Memorandum

To: Michael Buonocore, Interim Director, Portland Housing Bureau

From: Matt Kowta, Managing Principal
Matt Fairris, Vice President

Date: November 3, 2023

Re: Portland Inclusionary Housing Calibration Study - Foregone Revenue Analysis

Introduction

Following BAE’s analysis of the financial impact of Portland’s inclusionary housing ordinance on project feasibility, the City engaged BAE to estimate the potential foregone property tax revenue associated with the City’s ten-year property tax abatement program. This property tax abatement program is offered to multifamily developments of 20 or more units that abide by the City’s inclusionary housing ordinance by providing units affordable to lower-income households within new market-rate multifamily development. Specifically, the City’s property tax abatement applies to the improvement value of the new residential development, although the percentage of the project eligible for the tax abatement differs by location. Currently, new multifamily developments of 20 or more units within the Central City Plan District (“Central City”) that provide inclusionary housing units on-site receive a full-building ten-year property tax exemption on the value of the improvements of all residential units (both market rate and affordable). For new multifamily developments outside of the Central City that provide inclusionary units on-site, only the affordable units are eligible for the property tax exemption, or between ten and 20 percent of the improvement value.

Based on BAE’s financial modeling, the Central City full-building tax exemption program currently offsets the financial impact to the project of the reduced rents required by the inclusionary housing ordinance. Outside of the Central City, however, the reduced tax exemption amount leads to an imbalance between the financial impact on project value from the inclusionary housing requirements and the various incentives provided by the City. As a result, BAE recommended that the City consider extending the full-building property tax exemption to high-cost areas outside of the Central City in order to provide a sufficient subsidy to offset the impact on project value from the inclusionary housing ordinance.

The following analysis and modeling tool provides an estimate of the potential foregone property tax revenue from a series of potential scenarios involving future housing unit production estimates and extensions of the property tax exemption outside of just the Central City. These initial tax abatement extension ideas are merely intended to capture potential options, and BAE will provide City staff with a working version of the foregone property tax...
Methodology

To estimate the foregone property tax revenue associated with the inclusionary housing program, BAE worked with various City departments to create a series of annual multifamily housing unit production estimates. These sources include:

**Bureau of Planning and Sustainability (BPS) Demand-Driven Unit Production.** Based on data compiled by BPS to support the City of Portland Housing Needs Analysis and Housing Production Strategy, BPS estimated the multifamily unit capacity and production between 2021 and 2045, by Neighborhood Analysis Area (see Figure 1 below). From the total expected demand-driven production, BAE calculated the average number of multifamily units produced per year over the 24-year production period. After accounting for an assumed percent of multifamily units that will be delivered using Low-Income Housing Tax Credits, and therefore subject to a different property tax abatement program, these estimates indicate that an average of approximately 3,026 new multifamily residential units will deliver per year through 2045.

**Portland Housing Bureau (PHB) Historic Housing Production Data.** BAE also reviewed historic multifamily housing production data produced by PHB. As shown in Figure 2 on the following page, over the last market cycle, the City of Portland had an average of 2,905 new multifamily units deliver per year. This occurred in a cyclical pattern, with five years of above-average growth, and eight years of below-average growth, including less than 1,000 housing units per year between 2010 and 2012. To inform the potential future housing production, BAE also leveraged these past production estimates to capture the potential swings in production driven by traditional market cycles.

**PHB Multifamily Housing Development Pipeline.** Lastly, BAE compiled development pipeline information from PHB estimating the number of units in various stages of the housing production pipeline. According to this information, the city has roughly 1,300 multifamily housing units that have been approved but are not yet under construction. In addition, the pipeline includes another 3,850 housing units that have not yet been approved but have submitted some form of entitlement or development application. Together, this indicates that roughly 5,150 units are at some stage of the development pipeline, likely accounting for the bulk of new housing development in Portland for the next two to three years.
**Figure 1: Neighborhood Analysis Areas**

Sources: PHB, 2023.

