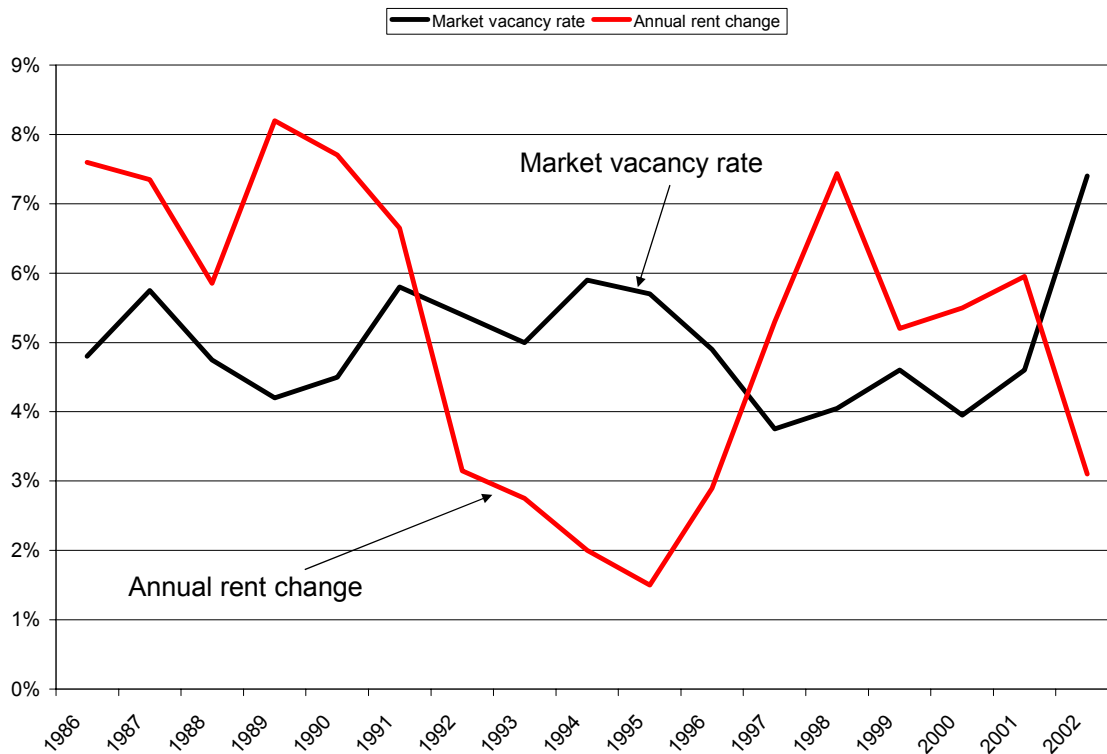
Like any investment asset, apartment buildings are regularly bought and sold. The value placed on a building is determined by a formula involving current net income and a figure known as the capitalization (cap) rate. Cap rates can vary according to a whole host of factors having to do with the overall climate for investment, expectations of future income in a building and the prospects for its neighborhood (the cap rate is analogous to the price/earnings ratios used to value stocks). Owners who want to maintain the market value of their buildings have little influence over cap rates, but can work on the other part of the equation by getting the highest rents the market will support.

### **Offering incentives**

When vacancy rates are high owners and managers often find that they must offer incentives to lure in new tenants. These may include free rent or gifts. The move toward incentives is often started by owners of new buildings who face a soft market as they try to fill those buildings up. Owners of existing buildings then may find that they too need to offer incentives to stay competitive. According to Dupre + Scott Apartment Advisors, over 50 percent of the larger properties (20 or more units) in the region are now offering move-in incentives.

### **Rents must cover expenses**

The first thing an apartment owner or manager must worry about, after paying the mortgage, is covering basic expenses of operating the building, some of which can rise sharply with little warning. Expenses include management fees, utilities, maintenance, capital expenses, insurance and property taxes. These last two have been major cost drivers in the last few years. According to Dupre + Scott, expenses have increased an average of 4.4 percent per year (compounded annually) over the past fifteen years. There have been many years, including this one, in which rent increases were well below that level. To make matters worse, at a time of high vacancies, some expenses may be higher than normal. Owners will have to do more advertising and may need to do upgrades to attract and retain tenants. And don't forget about all those free TVs and microwaves!



### Can we get off the roller coaster?

Chart 1 shows the dramatic ups and downs of vacancy rates and rent increases over the past fifteen years. That they are mostly the inverse of each other should be obvious. Although: rental housing is an excellent example of the basic laws of supply and demand, a few things make it difficult to smooth out the bumps.

Construction is cyclical. Development of multi-family housing seems to come in waves. Construction peaked in the late 1980s and late 1990s, and since it takes a few years to get from permit to move-ins, the peak in permit activity in 1989 and 1999 correspond to the higher vacancy rates in 1993-94 and 2002. In both cases, the construction boom began in a period of rapid economic growth, when developers and investors saw good prospects for the industry.

Construction lags new demand. When the economy begins to heat up, and demand for apartments increases, it takes at least a couple of years for developers to respond with new buildings. A sudden shortage of apartments allows owners to push up rents well before new buildings can provide competition that will slow rent increases.

Recessions affect demand. The recent recession puts a damper on demand for apartments. Fewer young people are getting the kinds of jobs that allow them to move out on their own, so they stay with their parents or double up. Fewer jobs mean fewer people moving to the area. Flat wages mean that fewer people will move up to higher quality buildings.

Because the economy of the Puget Sound area is so cyclical, it is probably inevitable that we will see another period during which rents rise faster than inflation. Two things will definitely help ease this cycle.

Permit new buildings faster. The faster that accelerating demand can be met, the less likely that vacancy rates will plummet to the point where rents are pushed up rapidly. Construction will never move as fast as an economic recovery, but faster unit growth will definitely help moderate rents.

Don't panic. No one likes rent increases, but any move to artificially hold down rents will put a major damper on construction. Few investors will want to buy buildings in a rent-control environment, and the investors who really make the difference – real estate investment trusts, pension funds, insurance companies and other institutional investors – will avoid the market like the plague. Without the big national investors to buy new buildings, construction will halt.

For now, those who felt the pinch of the past few years can enjoy at least a year or two of relief. And maybe a new DVD player.

# Part II: Buildable Lands

## Buildable lands and housing targets (Winter, 2002)

A big chunk of the action on growth management and housing policy this year will revolve around number crunching. With the ten-year anniversary of GMA implementation, cities and counties are looking at what they have achieved and where they think they will go in the next ten years, and the ten years after that.

While there have been some encouraging developments in the region, some things have not worked out at all according to plan. Once the successes and shortcomings are better understood, policymakers will have to tune up their plans.

### **Buildable Lands: where's the dirt?**

The first step is the Buildable Lands exercise. Under this state-mandated process, jurisdictions try to figure out whether they will be able to meet their growth targets in the remaining 10 years of the original 20-year planning cycle, which ends in 2012.

Buildable Lands has two parts. First, cities and counties look at the development that has taken place since 1995, comparing the actual housing and commercial densities to the densities they had planned to meet. Second, they look at the land that is left to be developed or redeveloped, taking into account sensitive areas, the need for public rights of way, etc.

Combining these two studies yields an assessment of remaining development capacity in terms of housing units and employment. That assessment is then placed alongside the number of housing units and jobs that remain in the jurisdiction's original target.

All of this leads to one question: given how the market has been responding to current zoning, is there enough development capacity remaining in the jurisdiction to meet its targets?

Growth Management Planning Council (GMPC) staff have been hard at work on this process for well over a year, and the results of their efforts will come out in draft form in late April.

Then it gets interesting.

### **“Reasonable measures”**

What happens if there turns out not to be enough capacity in a jurisdiction to meet its housing target? Although comprehensive plans would have originally included enough zoned capacity to meet the targets, two things might have been happening. First, theoretical densities may not be achievable after applying various codes and development standards. Second, builders, for various reasons, may intentionally be building fewer units than the zoning would allow. For example, in some areas zoned for stacked-flat condominiums it is more advantageous to build townhouses.

The simple answer to meeting housing targets would be to expand the urban growth area. But the GMA says that before the boundary can be moved, the jurisdictions falling short must adopt “reasonable measures” to increase the density of subsequent development. Many of these measures (see box) have been consistently advocated by The Housing Partnership.

What might be reasonable to a local government and its planners, however, may not have much impact in that particular marketplace. Like the rest of the GMA, this process lacks any market test. Jurisdictions that need to increase their densities should be working closely with homebuilders to identify measures that will have a high likelihood of attracting the desired type of development in the very near future. The ten years remaining in the housing target horizon may seem like a long time, but the product mix in most market areas will not change quickly. And given the time it takes to get large, innovative projects approved, a decade will pass quickly.

### **Onward to 2022**

The Buildable Lands process, and subsequent adoption of “reasonable measures” gets us only as far as 2012 – the original 20-year planning horizon. The next step is to use the recent population projections from the Office of Financial Management (OFM) to develop the next set of housing targets.

The new OFM projections, which were released quietly in late January, provide fairly wide ranges of growth estimates, with most jurisdictions concentrating on the mid-range projections. Figures A and B show actual growth for 1990-2000 as well as estimates for 2000-2010 in terms of both numbers of new residents and growth rates.

In King County, the 2022 target process is already underway. Staff of cities and the county will recommend policies to extend the current 2012 targets to 2022. They are gearing most future household growth to three urban sub-areas of King County where job growth is forecasted, in order to maintain a reasonable jobs/housing balance. Draft target extensions will be presented to the GMPC in April along with the Buildable Lands information.

These projections and targets can be a bit scary. During the original debate over growth management in the late 1980s we were warned that we would be adding the equivalent of another Portland on top of ourselves in the coming decade. That turned out to be true, with nearly a half-million people added to the three-county region. The mid-range of the new OFM projections shows that by 2025 we will have added over 900,000 people to the three-county region – more than the combined population of Pierce and Thurston counties today!

Accommodating that many people while maintaining our quality of life will require more than “reasonable” measures. Preserving livability and affordability means all jurisdictions are going to have to be both realistic and aggressive in their approach to their housing market.

## **Reasonable Measures** *(Winter, 2002)*

The Buildable Lands statute required the state Department of Community, Trade and Economic Development to compile a list of actions that jurisdictions could take to increase densities and allow them to meet their housing targets, while leaving the urban growth boundary in place. The suggested actions include:

### **Change zoning:**

Allow higher densities.

Encourage clustering of new housing.

Institute density bonuses in exchange for investments of community value.

Establish maximum lot sizes.

Institute minimum densities.

Allow small lots within single family neighborhoods

**Increase housing choices:**

Encourage accessory dwelling units.

Allow co-housing as an additional housing option.

Permit duplexes, townhouses and condominiums in residential districts.

**Use planning tools:**

Perform up-front environmental review along with subarea planning.

Provide property tax incentives for multifamily development in targeted areas.

Allow narrow streets in new developments.

Provide amenities to attract development to urban areas.

Adopt design standards to encourage attractive compact development.

Shift capital facility investments toward projects that support residential density.

## **Buildable Lands: the results are in! (Spring, 2002)**

Well, at least at the sub-regional level. The final city-by-city report comes out September 1. The next issue of Housing Stock will have the full results. The table shows the capacity, in terms of housing units, for the four sub-areas of the county, and by zoning type.

	Capacity in Single Family Zones	Capacity in Multi Family Zones	Capacity in Mixed Use Zones	Capacity in Rural Cities and Planned Developments	Total for subarea
East King County	19,201	9,726	24,505	9,340	62,772
Seattle/Shoreline	17,191	39,894	65,255	N/A	122,340
South King County	40,854	12,573	11,971	3,216	68,614
Rural Cities and UPDs	2,433	700	208	5,835	9,176
Total by zone type	79,679	62,893	101,939	18,391	262,902

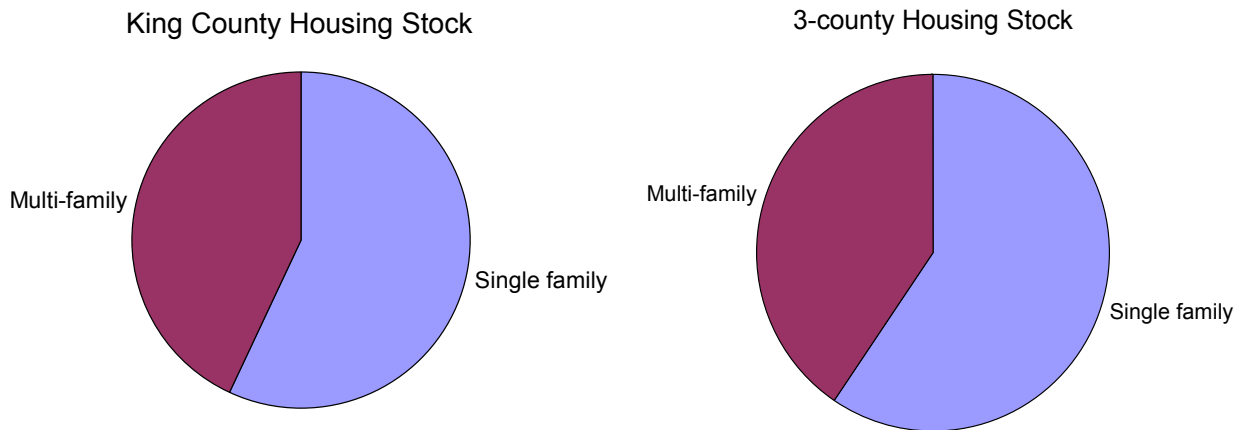
The following pie charts show the extent to which future capacity and housing targets rely on a dramatic increase in housing production in the Seattle/Shoreline/Lake Forest Park subarea. This heavily built-out and urbanized area has nearly half of the identified residential capacity within the urban growth areas of the county. And while it accommodated just 22 percent of the housing growth of the past decade, it is expected to accommodate over 36 percent of the housing growth of the next 20 years. There is little room left for single family homes in these cities, so the projections seem to suggest a significant increase in the percentage of households living in apartments and condominiums. All jurisdictions need to find out whether these assumptions are consistent with the market projections of the homebuilding industry.

## Buildable Lands: We Don't Live in "Units" (Fall 2002)

Buildable lands treats all housing units alike. For purposes of assessing overall housing development potential, capacity for a studio apartment is treated the same as capacity for a 3000 square foot house. But no one looks for a "unit" to live in. On the contrary, individuals and families looking for a place to live have very definite ideas about what will meet their needs. They look for single family houses, condominiums, townhouses, apartments, manufactured homes, or whatever satisfies their lifestyle needs within their budget.

The Buildable Lands process consciously did not address the demand side of the housing market, but before jurisdictions make any planning or policy changes based on the Buildable Lands data, they must understand the components of demand likely to emerge in their community.

A rigorous market analysis will provide a complete picture of the overall market. A simple starting point, however, is to look at the relative demand and supply of single family and multi-family/mixed use housing. The charts below show the existing mix in King County, as well as the larger three-county area. (Source: 2000 Census)



The chart below shows the development capacity within King County for single family, multi-family and mixed use housing, according to the Buildable Lands report. (The Buildable Lands report breaks out mixed use since it a distinct zoning designation, but the housing components of mixed use developments are almost always multi-family. The chart assumes that all rural UGA capacity is single family and half the capacity in urban planned developments is single family and half multi-family).

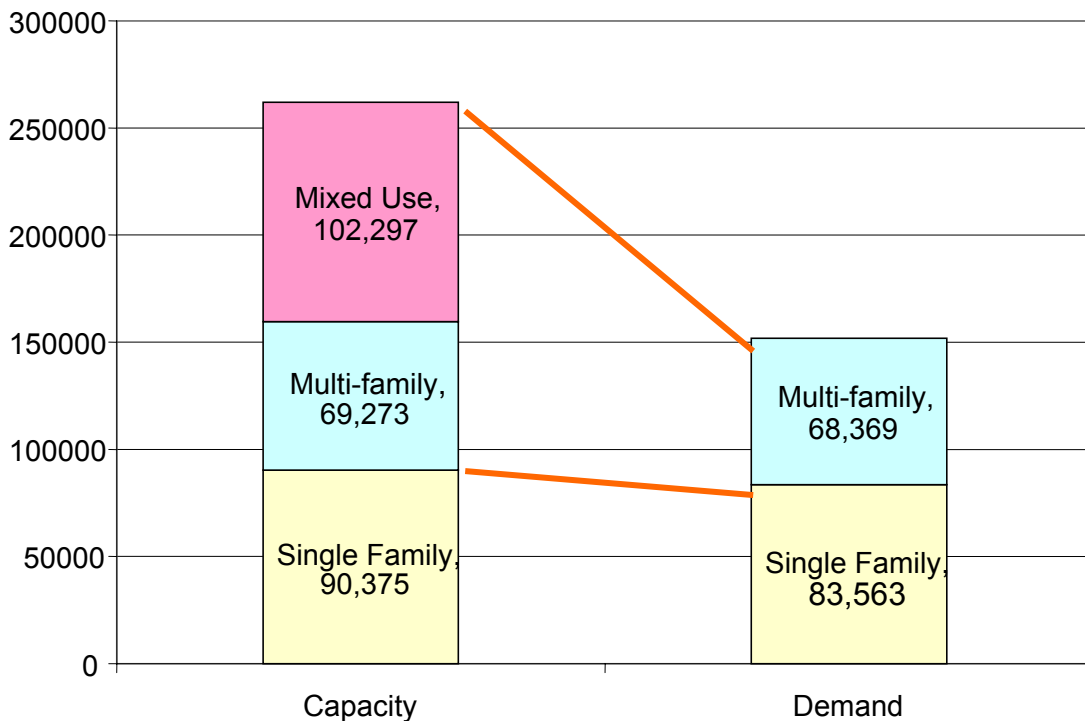
### King County Capacity



The distribution of zoned capacity is clearly out of line with the current pattern of development in the region. The existing housing stock in the region is nearly two-thirds single family, but the future capacity is only one-third single family. Since development patterns can be assumed to correspond to market preferences (builders only build what they know they can sell or rent) capacity for housing types does not match current market preferences.

The market has, however, been gradually shifting toward multi-family development. In 1990, 62 percent of the three-county housing stock was single family, and that had dropped to 59 percent by 2000. For purposes of illustration, a reasonable guess at future demand in the region might be 55 percent single family, and 45 percent multi-family.

The housing targets recently adopted for King County by the Growth Management Planning Council indicate a need for just over 151,000 housing units by 2022. The following chart shows the capacity under Buildable Lands compared with that target, split 55/45.



Under this analysis, single family capacity is very close to the projected demand for single family houses in the next 20 years. When demand approaches the limit of supply, prices will rise dramatically. It is difficult not to conclude that developable single family zoned land in King County will rise significantly in price over the coming years, exacerbating affordability problems.

As jurisdictions use the Buildable Lands analysis to update their comprehensive plans, they must look at the components of demand in the housing market of their area, and not just focus on overall housing unit counts. An insufficient supply of certain housing types, particularly single family, will simply drive buyers further into adjacent counties.

## **Buildable Lands: Getting the Bulldozers Rolling** *(Fall 2002)*

Most people would agree that redevelopment of obsolete or underutilized properties is a worthy goal for any community. There is nothing appealing about the hollowed-out centers that continue to blight so many U.S. cities. And redevelopment takes advantage of existing public and private infrastructure and contributes to slowing the expansion of development into rural areas.

The recent King County Buildable Lands report shows that only 41 percent of the housing development capacity in the County is on vacant land. The remaining capacity is on "underutilized" land zoned for single family or multi-family housing, or for a mix of uses that could include housing. While much of the land zoned for mixed-use or multi-family development would be expected to have a current use, nearly half of the available land zoned for single family housing also has some current use. This land consists mostly of larger lots with an existing house. If the large lot is actually more than one parcel, the parts without the house are considered vacant, even though they may be fully incorporated into the landscape and use.

A redevelopment strategy for underutilized land presents significant challenges for both developers and local governments. Following are some questions that need to be answered.

### **Is it for sale?**

For any developable land, the first question is whether the owners have any interest in selling it for development, and in what timeframe. Each jurisdiction used its own "market factor" to apply a downward adjustment to total projected development capacity by presuming a certain percentage of land would be unavailable during the next ten years. Market factors range from zero (i.e. all listed land would be available) to fifty percent (half would be available.) Countywide, the report assumes that 20 percent of buildable acres – both vacant and redevelopable -- with residential or mixed use zoning would not be for sale before 2012.

The accuracy of these factors is unknown, and probably unknowable. Given the tightness of the land supply, especially in single family zones, however, they will play a critical role in determining when, as a practical matter, builders run out of available sites they can afford.

Owners of land have all sorts of reasons for keeping it off the market or turning down offers to purchase. A reluctant owner's motives might reflect one or more of the following:

Current income. Older properties, especially small commercial spaces in mixed use zones, are often owned outright by individuals who enjoy the predictable income. Although they might earn more through selling the property and investing the proceeds elsewhere, doing nothing is the easy option. This is especially true for absentee landlords.

Waiting for prices to rise. In an environment with a ceiling on land supply, prices will certainly rise over time, especially in high-demand areas. The capital gains realized through holding onto property, combined with rental income from it, may result in higher earnings than investments made with sale proceeds. As the stock market continues to stumble, this becomes even more true. So unless owners feel some personal or financial urgency, holding onto property often makes good financial sense.

People like large lots. The region is dotted with homes sitting on parcels that would accommodate more than one house, and these are counted as redevelopable. Many people, however, enjoy the space and use it for gardening, keeping horses, running dogs, etc. If the taxes are not a burden, owners can remain on their larger parcels for quite a long time. And in many areas, when such parcels come on the market, they may be purchased by an individual who will keep the parcel intact and just remodel or build a new home.

The family business. Older commercial buildings in neighborhood commercial zones are often owned by the occupants, who operate a business there. Selling the property for redevelopment would mean relocating the business or shutting it down, prospects that many business owners would not relish.

Home sweet home. Many people are simply attached to their homes, regardless of the financial rewards that might come from a sale. They may choose to move or subdivide eventually, but for the time being will continue turning the realtors away from the door.

### **Is the market ready?**

Many areas have good theoretical redevelopment potential for a reason: owners have not maintained property because they had little incentive to do so in that neighborhood. So even if the owner is eager to sell at a good price, and the existing use has little value, the area itself may not offer sufficient rents or purchase prices to justify new construction.