**Figure 2: Historic Multifamily Development Production by Year (20 or more Units)**

Sources: PHB, 2023.
After compiling data to inform the potential future multifamily housing production, BAE then reviewed property tax bill information, in addition to the Inclusionary Housing Calibration Study pro forma financial models, to estimate the per-unit property tax associated with the improvement value of multifamily residential units throughout the City. As seen in the tool, BAE created four unique “Market Strength” categories, including Low, Medium/Low, Medium/High, and High. For each market strength category, BAE estimated the typical annual property tax associated with the improvement value of new multifamily construction, ranging from $1,750 per unit to $2,750 per unit. These estimates are based on a review of current property tax bills for new multifamily development in various markets throughout the city, as well as developer feedback and financial modeling as part of the inclusionary housing calibration study. BAE then assigned a preliminary market strength category to each Neighborhood Analysis Area based on the prevailing rent in the general area and overall demand for high-rent multifamily housing (which characterizes most newly built multifamily housing) in the area.

BAE then created a financial model that incorporates a range of annual housing unit production estimates. Each model can adjust the Neighborhood Analysis Areas where the full-building ten-year property tax exemption will apply. For all other areas where the full-building exemption does not apply, the model assumes ten percent of the new housing units will receive the tax exemption, a conservative estimate based on the City’s policy that applies the tax exemption to the affordable units only. Lastly, based on initial conversations with City staff, BAE incorporated the ability to include the units in a Tax Increment Financing (TIF) district. The intent of this addition is to calculate the property taxes that will be foregone by various tax-receiving entities. For example, for a project outside of any TIF district, the foregone property taxes would affect various public agencies, including the City of Portland, Multnomah County, etc. However, in a TIF district, any foregone property tax would reduce the funds flowing into the TIF district from projected new development for spending on infrastructure and other targeted investments but would not affect other entities, since the TIF district already diverts all of the property tax.

In addition to estimating the annual and cumulative foregone revenue over the ten-year projection period, the model then estimates the amount of property tax revenue that will be generated following the expiration of the ten-year exemption period.

**Growth Scenarios**

Based on the data sources summarized above, the analysis incorporates three growth scenarios, including:

**Demand-Driven Growth Scenario:** Based on the BPS demand-driven production data estimates through 2045 as part of the Housing Production Strategy. These estimates assume an average delivery of approximately 3,025 units per year. Roughly 38 percent of this development is assumed in the Central City Neighborhood Analysis
Area, with the Interstate Corridor, Northwest Portland, and Hollywood neighborhood also projected to accommodate a significant amount of housing unit production. For the purposes of this model, BAE assumes a constant number of units delivered per year.

**Cyclical Growth Scenario:** Based on the previous market cycle, from 2010 to 2022, the Cyclical Growth Scenario assumes an average of 2,920 units produced per year, but the actual number of units produced annually fluctuates based on the data from the previous market cycle. While the number of units produced is comparable to the Demand-Driven Growth scenario, this allows the City to understand the impacts of a shorter period of significant unit production, with lower production numbers before and after the years with significant production. The distribution of unit production by Neighborhood Analysis Area is the same as in the Demand-Driven Growth scenario, with the Central City accounting for a large share of the future housing development.

**Lower-Growth Scenario:** With a lower number of units in the development pipeline, the Lower-Growth Scenario models the impact of fewer multifamily units produced relative to the Demand-Driven Growth Scenario. Given that there are approximately 5,000 units in various stages of the pipeline, this scenario assumes roughly 1,500 units from the pipeline will deliver per year. Given this, BAE assumes the Lower-Growth Scenario is equal to half of the projected unit totals in the Demand-Driven Growth Scenario, or roughly 1,500 multifamily units per year.