### **Is the infrastructure in good shape?**

In many areas ripe for redevelopment the existing infrastructure is undersized and/or in poor condition. Some areas have large parcels for a good reason: no sewer service. Due to fisheries concerns, there has also been increased attention to retrofitting storm water systems or providing new systems. The developer will likely get hit with fees to extend or rebuild infrastructure, driving up the cost of the project. This is especially a problem in jurisdictions that do not have latecomer fees, meaning that the first developer ends up subsidizing future developments.

### **Does the site have environmental problems?**

Uses being displaced through redevelopment will mostly be quite old and may have unpleasant things underground. This may include underground tanks, abandoned utilities, or persistent spills from light or heavy industry. Current owners may not be able to afford cleanup, and developers will be reluctant to take on the liability themselves. In either case, cleanup costs can be very high and unpredictable, since standards will be highest for residential use.

### **What will it cost to prepare the site?**

Except in the case of a short-plat where the existing house is retained, redevelopment begins with demolition. This begins at perhaps \$30,000 for removal of a small house, and goes up from there. Asbestos or other toxics found in commercial buildings add to that cost. Adjacent properties need to be protected, and this is especially expensive if it involves shoring for excavation. Relocating utilities can also be difficult and expensive, particularly if such work affects other properties.

### **Can we get economies of scale?**

Many single family redevelopment sites will accommodate just a few new units, at best. Efficiencies in homebuilding, however, come with larger developments. Costs such as subdividing, utility work, site preparation, design, marketing and management can be spread over more units. The most efficient

and low-cost builders will get control of the remaining large undeveloped parcels and will tend to avoid small short-plats, especially in areas at the lower end of the market.

### **What will the neighbors think?**

Local plans may embrace redevelopment, but the time lag between plan and implementation can be problematic. New citizens, new decision makers and new staff sometimes have a different "vision" than those before them. As such, even redevelopment plans that are consistent with the plan "vision" can be very controversial.

Imagine the scene. An older couple in a small rambler with a huge back yard. The neighbors keep it mowed and their kids and dogs enjoy the couple's generous hospitality: apple trees, baseball games, treehouses, rope swings. Then the couple must move on and their children sell the acre and a half to a developer who wants to put in a dozen homes. The neighbors are livid and vow to fight the project every step of the way.

Imagine another scene. An old, one-story grocery store on a corner at the edge of a neighborhood commercial zone. The neighborhood gets popular, and a developer buys the parcel and plans a five story mixed use complex that goes all the way to the lot line. Although consistent with zoning, the big new building threatens the funky character of the neighborhood, and remaining older businesses will be dwarfed. Local business owners and residents gear up to fight every step of the permit process.

These scenes will be repeated over and over in the coming years.

### **So, what do we do?**

To a large extent the market will eventually push redevelopment as demand rises and vacant sites become increasingly scarce. Over the past six years, about a quarter of all housing units have been built on re-development sites. There are, however, some steps that local governments can take to accelerate redevelopment and promote it in targeted areas. These include:

Simplify environmental review. By performing an up-front environmental review for an area, or by authorizing "planned actions," local jurisdictions can make redevelopment easier, less time consuming and less costly. Jurisdictions can also raise the threshold for SEPA to 20 units, removing one cost and time factor from small redevelopment projects.

Infrastructure retrofit. If areas targeted for redevelopment have obviously inadequate infrastructure, jurisdictions can determine needed upgrades and find public and private funds to make them. Using future property tax growth to pay for these improvements makes sense, although formal tax increment financing remains problematic in Washington State.

Simplify short platting. An application for a short plat that is inside the urban growth boundary, consistent with current zoning and involves no sensitive areas should sail through quickly and require minimal consulting and permit fees. Recent legislation allows jurisdictions to permit short plats of up to nine lots.

Land assembly. Jurisdictions can assemble redevelopable land into economically feasible parcels, take care of environmental problems, and then sell the sites to developers. This would remove some of the headaches and uncertainties from redevelopment.

Provide amenities. Local governments can accelerate the emergence of residential markets in redevelopment areas by improving safety, enhancing streetscapes and providing parks and other amenities.

Engage Community. Local governments can help to facilitate redevelopment by keeping citizens and decision makers informed and in support of redevelopment contemplated in local plans.

Most developers will admit that it is much easier and less expensive to build housing on large parcels of vacant land. In King County, however, they increasingly face the prospect of infill projects on redevelopment land. Local governments can help to ensure that there is real capacity for growth by making these parcels attractive to developers and by bringing down the cost of building on them.

# Part III: Economics of Homebuilding

## Twelve Laws of the Homebuilding Business (Spring 2000)

Growth Management, Smart Growth, New Urbanism. Whatever the tag, efforts to control the spread of urbanization and create more compact development patterns will require homebuilders to do business differently. This will not happen overnight. Homebuilding is an inherently cautious industry, in many ways the opposite of the technology sectors that have captured our attention. The following perspectives on the industry can help guide efforts to bring homebuilders into the process of transforming the urban landscape.

### **1. Homebuilding is a small and local business.**

While a few large national developers operate in the region, most single and multi-family homebuilders are small businesses, relying on expertise in particular markets and regulatory environments. In this area, the average single family builder starts five to ten homes a year, and the average multi-family builder starts 25 to 50 units a year. These firms have just a handful of employees and contract out most of their work. This industry structure encourages lots of competition, to the benefit of consumers. In a difficult regulatory environment, however, small builders can be frozen out by long lead times and high up-front costs which cannot be financed.

### **2. Homebuilding is low margin business.**

Risk and reward go hand-in-hand, and one reason homebuilders avoid risk is that the accompanying rewards are not great. This mature, competitive industry lacks dramatic upside potential. No killer application waits to be discovered and propel the entrepreneur to instant wealth. Builders make money the old fashioned way: good business practices and long-term consistency in producing quality products that meet market demand. The risks of innovation can far outweigh potential rewards.

### **3. Homebuilding has long time horizons**

Homebuilders measure their product cycles in years, even decades. Economic conditions can change dramatically between property acquisition and final sales: prices may not materialize, large employers may downsize, consumer confidence may drop, other builders may bring projects to market at the same time. To be viable, then, a homebuilding project must make sense under a variety of future economic scenarios.

### **4. The housing industry is elastic.**

If economic or regulatory conditions become too difficult, homebuilders may simply disappear. With limited fixed assets they can move their business to new areas of opportunity or lines of work. A small builder may shift to remodeling, and a large builder may move to another region or state. The skilled workforce can move into other trades or relocate. Once the industry downsizes it takes years to rebuild.

### **5. The numbers always matter.**

Homebuilding has so many inherent risks that the builder must plan very carefully in order to minimize them and ensure margins for the unexpected. A project must pencil out based on the best available market information and on accepted industry principles such as the ratio of land price to unit sales price. Solid numbers are an absolute pre-requisite for bank financing, so even if the builder decides to take a chance on the numbers, their banker will not likely take the same chance.

## **6. Time is more than money; it is survival.**

Once a builder has committed to a project, delays in getting permits to build are deadly for several reasons, the most obvious being the cost of financing land and up-front design and development work. Less obvious is the impact on basic business planning. The builder needs to know when to commit scarce capital, when to gear up for construction, when to sign on sub-contractors, when to initiate other projects and how to keep cash flowing to cover overhead. When sales income is pushed further into the future, either prices must rise or profits will be eaten up. Imagine a retailer trying to survive with no inventory to sell.

## **7. Debt financing discourages risk.**

Homebuilding is a high leverage business. Most builders, especially small ones, use bank debt to finance their projects. Unlike equity financing, where investors accept the risk of losing capital, banks fully expect to get all of their money back, on time and with interest. Builders borrow between 70 and 100 percent of their costs. The percentage of capital required of the builder depends on the risks in the project, with higher risk projects requiring more builder investment. Or, put another way, by lowering risk, builders can leverage their own limited capital into more units.

## **8. Profit equals personal income.**

Builders cannot rely on a steady cash flow to pay their own salaries. They only make money when they sell their units or begin to receive rents from them. The builder's personal income is embedded in the project, and this income can vanish quickly if costs rise or customers become scarce. Banks, contractors and suppliers must get paid first, so the builder's livelihood tends to come last. As a result, the builder will make every effort to load all costs, including fees levied by local governments, onto the final customer.

## **9. Supply follows anticipated demand.**

"Build it and they will come" is a good way to go broke. It must be emphasized, as obvious as it may seem, that homebuilders respond to a demonstrated need of people for homes. Most homebuilders do not think of themselves as being in the business of implementing land use plans or community visions: markets, not plans, point to opportunity and determine success. Once builders identify overall demand in an area they look at what potential customers in that market can pay. Anticipated sales prices or rents will determine unit size and the features and amenities the builder can add. The wider the variety of housing types allowed, the more ways a builder can find to meet customer demand.

## **10. Buyers avoid risk.**

Most builders do not hold onto the units they develop. Single family and condominium builders sell to individuals, and apartment builders often sell to investors. Individuals are making a large financial commitment and need reassurance that they can sell for a good price should relocation or other life changes dictate that necessity. Apartment investors seek solid returns and low vacancies based on rents that the local market can support over the long term.

## **11. Buyers and renters have options.**

Even in the hottest market, buyers and renters have options that the builder must consider when deciding what to build. For example, a couple without children may consider a townhouse, a small detached house or a view condominium, all in the same price range. New houses compete with existing houses. Stocks or other investments compete with housing for long-term returns.

## **12. "The earliest Christians get the hungriest lions."**

Like any business, homebuilding has a learning curve. But unlike other industries, being first to market with innovative products does not necessarily promote market leadership. Branding is weak and innovative projects are easily imitated, so subsequent developments can take advantage of the experiences and lessons of early money-losers. In an open environment, therefore, innovation tends to be incremental and small scale. Larger scale innovation can be found in masterplanned communities where the developer can control more of the inherent risk factors.

The common thread through these "laws" is the reluctance of homebuilders, lenders and buyers to take on more than the usual amount of risk. Communities that want to attract new and innovative developments or want to expand housing in slow markets can do two things to entice builders and buyers: mitigate risk or raise rewards. The process of transforming development patterns will be slow if responsibility is placed solely on the shoulders of the homebuilding industry.

## **Why Time Matters to Homebuilders** *(Fall, 2000)*

Homebuilders and housing advocates frequently express concern over the time it takes to process permits and get projects underway. Although it is generally understood that delays have an impact on housing production and costs, following are some specific ways in which time and costs are linked.

### **Delays tie up scarce capital**

Most homebuilders finance construction with a combination of their own equity capital and bank debt, just like a consumer buying a home with a combination of their own cash down payment and a bank loan. The ratio of equity capital to debt varies through the different stages of the project. Generally, the farther the project is away from completion and sale to the customer, the higher the risk and therefore the more equity required. So, in purchasing raw land or finished lots, the builder must put up a large amount of equity.

Other costs that arise early in the development process may not be financed with debt at all. Because bank debt is generally secured against hard assets like raw land, lots or finished homes, builders may have to use their own capital to pay for soft costs like design, engineering, market research and fees.

Before the first yard of concrete is poured, therefore, the builder has invested a substantial amount of both equity and debt. Delays in recouping this money from the sale or rental of finished units has several impacts on housing costs and availability.

First, heavy demands on capital keep all but the most established builders out of the market. Smaller builders simply do not have access to the patient capital and income streams needed to ride out lengthy and expensive permitting processes. Smaller builders tend to be the ones attracted to innovative products, infill sites and other projects that contribute to housing affordability within the growth management context.

Second, delays increase the return that must be provided to equity and debt. Interest must be paid to banks of course. Builders (and especially any equity partners they may have) should expect to earn at least as much on their equity investment as they would on alternate investments of similar risk. Longer delays lead to higher risk of market shifts and, therefore, expectations of higher returns. Interest and return on equity are costs that must be recouped in sales of units, and therefore are reflected in prices.

A third impact is that equity tied up in idle projects cannot be invested in new projects. A builder waiting for permits on one project may not have enough equity available to acquire land and get future projects underway. So while there may be market demand for housing, a builder waiting on permits may not have capital to aggressively try to meet that demand.

### **Delays affect scheduling and the availability of contractors and subcontractors**

Most builders do not employ many of the people who do the actual building of homes. They rely on a network of contractors and subcontractors to perform the various specialized work involved in homebuilding, all the way from foundations to landscaping.

These contractors, in turn, employ people with the necessary skills. The contractors and skilled craftspeople want to stay busy at least five days a week, especially during good weather. As the construction season gets underway, contractors schedule themselves so they can move with some certainty from project to project. Few contractors or skilled workers are willing to wait around for permits to be issued, making it difficult to begin a project in July, August or September on short notice.

In order to engage the various contractors in the right sequence, builders must know when they can begin. If permitting is uncertain, builders have two choices. They can schedule start dates well in the future to allow extra time for permitting, which ties up capital even longer. Or they can schedule a start time within a reasonable permitting time, and run the risk that delays will cost them their slot in the contractors schedule. And since work must be done sequentially, and most site work cannot be done in poor weather, delays ripple through the whole schedule.

### **Delays increase market uncertainty**

The economy in the Puget Sound area, and therefore the housing market, is notoriously cyclical. Developers and builders in the area have learned this, sometimes through bitter experience, and tend to be conservative in their business practices.

No one wants to get stuck with unsold homes or lots when the economy turns down, so at the first sign of economic slowing, new development activity can slow dramatically. Inventory not sold or rented during the previous up-cycle helps meet the weak market demand of the down-cycle, so that by the time the next upturn comes, little or nothing is in the pipeline.

The longer it takes to meet newly accelerating demand for homes in a resurgent economy, the higher prices will spike for both new and existing homes. Then, as the business cycle matures, builders begin to anticipate the next downturn. The longer it takes to get homes built, the more likely the builder will be to pull the plug on projects in the face of an uncertain economy.

In other words, the longer the time to get finished homes to market, the less likelihood that new homes will be available in a timely way to fill strong demand.

### **Inflation and Industry Dynamism**

The three impacts of delays described above all work to drive up housing costs. The first two increase the cost of producing housing resulting in price increases. This is classic cost-push inflation. The third acts as a damper on how much production builders are willing to commit to, making it less likely that supply will catch up to demand. This leads to demand-pull inflation.

Another longer term impact is felt in the structure of the homebuilding industry. Higher capital requirements and interest costs, and greater operational uncertainties all act as barriers to entry to the industry. Smaller builders simply do not have the financial capacity or staying power to weather delays, and they may not have much scheduling leverage with contractors. With fewer builders we begin to lose the benefits of a diverse and dynamic industry that provides healthy competition and a wide range of product choices for consumers.

# How Homebuilders Finance their Business

## *(Winter, 2001)*

Homebuilding is a very capital intensive business. Nearly all developers and builders rely on borrowed money to build projects, and the cost and terms of that borrowing have a strong influence on their business practices. This paper provides a short overview of homebuilder financing and how it shapes the industry.

### **Financial objectives of the homebuilder**

Like any business making a product, homebuilders are attempting apply their knowledge and skills to a collection of ingredients in order to make something, the value of which is greater than the cost of materials and labor. That additional value, or profit, is usually measured in terms of "return on equity." (more on equity below).

Builders have another, more immediate, objective: getting paid. For most builders this is their full-time occupation and they need to get paid for their time.

It is crucial to remember that the builder is always last in line for payment. Bank loans get first call on sales revenues, and then come equity partners. Only after everyone else is paid does the builder get paid. With the huge amount of cash flowing through a project, even a relatively small cost increase or price decline can wipe out the builders income.

Builders, then, have two principal financial objectives. First, they must earn enough money on projects to pay their expenses including their own salaries. Second, they must earn back the equity capital they have used, and with a return sufficient to justify its use for that project. The builder's expanded base of capital can then go into future projects.

### **Building with equity and debt.**

Most builders finance their projects with a combination of equity capital and bank debt. The proportion and cost of each has a strong influence on the financial viability of a project.

As a rule, the higher the risk in a project, the lower the proportion of debt to equity. If a project fails and goes into default, banks will usually take possession of the project and try to liquidate it to get their money back. Banks know that a lower risk project will be easier to sell and poses less risk of loss, so they are willing to take more exposure. As a project becomes riskier, the bank faces higher losses in the event of liquidation, so they want to make sure there is lots of equity to absorb those losses.

For example, if a bank loans 70 percent of the value of a project, and that project defaults, the bank can sell it at up to a 30 percent loss and still come out whole. It is the builder that loses the 30 percent. The higher the percent of the financing in debt, the less of a loss the bank can sustain in a liquidation.

So the lender, after examining the project and the experience and reliability of the builder, will determine what percentage can be financed with debt and what percentage must be financed with equity.

For the equity portion of the financing, a builder must generally begin with his or her own money. The bank and other equity investors will want to know that the builder is willing to share in the risk of the project.

On larger projects other equity investors may come on board. A sophisticated investor will expect the return on their investment in the project will be comparable to the return they would get from other

investments of comparable risk. Strong historic returns from stocks, venture capital funds and other equity investments mean that homebuilders must offer relatively high returns and minimal risk in order to attract equity investors. This can be difficult, however, because homebuilding is a mature, competitive industry without the explosive returns we have seen from the technology and communications sectors in the past decade.

With equity so much more expensive than debt, builders will want to maximize the debt-equity ratio on a project. That, in turn, means minimizing risk and sticking to projects that have a high likelihood of success.

To really push the envelope in terms of markets or building types a builder must have access to a lot of equity capital and be willing to risk a total loss of that capital. In light of the financial goals named above, not too many builders will be out on the cutting edge.

### **Financing different stages of a project**

Debt and equity play different roles at various stages of a project. Bank debt is generally secured against a hard asset that can be liquidated in case of default. Builders can use debt to finance land purchases, physical improvements to the land (utilities, roads, etc), construction of buildings and some of the services associated with these improvements.

The debt-equity ratio for each of these hard costs will vary. For example, raw land with no entitlements is a much riskier investment than finished building lots or a clean in-fill site, so more equity must go into it.

Many soft costs must be paid for with builder equity. This may include design and engineering work, marketing studies, interest on bank debt, permit fees and processing costs, legal fees, etc. These soft costs place a financial burden on builders for two reasons. First, equity investors may demand a higher return on money they put into early-stage costs, since these costs occur long before the sale of a finished product and some even occur before financing is secured. Second, some of the equity that must be put into soft costs cannot be credited to the overall equity requirements in the project and therefore cannot be used to leverage debt.

### **What it means to "pencil out"**

As a project takes shape, a builder must undertake a rigorous financial analysis to ensure the best chance of meeting his or her financial goals. A "pro forma" analysis of a project describes the revenues and expenses of a particular scenario and, on the bottom line, the return on equity.

The whole point of "penciling out" is to plan a project that meets an identified market demand and provides an attractive return on equity. In planning the project the builder is constantly adjusting cost factors (brick or stucco, vinyl or laminate flooring, etc) and market factors (condo or rental, what size units, how much parking, etc) to bring units in at a price the market will support.

For most builders, the ultimate objective is to sell the units. For single family homes or condominiums, the builder can establish sales price targets based on comparable sales and known market trends. In a rental building, the builder can approach investors with a value based on prevailing rents and "cap rates" (a formula for converting rental income into value).

All of this analysis feeds into the process of financing the project. Banks will want to know that the project will generate enough revenue to repay their loans. Equity investors will want to know the return they can expect. So unless the builder has enough capital to finance the entire project, it must "pencil out" in order to get started.

### **It's all about minimizing risk**

In any investment decision risk and reward go hand in hand. As a mature and competitive industry, homebuilding cannot offer investors extraordinarily high rewards, so it must offer minimal risk.

Risk aversion permeates the residential real estate industry, from land development all the way through final sales. Capital intensity, long lead times, uncertain processing times and susceptibility to business cycles make homebuilding an inherently risky industry under the best of circumstances. It should be no surprise, therefore, that builders and those who finance them will avoid any additional risk.

Communities can, however, shift the risk-reward equation. They can, for example, lower risk by shortening permitting times. Community improvements, like parks or transportation facilities, can increase the value of a project and make it more likely to pencil out.

In the current political environment, homebuilders are being asked to shift their business practices to conform more closely to "smart growth" principles. The nature of homebuilder financing will, however, make builders cautious about moving into new products and markets on their own.

## **What it means to “Pencil Out”** *(Winter 2002)*

A homebuilder contemplating a potential project needs to determine, first of all, if it makes financial sense. Does it “pencil out?” In other words, is the anticipated profit sufficient to offset the risks inherent in the undertaking. Community leaders who understand this equation will have a greater likelihood of seeing their housing plans turn into real buildings on the ground.

Following is a brief explanation of what goes into the estimating process and factors that can effect the outcome. But first, . . .

### **Why it matters**

With its substantial capital requirements, homebuilding relies heavily on OPM: “Other People’s Money.” Most of this capital comes from banks, which insist on getting all their money back, on-time and with interest. This is non-negotiable. The rest of the capital comes from individual investors, beginning with builders themselves and often including other equity partners.

If a project does not “pencil,” OPM will not be available from either banks or equity investors, thus the project will not get built. This rule applies to all builders, whether they are financing a few homes with the help of their in-laws and their local bank, or they are financing huge developments through national capital markets.

### **Revenue: who will buy and how much will they pay?**

A builder first needs to know if there is demand for the kinds of homes they want to build, and how much people will pay to buy or rent them.

In for-sale projects a builder will look at sales trends in the area, employment growth and incomes. This will help determine whether there is demand for new homes, and if there is, what unit types and sizes and what fixtures and finishes will make the best use of the property. For example would a particular neighborhood be appropriate for 3500 square foot houses? 2800 square feet? 2200 square feet? Should countertops be granite, Corian or laminate? Can condominium buyers afford underground parking?

An apartment builder will survey vacancy rates, prevailing rents and demographics to help determine whether a particular neighborhood is under-served by existing housing. If the builder wants to sell to investors when the building is finished, anticipated rents, along with the “capitalization rate” will determine the market value of the building. The capitalization rate, in turn, is determined by the investor’s expectations for future rents in the building and its neighborhood.

The amount of financing available is determined by, among other things, the estimated market value of the finished project. Banks typically lend no more than 80% of the projected market value. Builders who want to “pioneer” and introduce new kinds of housing to an area may have trouble lining up financing since no market data is available.