### Units Delivered by Growth Scenario

<table>
<thead>
<tr>
<th>Growth Scenario</th>
<th>Total Multifamily Units Delivered</th>
<th>10-Year Total</th>
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</thead>
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<tr>
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<td>29,195</td>
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<tr>
<td>Demand Driven Growth</td>
<td>3,026</td>
<td>30,260</td>
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**Preliminary Property Tax Abatement Geographies**

To inform the impact of extending the property tax abatement to areas outside of the Central City, the following analysis includes three scenarios relating to the geographies where the full-building property tax abatement applies. These include:

**Central City Only (Existing Policy):** The first scenario models the existing policy, which offers the full-building property tax abatement to new development in the Central City, while residential development in all other areas receives a tax exemption equal to the percentage of the units that are affordable.
**High-Cost Markets:** The second geographic tax abatement scenario assumes the policy extends to all “high” market neighborhoods. Based on a preliminary classification of these neighborhoods, this scenario assumes development in the Central City, Northwest, South Portland-Marquam Hill, Hillsdale-Multnomah-Barbur, and Forest Park-Northwest Hills Neighborhood Analysis Areas would receive the full-building property tax exemption. The other neighborhoods that do not have the extended property tax exemption would still receive the ten percent property tax exemption driven by the percentage of units affordable to lower-income households in this scenario.

**All Multifamily Development:** The final scenario assumes all multifamily development would be subject to the extended property tax abatement program tied to the inclusionary housing ordinance, regardless of geographic location if providing affordable housing units onsite in compliance with the ordinance.

**Foregone Revenue Estimates**
Table 1 below summarizes the total number of units produced, units receiving the property tax exemption (including the full-property tax exemption and the affordable-only property tax exemption), and the total amount of foregone property tax revenue by growth scenario and tax abatement geography.

**Central City Only (Existing Policy)**
Under the Central City Only approach to providing the full property tax exemption, which is the current policy in place, the policy provides a ten-year property tax exemption on approximately 44 percent of the total new multifamily development. In the Lower Growth Scenario, this equals an average of just 670 units per year, or nearly 7,000 units over the ten-year projection period. Under these assumptions, the City would forego roughly $2 million in annual property taxes, or approximately $20 million over the ten-year period.

Should the City receive multifamily housing unit production similar to the prior market cycle, or nearly 3,000 units per year on average, the property tax exemption would apply to nearly 1,300 units annually, or 13,000 units over the ten-year projection period. With this increased number of units, the model estimates an average of nearly $4 million per year in foregone property tax revenue, or nearly $40 million over the ten-year period.

Lastly, the Demand Driven Growth scenario results in figures similar to the market cycle growth scenario, albeit more constant in terms of annual housing unit production and property tax abatement amount. As seen below, in providing the full ten-year property tax exemption to developments in the Central City, the Demand Driven Growth scenario provides the tax exemption for nearly 1,340 units per year, or 13,400 over the ten-year projection period. This translates into approximately $4 million in annual foregone revenue, or $40 million over the ten-year period.
All High-Cost Markets

If the full-building property tax exemption were extended to all high-cost markets in Portland, the number of units receiving the tax exemption would increase by nearly 30 percent. As seen below in Table 1, under the Lower Growth Scenario the tax exemption would apply to roughly 8,620 housing units over the ten-year period, or roughly 860 per year. Based on the total projected units delivered over that time frame, this extended tax exemption would apply to roughly 57 percent of multifamily units produced in the city. Under this tax exemption policy, the estimated total foregone revenue would amount to $2.6 million per year, or $26 million over the ten-year projection period.

Under the Prior Market Cycle Growth scenario, extending the full building property tax exemption to all multifamily developments in high-cost markets translates to roughly 1,660 units receiving the tax exemption, or 16,630 over the ten-year period. In terms of the foregone revenue from these units, this extended policy results in roughly $51.2 million in cumulative foregone revenue over the ten-year projection period, or $11.7 million more than the baseline tax abatement scenario where the full building tax exemption is only offered to projects in the Central City.