### **Costs: Some predictable and some not**

Land. It all begins with the dirt. This can be a relatively straightforward process, as when a builder buys lots with all the entitlements, roads and utilities taken care of. More complex are projects that involve development of raw land, redevelopment, environmental hazards, wetlands or other sensitive areas.

Soft costs. This broad category includes such expenses as design, engineering, legal fees, insurance, market research and permit fees. Although each item may not seem too big, they can add up to perhaps 20 percent of the total project cost.

Mitigation. Many jurisdictions charge fixed impact fees for roads, schools, parks etc. which are predictable. Larger projects may be charged less-predictable project-specific mitigation fees for transportation and utilities.

Construction. Before a project is designed and bid, an experienced developer can set a per-square-foot target based on the “specs” they determine the market will support. Material and labor costs can, however, change significantly over the course of a project, as they did during the late 1990s.

Finance. Loans for land acquisition and construction carry interest and fees. Apartment builders factor in the cost of long-term financing.

Sales. Most new houses and condominiums are sold through real estate agents who receive a commission paid by the builder. The builder may do additional advertising and will be responsible for a portion of closing costs. A new apartment building will need to do a big marketing push to get filled up the first time.

Management and overhead. Most of the work on a project is contracted out to professional service and construction firms, but someone has to manage the whole project and cover the many miscellaneous costs that spring up.

### **The bottom line: return on equity**

As the units are sold, the builder pays off the bank loans and then pays the equity partners their original investment along with a return on it. It is the size of this “return on equity” that determines the financial success of a project. Equity partners have choices of where to invest their money, and a homebuilding project should provide them with a return comparable to a return they might get in another investment of similar risk. A builder who does not make enough profit to provide a reasonable return will have a difficult time lining up investors for the next project.

### **Variables: unknowns that can sharpen or break the pencil**

A number of variables can affect the overall feasibility of a project and make the penciling process uncertain. Among them:

Economy. The primary determinant of demand for housing is job growth. The more jobs in an area the more people the area will attract, and the more young people can move out on their own. Higher incomes mean more move-up buyers and a taste for larger or more elaborate housing. On the other hand, slow growth in jobs and incomes results in reduced demand and more modest expectations.

Vacancy rates. Closely tied to the economy is the vacancy rate for apartments. Overbuilding and/or an economic downturn will lead to higher vacancies and flat rents, making new projects less viable.

Timeframes. Since land acquisition and many soft costs must be financed up-front, the longer it takes to get a project underway, the higher the overall financing costs will be. Uncertain timing drives up construction costs as it becomes more difficult to schedule contractors. And the longer it takes to get a project to market, the greater risk that economic conditions will deteriorate.

Interest rates. Short-term interest rates determine the cost of construction financing, and long term rates have a profound influence over consumer demand and affordability, as well as permanent financing of apartments.

Cost of equity. When stocks, bonds, venture funds or other investment opportunities are providing big returns, equity investors will demand higher returns from homebuilders.

Holding time. Finished units that remain unsold soon begin to eat into the builders profit margin. The entire return on equity can vanish in as little as six months, with losses after that.

Take-out financing. When an apartment building is finished, construction financing is replaced by long-term, or “take-out” financing. If economic conditions deteriorate, that financing may be insufficient to cover construction costs, forcing the builder to leave their equity in the building.

Liability insurance. All builders must carry general liability insurance. The growing number of defect lawsuits, especially against condominium builders, has made this insurance very expensive.

### **Homebuilding is a business**

People who build houses, apartments and condominiums are not much different from entrepreneurs who sell other products and services. When builders “pencil out” their projects they adhere to a few basic business practices.

First., they concentrate on their customers. A house, condominium or apartment unit is a huge, long term investment that must appeal to the very exacting requirements of the homeowner or investor.

Second, they plan their business so they can sell their wares for a price that covers their costs and nets enough profit to make the whole exercise worthwhile.

Third, they look out for the long term. They must satisfy the needs of current customers and investors in order to make sure they will have future customers and investors.

### **Penciling out is a community exercise**

As communities envision what their neighborhoods might look like in the future, and what sorts of projects they would like, they need to work closely with the people who will build those projects to ensure that their visions make good business sense. If community plans call for development scenarios and housing types that do not pencil out to the satisfaction of homebuilders, bankers and investors, nothing will get built and the visions will remain on paper.

# Part IV: Affordable Urban Housing

## Insights on urban center housing (Spring, 2000)

In implementing the Growth Management Act, local leaders decided that 25 percent of the region's housing growth over the next 20 years will take place in urban centers. Development in a few of the 12 designated centers has taken off, but most are not developing as quickly as hoped. To better understand how local governments and the development industry can work together to bring the urban center vision to fruition, The Housing Partnership convened a Workshop on Housing in Urban Centers on May 3, 2000, which was attended by over 100 representatives of local government, the housing industry and business and community groups. Following are some conclusions.

### The Urban Center Vision

#### **Begin with a vision . . .**

A community must begin with a widely shared vision of how its center might evolve. Then there are some very practical questions about demographics, finance, infrastructure, and community impacts.

#### **. . .Then add money . . .**

Lots of public investment in things like parks, transit, streetscapes and parking will be required to make most centers truly attractive places for housing development. To spur center development, local governments need to absorb some of the costs normally imposed on development.

#### **. . .And stick with it for the long haul**

Since centers can take decades to develop, the vision must be durable. In a political environment characterized by two and four-year cycles, this can be a challenge.

### **Demand for Housing in Urban Centers**

All of the speakers at the workshop described a regional and national trend toward a return to urban lifestyles. Unlike the last century, however, when transportation largely dictated dense urban living, that lifestyle today represents a choice made by people who have alternatives. What can local governments and developers do to create a quality environment with good value that will lure these new urbanites into their centers? Lots of ideas came from presenters and table discussions.

Create an identity and sense of place. People attracted to urban lifestyles want to live in a neighborhood that has an identity. Developing and preserving community character includes attention to long-established business cores with older buildings and interesting business, views, water, landscaping and community activities.

Create pleasant surroundings. In center living, people trade private space for public space, so those public spaces should be really nice. This calls for creative regulation of both open space and the built environment.

Provide local services for convenience and pleasure. Important services are provided by small neighborhood businesses, which are among the most fragile parts of the economy. Local governments need to help these businesses thrive, paying close attention to such needs as parking, access, signage, and visibility.

Ensure safety. Local governments must ensure safety, not just from crime, but also from traffic. Design that emphasizes visibility, along with safe sidewalks and crossings will make residents feel more like walking than retreating to the safe refuge of their car.

### **Attracting Housing Developers to Urban Centers**

Some urban centers in King County have seen an explosion of development in the current hot housing market. Others have seen little or none. High land costs, however, will eventually spread center growth, and developers will look elsewhere to other emerging centers. How can local governments interest developers in their centers? Following are some areas covered by presenters and table discussions:

Land. Local governments have limited tools to deal with land costs, but they can assemble land and make it available to builders. They can also make sure that enough land in centers is zoned for higher densities and that developers can get the maximum yield out of that land.

Infrastructure costs. Many centers still lack the roads, sidewalks, parks, stormwater and other systems needed for high density residential living. Local governments should plan and design these ahead of time, and find equitable methods of paying for past infrastructure deficiencies as well as new improvements.

Parking. The cost of providing parking drives up overall development costs and pushes prices and rents out of range of moderate incomes. Speakers and participants at the workshop expressed wide support for changing parking requirements in centers, allowing shared and off-site parking, and providing public parking in centers.

Processes. Development processes can be a challenge under any circumstances, but those processes can be even more difficult in centers. As with infrastructure financing, processes should not penalize developers working in centers, especially those pioneering the market. Processes should be predictable, fair and finite.

Flexibility An overall vision for a center must be accompanied by flexibility. If developers are locked into certain configurations and uses they may miss important market shifts. One solution to this problem is to regulate by design rather than use or density.

### **Conclusion**

A centers strategy must assume that potential residents have choices and that the center must compete with alternative housing options and lifestyles. In marketing terms, the centers must offer a "value proposition" equal to or greater than the value propositions offered by other options people have.

Fortunately, centers are part of a historic shift in lifestyles. But historic shifts can be slow. The true test of success with a growth management strategy based on centers will be the willingness of communities to invest for the long-term.

## **Housing Solutions Conference finds broad agreement on strategies (Winter, 2000)**

For those groups, like the Partnership, that have been working to raise the profile of housing issues in the region, the planets finally seem to be lining up. With increased awareness of the problem and a willingness on the part of leaders throughout the community to address it, we need to identify concrete actions that local governments can take to promote greater housing affordability.

To create a starting point for action, the Partnership, along with the Seattle-King County Association of Realtors and the Seattle-King County Economic Development Council convened the Housing Solutions Conference last Fall. Over the course of two lively meetings, a very diverse array of groups from across the political spectrum pooled their agendas and arrived at a consensus list of actions.

Fourteen prominent organizations, representing business, community groups and the housing industry have endorsed the list, meaning that local governments that propose items on that list can be confident they will receive support.

The list of recommended actions covers five categories:

**Regional Policy and Planning** Although most solutions must be implemented locally, meaningful actions that can be taken at the regional level. This includes sub-regional planning to achieve a better jobs-housing balance, a strategic use of investments in infrastructure and amenities, and a hard look for opportunities to make underutilized land available for housing.

**Local Policy and Planning.** Most housing ties into local comprehensive plans adopted under the Growth Management Act, and many of those plans are coming up for review. The Solutions Conference urges cities to pay closer attention to the housing targets under those plans, and to use local infrastructure and amenity investments to attract new housing.

**Public Perceptions and Politics.** These recommendations recognize the need for improved processes that both allow for input by concerned citizens, but also allow good projects to go forward with minimal delay.

**Permit Process Changes.** In housing, time is money, and delays drive up costs. Although many jurisdictions have made real progress in permit processing, it is a source of continued frustration for many builders.

**Land Use Code Changes.** These recommendations cover a wide range of changes to codes, including parking requirements, retail requirements in mixed use buildings, and the impact of setback and building envelope restrictions.

The recommendations of the Housing Solutions Conference were never meant to be exhaustive, but to signal areas of broad agreement among those advocating for an increase in the supply of affordable housing within the context of growth management.

The recommendations, along with a list of endorsing organizations, will be distributed to local government and civic leaders throughout the county. To make sure you get a copy, email your snail-mail address to Partnership Manager Michael Luis at [mluis@seanet.com](mailto:mluis@seanet.com).

## **Cottages: Affordable Privacy** *(Spring 2000)*

It all began with the Pine Street Cottages.

When this cute-as-a-bug's-ear cluster of ten cottages on Seattle's Capitol Hill emerged from decades of neglect, people sat up and took notice. Here, sitting under our noses since 1916, was another arrow for the quiver of affordable housing strategists, offering the privacy of a detached house with the economics of modest size and medium-density land use.

Eight years later, the same team that restored the Pine Street Cottages is about to put an updated version on the market. The Ravenna Cottages, now rising out of the ground just southeast of Seattle's Greenlake, will offer six 950 square foot cottages and three carriage units, each for about what a decent condo goes for in that neighborhood.

All this is part of the ongoing quest to make cottage housing a real option for affordable, private living. Throughout the region right now cottages are only allowed in multi-family zones, and with land prices the way that are in those zones, the economics just do not work. Ravenna is being built in a single family zone under the Seattle Design Demonstration program, with the goal of showing that well-designed cottage clusters can fit very nicely into single family areas where land costs make them feasible.

Threshold Housing, which is developing the Ravenna Cottages, is run by John Kucher, who pulled off the Pine Street restoration. A key Threshold board member is Marcia Hadley, former Partnership Director, who also served as project architect of Pine Street. This team is also about to launch another cottage project in West Seattle, featuring six cottages and two carriage units.

To help move the cottage idea forward, the Housing Partnership recently completed a report that describes the basic features of this type of development. A follow-up report will document the experience of building and marketing the Ravenna Cottages. Among the findings in the first report are:

**Design Features.** Cottages range from Pine Street, at about 450 square feet (plus a 100 square foot loft) to the Ravenna cottages at 950 square feet in two stories. Cottages are typically arranged in clusters, with a courtyard or walkway in the middle. The Ravenna Cottages include storage units, and the Third Street Cottages in Langley have both storage units and a workshop/utility building.

**Land use.** Existing and new cottage clusters in the region are all in single family areas. Most are in mid-block with a walkway between front porches. The Pine Street Cottages wrap around a corner. Densities range from 12 units to the acre in Langley to 36 units to the acre in Ravenna. They typically have condominium land ownership.

**Market.** Since anyone has been keeping track, cottages have been selling well and providing good value for the purchaser. Although two people could easily live in most cottages, the primary target market is single people. These people have the resources to buy a condo or maybe a small house, but cottages offer privacy, new construction and ease of ownership at an affordable price. An important consideration for this market is the exchange of quality of space for quantity of space.

**Economics.** Although they could be built for a luxury market, cottages can be part of an affordability strategy. Depending on land prices and construction quality, well-designed cottages could come in as low as \$150,000 per unit. In deciding what price range to aim for, the developer needs to look at the primary options available to the potential buyer in that market. After all, affordability is a relative thing, and although the \$230,000 price tag for one of the Ravenna Cottages may seem steep, it is well below new construction single family houses in North Seattle, and comparable to ordinary stacked-flat condominiums.

If residents of the region are going to support the kinds of dense housing envisioned by growth management, they need to be given choices. While not for everyone, cottages do offer a choice to the home buyer looking for affordability and privacy. Help the Partnership and Threshold make this choice more widely available.

# Cottage Housing fills a market gap

## (Spring, 2001)

Americans love choice.

For most products and services, the consumer has a choice across a wide range of price, features, quality, etc. A car buyer can find, at the same dealer, everything from big trucks and SUVs to sedans and sub-compacts. Dinner can be found at a fast-food outlet, a vegan restaurant, a steak house or a four-star dining room. And when you order a latte? Well, . . .

This kind of choice, however, is just not available in the housing market. Although households come in all shapes and sizes, most new housing falls into just two categories: Single family detached houses with several bedrooms, and stacked-flats in large buildings.

The optimum housing stock would offer a much bigger variety. Individuals and families should be able to find a kind of home that matches their needs and lifestyles, especially as they change over time. It's time we started filling these gaps in the housing market.

Cottage housing fills one gap very nicely. Small detached homes built in clusters around courtyards offer many of the advantages of conventional single family houses -- quiet, privacy, a sense of neighborhood -- but in a size suitable for those with less need for space.

A year ago we reported on some preliminary research on cottage housing, and in the meantime lots has happened:

- Threshold Housing has completed the Ravenna Cottages and watched them sell almost instantly.
- Shoreline became the first local jurisdiction to allow cottages in single family zones, and The Cottage Company, which blazed the trail with the Third Street Cottages in Langley, has broken ground on a cottage cluster there.
- Security Properties has included a large cottage component in its Poulsbo Place development.
- The Cottage Company has acquired property for a cottage cluster on Bainbridge Island.

These projects are, however, still the exception rather than the rule. In the economic and regulatory climate of the region cottages are very hard to develop, since most current zoning makes them infeasible. Lot sizes are too large in single family zones, and in multi-family zones the high price of land encourages larger projects.

A high priority for The Housing Partnership this year will be getting more jurisdictions to adopt cottage zoning codes that will allow cottage clusters in single family zones. With proper community safeguards this popular form of housing can move from being an interesting anomaly to being a widely-available choice.

Following are profiles of the three newest cottage projects in the region, and two more that will break ground soon, showing the variety of ways cottages can fit into a community.

# Build an ADU: Be an Accessory to Affordable Housing

## (Fall, 2000)

In a region reeling from high housing costs what could be better than inexpensive housing that goes almost un-noticed in the neighborhood?

That describes accessory dwelling units (ADUs) and although they are now legal throughout the county, ADUs, (also known as "mother-in-law apartments" or "granny flats") have not quite blossomed as many had hoped. Seattle, where many had expected a stampede to the permit counter, has averaged about 68 permits per year for new units.

ADUs, the ultimate infill development need to be part of every community's strategy for increasing housing availability with minimal impact, and work is underway to figure out how to boost ADU construction.

### **Benefits to the community**

As a basic principle of growth management, all communities need to share in creation of new housing so we can preserve rural areas. For many built-out residential communities, especially smaller cities, this is a real challenge. Encouraging ADUs can help these cities meet their housing obligations.

Mercer Island, for example, has a very aggressive program to encourage ADUs in its otherwise expensive housing market. Since 1995, 150 ADUs have been permitted there, with about one third in detached buildings.

ADUs also increase the range of housing choices. They allow people to live in a single-family neighborhood setting who might not otherwise be able to afford it. An ADU would work very well, for example, for a single parent with a child, for whom a large apartment building might not be appropriate.

### **Benefits to the owner**

An accessory apartment allows a homeowner to earn income from an underutilized asset, like an empty basement or garage. Most units can be fit into the basic structure of a house or over a detached garage, so a big chunk of the costs of building an apartment are already taken care of. The market value of a finished accessory apartment generally far exceeds the construction cost of the unit, providing a very handsome income stream for the owner.

This income can be especially valuable to retirees on fixed incomes. It can also allow people to keep their house after experiencing life changes (e.g. loss of a second income) that lower their income. Income from an accessory apartment, if properly secured, may allow a buyer to qualify for a larger mortgage than their income would otherwise allow.

For people living alone, an accessory apartment provides the added security of having someone else looking after the property. And, of course, many ADUs actually do house mothers in law or grannies (or daughters or sons or nieces or nephews . . .).

### **Issues that crop up**

Accessory apartments do come with their own set of challenges, in addition to the obvious ones of having very close neighbors. For the owner, issues arise around noise and shared utility costs. For the surrounding community, the most frequently-cited complaint surrounds parking for tenants.

To better understand the experiences of people building and managing accessory apartments, the City of Seattle Office of Housing has undertaken a research effort that will look at units built since they were legalized in 1995. This research will result in recommendations, applicable in Seattle and other communities, that should encourage more homeowners to build accessory apartments. A future edition of *Housing Stock* will report on the results.

## **New research on mixed use housing** *(Winter, 2000)*

In its outreach efforts last year, The Housing Partnership found many communities embracing mixed use housing as a way to add new housing in urban centers while creating convenient, pedestrian-friendly neighborhoods. At the same time, those working on transit-oriented development (TOD) efforts envision a role for mixed use development around new Sound Transit Stations.

With so much future housing capacity tied to this challenging form of development, the Partnership set out to document the lessons learned in the region over the past decade or so. A wide range of new mixed use developments have been completed in Seattle and on the Eastside, and some clear patterns are emerging that can point other areas toward successful planning for mixed use.

The final report will be published shortly, and the Partnership will sponsor a half-day program on the topic of urban center housing this Spring. A shorter presentation will be made available to anyone who wants to learn about to make mixed use development work. Included in the report are findings on:

**The retailing challenge.** Mixed use buildings in urban centers will generally have ground floor retail with housing above. Planners need to make sure that there is really a market for that space, and that key factors like access, parking and signage can work to the retailers' advantage. In areas that are still evolving as pedestrian centers, it may be best to allow flexibility in the use of ground floor space, so it can generate income for the owner in the near term while the market is maturing, and be converted to retail use in the future.

**Compatibility of uses.** Everyone likes lively neighborhood gathering spots, except, perhaps, those living directly above them. It is no accident that commercial and residential areas have been separated over the past decades, since they often do not get along well together. Ensuring that the commercial and residential portions of a building are compatible over time presents a major design, planning and management challenge.

**Parking and transportation.** Few issues cause as much angst in neighborhood business areas as parking and transportation. The irony is that as those districts become dense enough to support lots of retail, parking becomes more scarce and expensive. Spill-over parking angers adjacent neighborhoods. Local governments can help alleviate parking problems by preserving on-street parking and perhaps building neighborhood garages.

**Development and financing.** Because mixed use buildings serve two very different markets -- residential and retail -- making a development pencil out can be difficult. A developer who wants to take advantage of high demand for housing often must take a major risk if retail is required in the zone and the demand for retail space is weak. The banks that finance the development may not be as willing to go along with high risk retail space, and therefore require more equity on the part of the developer. The risk factors associated with retail can ultimately inhibit the construction of much-needed housing, especially in areas of the county where rents are not high enough to offset the risk.

**Incentives.** Most of the planned urban centers in King County will likely develop into mixed use areas eventually, but if jurisdictions want to accelerate that process they can consider incentives to attract development. This might include magnets like parks, landscaping and public facilities. It also might include zoning incentives that will provide for a greater return on mixed use buildings than on other types of development.

The 1999 King County Benchmark report made it clear that we are way behind in attracting housing development to urban centers. Of the 12 urban centers designated in the Countywide Planning Policies, less than half have seen significant housing development in the past five years. Picking up the pace will require concerned effort on the part of local governments, and receptiveness on the part of the development industry.

For more information, or to receive copy of the report or schedule a presentation, contact Michael Luis at 425-453-5123.

## ***Parking: Curbing a Housing Cost Driver (Winter, 2001)***

The vast majority of American adults own cars, and before they can park themselves in their office chair or their easy chair, they need to have a place to park their car. On tight infill sites, parking becomes an inescapable cost component. We will never get a grip on our housing affordability problems until we find a way to lower the cost of providing parking.

This fact became apparent at the Housing Partnership's urban centers workshop last spring. The Partnership decided to hit the topic head-on with a follow-up workshop entitled "Parking, Curbing a Housing Cost Driver" (November 29, 2000), attended by about 65 public and private sector representatives. Following are findings from the workshop.

### **Parking and the Development Process**

#### **The market demands parking**

Cars remain a very highly valued and utilized part of our transportation system, and they need storage space. Key features of parking demand in multi-family housing include:

Parking ratios. As a general rule, multi-family projects provide 1 to 1.5 stalls per one- or two-bedroom unit. A building with a mix of units should have 1 1/2 to 1 3/4 stalls per unit.

Condo vs. rental. Builders of apartments have more flexibility in providing parking than do condominium builders. Condo buyers bring a higher expectation of convenient parking, with numbered stalls for their exclusive use.

Retail parking in mixed use buildings. Retailers place customer parking at the top of their list of concerns. A mixed use building in an urban setting must have enough customer parking in the garage, and perhaps separate it from the secured parking of residents.