Assuming Portland experiences the housing unit production figures envisioned in the Demand Driven Growth Scenario, or roughly 30,260 units over a ten-year period, extending the full building property tax exemption to multifamily developments in high-cost markets would mean that roughly 17,240 total units will receive the tax exemption over the ten-year period, or approximately 57 percent of all multifamily units. This policy translates to roughly $52.1 million in total cumulative foregone revenue over the ten-year projection period, or $5.2 million per year.

All Multifamily Developments

Should the City extend the full-building property tax exemption to all multifamily developments subject to the inclusionary housing ordinance throughout the city, the number of units and associated foregone revenue would be roughly double the number under the current ordinance, which only applies the full-building tax abatement to projects in the Central City. As seen below in Table 1, under the Lower Growth Scenario, with roughly 15,130 new multifamily units over a ten-year period, the total foregone revenue amounts to an estimated $41.5 million over the ten-year projection period. On an annual basis, this full property tax abatement policy would exempt projects from roughly $4.1 million in property taxes.

If the number of units produced in the City of Portland aligns with the previous market cycle, or nearly 29,200 new units over ten years, the policy to extend the ten-year property tax abatement to all units would result in $81.5 million in foregone property tax revenue over the ten-year projection period.
Lastly, if the number of units delivered in the City aligns with the Demand Driven Growth Scenario, or roughly 30,260 new multifamily units over ten years, offering the full property tax exemption to all units would generate nearly $83 million in cumulative foregone revenue over the ten-year projection period, or $8.3 million per year.

**Table 1: Property Tax Exemption by Growth Scenario and Tax Abatement Geography**

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<thead>
<tr>
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<th>Total Multifamily Units Delivered</th>
<th>Ten-Year Property Tax Exemption</th>
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<td>Units with Tax Exemption Annual 10-Year Total</td>
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<td>Tax Exemption Amount Annual 10-Year Total</td>
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<tr>
<td>Demand Driven Grow th</td>
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**Other Considerations**

Although this model is intended to capture the total foregone revenue over a ten-year period based on a range of multifamily housing production estimates, there are other considerations and potential uses for this model.

**City-County Inclusionary Housing Tax Abatement Agreement**

While the above analysis outlines the foregone revenue over a ten-year period, this model can also inform the City of potential revisions to the agreement with Multnomah County. According to City staff, the County currently allows the City to allocate up to $15 million in total abated property tax revenue over a five-year period, which does not adjust with increasing assessed property values. Based on the above analysis, if the number of units delivered over the ten-year projection period aligns with the prior market cycle or the BPS demand driven growth, the five-year tax abatement amount will exceed the current agreement with the County under the current policy of offering the full property tax exemption to Central City projects. In the
Demand Driven Growth Scenario where the full-building tax exemption only applies to developments in the Central City, as currently instituted, the five-year foregone tax revenue amounts to roughly $25 million, or $10 million above the current agreement. If the tax exemption policy were offered to all multifamily developments, the five-year average amounts to roughly $40 million in foregone revenue, or nearly $25 million over the existing agreement. In addition, as it relates to the agreement between the City and County, the five-year cap on the total property tax abatement should increase over time to ensure the policy continues to support a similar number of units as originally intended.

**Tax Increment Financing District**

As previously noted, the model also allows testing the impact of the inclusionary housing tax abatement program on new Tax Increment Financing (TIF) districts. If a TIF district is formed in a certain Neighborhood Analysis Area, the foregone revenue from the inclusionary housing property tax abatement program would reduce the overall tax increment revenue that flows into the TIF fund for the ten-year period, as compared to the amount of revenue that would flow into the TIF fund if the same amount of development occurred without the tax abatement program. However, when the ten-year tax abatement expires, the TIF district would benefit from the property tax increment associated with such development for the subsequent years following the tax abatement period. During the ten-year tax abatement period, the revenue sharing provision of the TIF district will constrain the maximum potential amount of revenue that will flow into the TIF fund, independent of any impacts from the tax abatement program. Therefore, the inclusionary housing tax abatement program will not preclude the TIF district from reaching the maximum allowed amount of annual revenue, it will only delay the time it takes to reach that maximum annual revenue level. While each new TIF district will contain unique provisions for treatment of tax increment, this financial modeling tool can aid in discussions of new TIF districts by estimating the foregone revenue generated by multifamily developments over a ten-year period while also projecting the revenue from new development that would flow back into the TIF fund after the ten-year tax exemption period.