Visitor parking. Residents of an apartment or condo would like to have parking available for their visitors. Housing for seniors and the disabled also must have visitor parking. Although the residents may not own many cars, their friends and relatives do.

Demographics influence car ownership. Housing targeted at students, singles, seniors or low income people may need less parking.

### **Structured parking is EXPENSIVE**

The figure generally tossed around for underground garages is about \$25,000 per stall. Or, put another way, a parking space has to earn between \$250 and \$300 per month. The economics play out in a number of ways:

Underground makes the most sense. The combination of high land prices and height restrictions makes underground parking the most practical. Since cars do not need air and light, they can be buried, leaving the entire above-ground building envelope available for housing or commercial use.

Digging is risky and expensive. Even though underground parking makes the most sense, it comes with big risks and costs. Adjacent sites must be shored and protected, and you never really know what you are dealing with until you start digging.

The big cost is circulation. Parking costs may be measured by the stall, but the big cost is circulation: ramps, drives and turning areas. Circulation can present major problems on small or awkward sites where there is not enough room for ramps.

Building structure affects garage layout. The parking garage also serves as the foundation of the building above. The placement of walls and pillars determines the spaces available for parking and circulation.

### **Mistakes are costly and difficult to fix**

Getting parking right helps make a building financially successful. Insufficient or poorly-designed parking lowers the value of the building and makes it difficult to market. On the other hand, too much parking represents expensive space with little or no revenue generating capacity. Once a garage is in the ground, retrofitting it is extremely difficult, if not impossible.

## **Lowering Parking Costs**

Because parking is so important to the marketing of residential real estate, we can assume that the homebuilding industry will continue to want to meet consumer demand for it. A number of strategies can reduce the cost of providing parking:

### **Reducing the need for parking**

The place to begin is by reducing car ownership and, therefore, the need for parking spaces. This can be viewed as an extension of broader transportation demand management (TDM) efforts, but with an important twist. While TDM measures like improved transit service, carpooling, vanpooling, cycling and telecommuting may lead people to drive less, they may not necessarily lead people to give up car ownership entirely.

Important things to remember when considering demand reduction:

Neighborhood variation. Neighborhoods vary widely in their ability to accommodate carless households. High density neighborhoods with good transit service and close-in shopping can be comfortable places to live without a car.

Developers will follow, not lead. Because of the difficulty of fixing miscalculations, developers will not likely get out front in promoting carless lifestyles.

Alternatives need to prove themselves. Car sharing (locally under the Flex-car name) is perhaps the most promising way to reduce car ownership. This new service will take some time to prove itself to the point where developers will rely on it as an alternative to providing parking.

Alternatives need to be there for the long haul. A parking garage has a useful life measured in decades, and if a developer bases a garage's size on the availability of transportation alternatives, those services need to be in place for decades as well.

### **Reduce the cost of building parking**

Once developers determine how many parking spaces to provide, they can look for ways to reduce the cost of providing those spaces. Two techniques are:

Tandem parking. In tandem parking a double-length stall accommodates two cars front-to-back. As noted, the real cost in a parking garage is circulation, and tandem parking provides more spaces for a given area of ramp.

Car lifts. These devices allow stacking of cars two-high. Models installed in a pit have both cars on platforms that move up and down, allowing access to either car. Models installed in a flat garage place one car on a mechanical lift and one underneath.

### **Managing the parking supply**

The third way to reduce the economic burden of parking is to manage the supply more intensively, aiming for maximum occupancy. More intense parking management begins with a change of attitude on the part of building owners. Rather than thinking of their parking spaces as an ancillary part of their real estate business, they should think of parking as a separate business with its own expenses and revenue streams. Components of a parking management strategy include:

Neighborhood parking inventory. Once communities know all of the parking resources available, they can plan to make best use of them.

Uncouple parking and rent. Rather than including parking spaces in the monthly apartment rent, make them a separate rental. That way a tenant can choose to save money by not renting a space, and the owner can rent it out to another tenant or to an outside user.

Do not assign spaces. Managers need to guarantee that a space will be available to anyone entitled to one, but they should not guarantee a particular space. This provides the flexibility to offer parking in various locations, including other nearby garages or lots.

Share parking among complementary uses. In general, residential garages stay empty during the day, and commercial garages stay empty at night. Adjacent commercial and residential buildings can share some spaces so that many fewer are empty at any time

Provide off-site parking. A building can provide parking beyond the immediate area for some uses.

Explore community garages. Parking needs for many small residential and retail buildings can be met through a single community parking garage. This could be a stand-alone facility or one built in conjunction with a larger public or private development.

Consider residential parking zones. A big concern of neighborhoods is the potential for spill-over parking from urban centers and "hide and ride" parking by transit users. Residential parking zones, while not always popular, can control these problems.

Rent out spare parking. Owners of residential buildings who find themselves with extra parking could rent it out to nearby commercial buildings or other residential buildings.

Use technology. New technologies developed by the parking industry enable parking lot owners to monitor the use of parking spaces with less labor.

Use parking attendants. Larger buildings in high demand areas may find the use of parking attendants economical. With attendants, short-term parking can be provided in ramp areas, making maximum use of space.

## **Strategy for Parking Efficiency**

If we view parking as a community resource we can apply principles similar to those used in other resource conservation and efficiency efforts. In the same way solid waste programs have promoted "reduce, reuse, recycle" we can develop a similar three-step approach to parking:

- Minimize the overall need for parking spaces by providing alternatives to car ownership.
- Maximize the efficiency of parking facilities by getting more cars in a given ramp space or lot.
- Manage the use of each space through sharing and marketing arrangements.

Movement toward a more efficient and less costly approach to meeting the needs for parking in urban centers will require cooperation and trust on the part of the four primary players:

The development industry and its lenders need to better understand what alternative arrangements buyers and renters in various market segments will accept. Building owners must begin managing their parking resources more actively and pass some of the revenue on to tenants in the form of more affordable housing.

Local governments need to accept alternative parking arrangements and to allow building owners to generate revenue from their parking investments. They also need to guarantee the future of policies and programs that encourage carless lifestyles.

Communities need to trust that alternative parking arrangements will protect their neighborhoods and retail areas.

Consumers need to consider alternatives to car ownership and on-site parking when making rental and purchase decisions.

## **Conclusion**

Strategies that reduce the need for parking and allow it to generate additional revenue can lower the cost of developing and managing housing. In a competitive market these cost savings will be passed on to renters and buyers who choose to accept less than a dedicated on-site space.

More flexible approaches to parking can also increase the housing supply. Lowering the per-unit development cost will make more projects pencil out for developers, particularly in areas where prevailing rents cannot support expensive structured parking. Alternative arrangements will also make small, awkwardly configured parcels attractive for multi-family development.

Solving our housing affordability problems requires increasing the choices people have in their lifestyles and in how they spend their housing dollars. Alternative parking arrangements are a necessary addition to those choices.

# Getting a Lot Smaller

## (Spring, 2003)

A central principal of growth management is the efficient use of land, or, the dreaded “D” word. This can be seen as a coercive effort: by restricting the land available for development, prices are driven up, and large lots become unaffordable.

But smaller lot sizes can also be viewed from the demand side: there are quite a number of people who prefer less land and are more than happy to trade off lot size for a lower price, a shorter commute, or both. Small lot developments have become much more common in the past few years, and they are selling well. This edition of Housing Stock looks at the small lot trend and describes some of the issues for builders and local governments.

### **The demographic driver**

Small lot development is being driven by a significant shift in demographics. As the Baby Boomers move into their empty-nester and retirement years, a larger proportion of the region’s households have no children. “Active adult” lifestyles do not require big yards. In fact, many people would prefer not to have the hassle of maintaining a lot of landscaping.

At the same time, many empty-nesters and retirees still like the idea of a detached house. It offers privacy and quiet, and detached houses have reliable appreciation over time.

Small lot developments cater to those who want a detached house but do not need bonus rooms, and big back yards. There is room to putter, both inside and out, but weekends can be spent on things other than chores. While small lot projects can be sold fee-simple, they can include large common areas maintained by an owners association.

### **The cost driver**

Large finished lots have become very expensive. The price of raw land keeps going up, and much of the land on the market has constraints that make it expensive to develop. The cost of a raw parcel and many of the development costs are fixed, so having more lots to spread the cost lowers the per-lot cost.

Lot cost, in turn, drives the price of the finished house. Builders still go by the rule that lot cost is one-fourth of the sale price of the house. If they try to push land cost to a higher proportion of final price, they would not be able to compete with resale houses in which lot costs constitute a smaller part of the original cost basis.

If, as projected, lot prices move toward \$200,000 on the Eastside, the homes on those lots will be selling for \$800,000. But there is a limited market for houses in that price range, so builders will wanting to get to a lower price point will go to smaller lots. For example, in Sammamish, houses on 6000 square foot lots are in the \$400,000 to \$550,000 range, whereas houses on 4000 square foot lots will be in the \$325,000 to \$400,000 range. In South King County small lot projects are selling in the \$210,000 to \$290,000 range.

For many buyers, a larger back yard, a few hundred more square feet of house and some fancier finishes are just not worth an extra \$100,000. For many of those seeking value, compromising on lot size make a lot of sense.

### **The trend starts at the high end**

The concept of small lot housing still labors under the misperception that small lots mean cheap housing. Generally, however, the opposite is true. Small lots have been coming into the market as a

way to capture key market segments and hit a lower price point in areas that are getting expensive. Development costs being as high as they are, small lots are still not really inexpensive lots.

Small lot housing has also been integral to the major master planned communities in the region. Because they co-exist with much more expensive homes, often only a block or two away, these small lot houses can not give the impression of being cheap.

### **Its more than just shrinking the lot**

In some early, less-successful small lot developments in the region, builders made the mistake of putting the same houses they had built on larger lots onto the new smaller lots. It is not that simple. There are a number of design considerations that are particular to small lot development:

Parking. Two- and three-car garages out front are problematic enough on wide lots, but they can really look awkward on narrow lots. One solution used extensively is alleys, which puts the parking out back. But alleys require more pavement and squeeze back yards. Another technique is to build tandem garages (two cars front-to-back) with just a single door. A third solution – the auto court – uses a common driveway between two or more units, leading to garages and shared turnaround space in the rear.

Side yards. With minimum separations between units, the result is a narrow strip that is owned half by each unit. There isn't much that can be done with three feet of side yard. One solution is to go to zero-lot lines, moving the houses to one edge of their property, but this requires expensive fire walls. Another solution is to grant each unit an easement for one neighbor's side yard, so that each house controls an entire side yard. In any case, care must be taken with the placement of windows and doors so as to maximize privacy.

Open space. As with cottage development (a subset of small lot development) the site plan should maximize community open space. A large green at the center of the development is probably a better use of land than adding a few more feet of yard to each lot.

One way to ensure good small lot development is to maintain a strong link between the site development process and homebuilding. Ideally they would be done by the same concern. But if the developer is not interested in building houses, they must be very careful about to whom they sell lots and what they allow to be built on them.

The examples that follow provide good illustrations of how to do small lot development well. They are all commercially successful (which is possible only through fast sales and happy owners!) and add to the overall flavor of their neighborhoods. So go out and see the good things that can happen when we get a lot smaller.

## **The Affordability Triangle** *(Spring, 2003)*

Choosing a house is always an exercise in trade-offs, especially when cost is a major concern. Those with a half-million dollars to spend have plenty of choices, but those with much less have to make some serious decisions about what they value. In the King County market, those seeking an affordable place to live will face the “affordability triangle” in which they have to choose two out of three key features, and be willing to forego the third. Those in the more affordable end of the market must weigh:

**Proximity to jobs.** The greatest job growth continues to be in the Seattle-Bellevue-Redmond axis. Yet those are the most expensive markets in the region for all types of housing, especially new construction single family housing.

**New construction.** There is very little conventional new construction housing that would be considered “affordable.” New homes on the Eastside are in the \$500,000 range and heading up, and in South King County they are in the \$300,000 range and also heading up.

**Lot size.** Large lots are becoming very expensive. Projections are that conventional lots now in the pipeline on the Eastside will come on the market at \$200,000, and in the South County will come on the market at \$ 125,000.

Two scenarios are widely-available for dealing with the trade-off of one of these concerns for the other two.

**A. Get new construction and lot size, but forego proximity.** New, affordable communities are springing up in Pierce and Snohomish counties where \$200,000 gets a nice sized new house with a usable back yard. Some people will put up with the one- to two-hour commute each way, but many place a higher value on time.

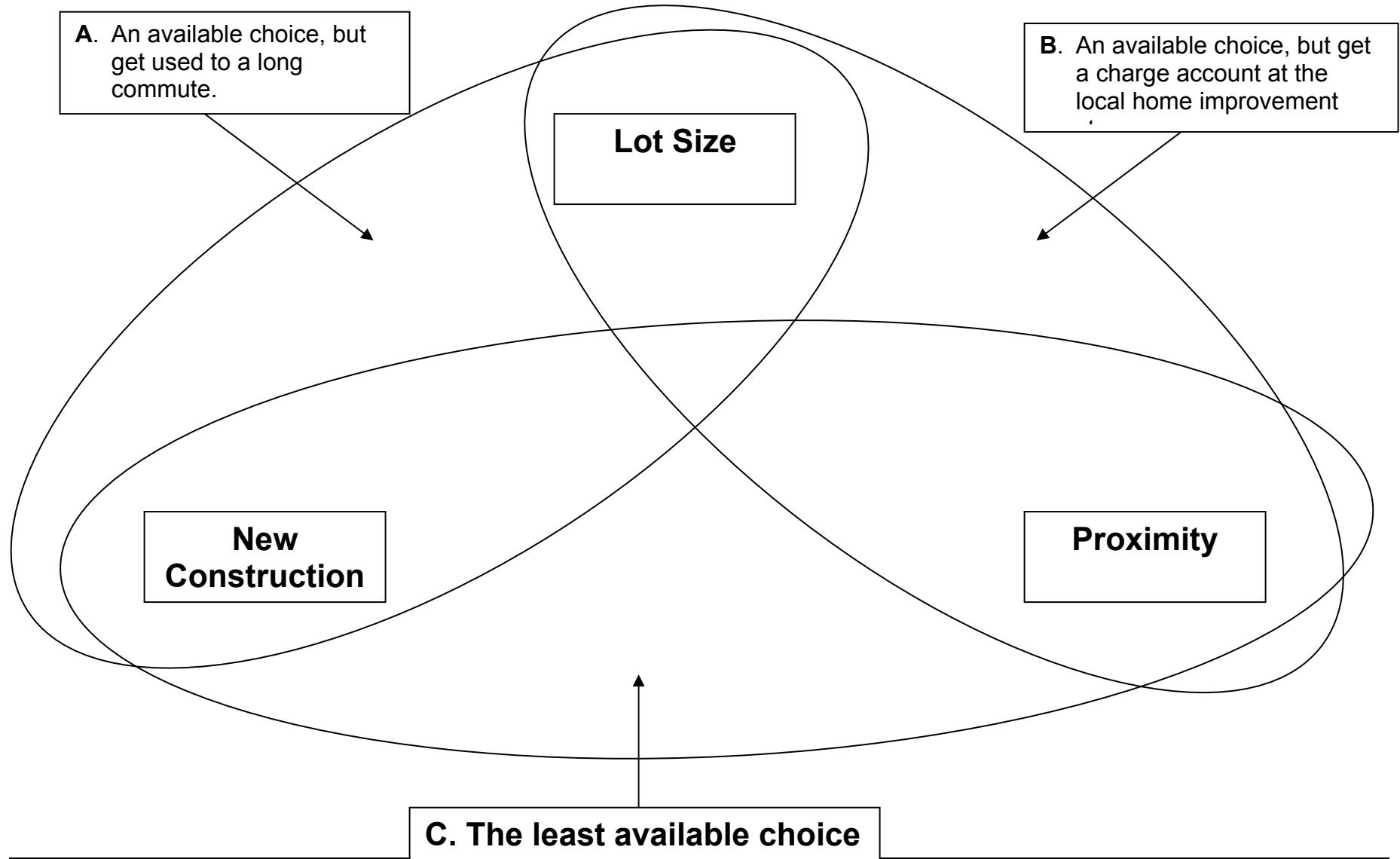
**B. Get proximity and lot size and forego new construction.** There are still houses on large lots available for reasonable prices in the close-in neighborhoods. They will, however, be older houses in older neighborhoods, many reaching the end of their useful life or in need of substantial upgrades. Some people look forward to the challenge of a fixer-upper, but many cannot afford the upgrades or find it a hassle.

There is a third, much less available scenario:

**C. Get new construction and proximity, but trade off lot size.** By spreading land and development costs over more units, a developer can produce a new community that is more affordable than the surrounding homes with large lots. But don't count on playing baseball in the back yard.

There is a substantial market for housing based on the third scenario, but this option is not widely-available. The success of small lot developments, such as those described in this issue, should give jurisdictions the confidence to develop their own approaches. While not for everyone, they meet a definite market need that is currently underserved

### The Affordability Triangle



## Part V: Design Standards

### Design Review comes up for review (Winter, 2002)

Design review has become a widely-used tool to get around the old conundrum that “no one likes density and no one likes sprawl.” Infill development is much more acceptable if it fits with the neighborhood and enhances its functionality.

At its best, design review provides a process for communities and builders to work together for a win-win: communities get input into design, and builders get their projects approved more smoothly. On the other hand, a poorly constructed design review program can result in a frustrating, expensive process for the builder and set up further antagonisms within the community.

Cities around the region have set up a variety of design review programs, and with a decade or two of experience, this is a good time to look at what works best. In 2002, the Housing Partnership will be examining design review and developing a “best practice” approach that can be used by cities looking to institute design review for the first time, or those looking to overhaul an existing program.

The Partnership’s current plan is to hold its spring half-day workshop on design review, and publish its findings later in the summer.

#### **What we will look at**

Key issues the Partnership will examine include:

What it is not. A public process like design review provides a tempting forum to try to deal with traffic, parking and other development impacts. Are cities able to keep the process focused just on design and leave these other topics to more appropriate venues?

Legal questions. A series of court cases, culminating in a 1993 case involving Issaquah, have drawn fairly tight lines around design review, mandating specific standards and objectives. Are the legal issues all settled?

Administrative vs. volunteer. Most design review programs are administrative, using city staff, while some use volunteer review boards. What are the strengths and weaknesses of each approach?

Financial implications. Many of the sorts of changes that might come out of a design review process can be expensive for the builder. How much additional cost burden is reasonable to ask?

Staffing and expertise. Since it is difficult for smaller cities to maintain in-house expertise for design review, what is the best way to ensure quality work?

The least definable, but perhaps most important issue involves the attitudes of participants and the general atmosphere within which design review takes place. Is it a collaborative process, based on trust? Is it as fair and objective as possible? Do all parties come to the table looking for a win-win?

Anyone with thoughts on design review should contact the Partnership (425-453-5123, [mluis@seanet.com](mailto:mluis@seanet.com)). And watch your mailbox for information on the upcoming workshop.

# The Many Faces of Design Review

## (Spring, 2002)

Regulation of land use and building has long been a jealously-guarded prerogative of local government, and design review programs are no exception. Applicability, processes and design standards vary widely across the region, but as the 100 participants at a recent Partnership workshop were reminded, that is not necessarily a bad thing. You would not want all cities to look the same.

Prior to the workshop, the Partnership asked for details of the design review programs in various cities in King County. The accompanying list shows the key elements in these programs.

The workshop featured presentations on the legal and political background of design review, followed by two case studies: Juanita Village, in Kirkland, and the Meridian, in Seattle. These presentations, followed by extensive dialog, yielded a number of observations and lessons.

**Administrative and volunteer processes.** Of the 12 cities responding to the Partnership's inquiry, seven have administrative processes and five have volunteer boards. Workshop participants heard the advantages and disadvantages of each, and no consensus emerged on a preferred method, although the trend has been more toward administrative processes.

**Design standards.** The court cases that have established the parameters within which design review must operate, emphasize the need for clear standards. As a result, most communities have adopted detailed design guidelines so that developers know up-front exactly what they will be required to do. These guidelines should be developed early on, from scratch with extensive public input. They should reflect the unique character of each community, and not borrow too much from other standards, no matter how attractive.

**Focus.** The presenters all emphasized the need to separate design review from zoning, SEPA and other processes. In both case studies, project opponents tried to use design review to attack traffic, view corridors and other issues. In the Kirkland case, a traffic-based appeal of the design review process was dismissed fairly quickly by a hearing examiner, but in the Seattle case, design review dragged on for three years, with extra meetings and significant cost to the developer. In other cases, project critics have tried to use design review to lower the size of a project, which is a zoning issue. Managers of design review programs must not let them get off-track and waste time and money.

**Financial considerations.** Although many changes that result from a design review process and the application of design standards can be made at little cost, design review can introduce substantial financial risk to the developer. Most programs do not take this into account. Additional costs can come from:

Expensive specifications. In some cases design review mandates changes in materials. A design review panel may not like a stucco exterior, but requiring brick adds costs.

Professional fees. A developer going into a design review process must employ architects, engineers, lawyers and consultants in order to ensure a good outcome. Major design changes increase these costs.

Delay. By the time a project has entered design review, the developer is already accumulating costs that must be financed. The interest payments mount up.

**Thresholds.** Many of the costs of taking a project through design review are fixed, so the per-unit burden falls heavily on smaller projects. Jurisdictions should look carefully at their thresholds for design review and should consider a sliding scale of fees to even out the per-unit cost.

**Predictability.** As with all development processes, design review must be predictable. Solid standards, reasonable timelines, and a tough appeals process will ensure that developers can go into design review comfortable that they can meet legitimate community desires without major financial penalties.

The final remark in the workshop, made by a well-known multi-family developer, was that “design review works.” Most multifamily developers want their projects to fit well with the surrounding community and will carefully consider suggestions from the neighbors. But they cannot accept demands that move them out of the bounds of financial prudence. Projects that do not pencil out do not get built.

The lesson of the Partnership’s workshop (the best-attended yet!) is that well-executed design review will continue to be an important tool in our efforts to provide housing choices and affordability in the world of growth management.

For more information on design review, see:

APA Planning Advisory Service Report #454, Feb. 1995  
By Mark Hinshaw

Anderson v. Issaquah, 70 Wn. App. 64, 851 P.2d 744 (1993)