In addition, according to City staff, any foregone property tax revenues from the inclusionary housing program that are located in TIF districts does not count against the five-year $15 million cap according to the City-County agreement. Therefore, if a new TIF district opens in an area with a significant amount of new multifamily development, the foregone revenue from the inclusionary housing program would reduce the revenue allocated to the TIF fund for a ten-year period but would not count against the City’s cap according to the agreement with the County. While the above analysis did not adjust the number of TIF districts in the City, the model allows adjusting the TIF districts by Neighborhood Analysis Area and the associated revenue diverted from the TIF fund.
**Increase in Land Values**

While the analysis focused on the foregone property tax revenue associated with various scenarios, it is worth noting that the property tax abatement policy only applies to the value of the residential improvements. This indicates that property taxes are still generated on the land value of the project, as well as any non-residential space. The increase in property tax generated by land values may be significant, as many vacant and underutilized properties in the City of Portland are assessed at much lower values than their real market values. With new development, the property would be reassessed, including the land value, likely leading to increases in property tax revenue relative to existing conditions, even with the ten-year exemption on the value of the improvements. While this increase in property tax revenue from the increased assessed land value is not sufficient to offset the foregone revenue from the new residential improvements over the ten-year period, it results in a short-term period with a slight increase in property tax revenue generated by the increased land value, followed by a more significant amount of new property tax revenue after the ten-year tax abatement on the improvement value expires.

**Tax Exemption Revisions Supporting New Development**

The above analysis leveraged existing data on historic unit production and projected unit growth in the City of Portland, as compiled by City departments. However, any revisions to the inclusionary housing property tax exemption policy are likely to stimulate development that otherwise would not have been feasible, at least in the short-term. Given this, the tax exemption policy can be seen as a tool to offset the impact of inclusionary housing while also supporting development outside of the Central City, where the impact of the inclusionary housing ordinance is currently imbalanced. For example, if the City does not change the policy, the “Lower Growth Scenario” may be the most likely, given the limited amount of development potential currently in the pipeline and broader economic challenges to development feasibility. However, if the City extends the property tax exemption to other areas in the city, this policy is likely to increase housing production in the near- to medium-term that otherwise would not have occurred. By doing so, as well as enacting other strategies to support housing development, the City may reach the unit estimates from the “Demand Driven Growth” scenario. Therefore, in extending the property tax abatement program, the City may not technically be “foregoing” revenue as that revenue may not materialize in the absence of a potential property tax abatement program expansion, due to current development feasibility challenges.

**Impact of Property Valuation Timing on Tax Abatement Benefits to Owners**

According to City staff, properties with expiring tax abatements have been subject to reassessment at the time of expiration. Depending on market dynamics over the ten-year tax abatement period, this reassessment can result in substantial increases in property tax liability, which may reduce the financial benefits of the ten-year tax abatement program. For example, if a project were assessed upon project completion, the assessed value would then only increase by the statutory maximum of three percent per year. However, under the current
program, the re-assessment at the time of tax abatement expiration may result in a much higher assessed value in year ten, and associated property tax liability, than would have been the case in the absence of the property tax abatement if the average increase in neighborhood real estate values exceeds three percent during the abatement period. By establishing the assessed value of the property upon completion of initial construction and then only increasing the assessed value by the statutory maximum each year, developers would have clarity on the expected property tax bill upon termination of the ten-year property tax abatement.