City of Mercer Island

Policy Brief

Department of Community Planning and Development

INCLUSIONARY ZONING

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Date:	April 10, 2026
Recommendation:	Set the inclusionary zoning requirement at 10 percent of units to be affordable at 50 percent AMI.

POLICY DIRECTION REQUESTED

Inclusionary zoning is a type of zoning that requires a set percentage of housing units to be income-restricted affordable housing units. There are two variables of inclusionary zoning that can be adjusted: (1) the percentage of units that must be affordable, and (2) the affordability level for the required affordable units. During the land capacity analysis and review of a potential fee –in lieu affordable housing program, staff have identified the preferred percentage and affordability level as follows: require 10 percent of units be affordable at 50 percent of the AMI. The analysis found that this rate and affordability level are the ideal levels to produce the needed units at 50 percent of the AMI and generate funding for lower-income units through participation in the fee –in lieu program.

<u>Alternatives</u>

A. **Set the inclusionary zoning requirement at 10 percent of units to be affordable at 50 percent AMI (Recommended).**
B. Set the inclusionary zoning requirement at 15 percent of units to be affordable at 50 percent AMI

BACKGROUND

AFFORDABLE HOUSING NEEDS

Central to the GMHB Order is accommodation of the City's assigned housing needs. Under the GMA, counties and cities are required to plan for adequate housing to accommodate the projected housing needs for each income segment (RCW 36.70A.070(2)(a)-(d)). The GMA establishes housing affordability levels based on income segments as a percentage of the Area Median Income (AMI). The housing affordability levels are categorized as follows:

1. Extremely Low Income (less than 30% of the AMI)
2. Very Low Income (between 30 and 50% of the AMI)
3. Low Income (50 to 80% of the AMI)
4. Moderate Income (80 to 120% of the AMI)
5. High Income (greater than 120% of the AMI)

The GMA also requires counties and cities to plan for Emergency Housing, Emergency Shelters, and Permanent Supportive Housing. Permanent supportive housing (PSH) is considered a subset of the 0-30% affordable housing level because these are permanent housing units. Housing needs for emergency housing and shelters are considered their own housing need because they are temporary shelter spaces for people transitioning from homelessness.

In late 2023, the Washington State Department of Commerce (Commerce) established housing needs by affordability level for each county. This data was then used by King County to allocate housing unit by housing affordability level to each City. The housing units assigned to Mercer Island by King County are shown in Table 1.

Table 1. Mercer Island Housing Needs by Housing Affordability Level.

	Housing Affordability Level								
	Total	≤30%		>30 to ≤50%	>50 to ≤80%	>80 to ≤100%	>100 to ≤120%	>120%	Emergency Housing[2]
		Non-PSH[1]	PSH[1]						
Housing Units	1,239	339	178	202	488	4	5	23	237

Source: King County Ordinance 19660 approved 8/22/2023.
Notes:
1. PSH = Permanent Supportive Housing
2. Emergency Housing is its own metric and not part of the housing need or housing growth target.

The GMHB Order requires the City of Mercer Island to demonstrate through a combination of land capacity and adequate provisions (further described below) the ability to accommodate the housing units assigned in Table 1.

ADEQUATE PROVISIONS

The GMHB Order requires the City to adopt adequate provisions which are incentives, mandatory provisions, and other actions that reduce barriers to needed housing production. Issue 2 from the GMHB Order identified that the City must perform additional analysis to document how adequate provisions will result in the City meeting its housing needs at all housing affordability levels over the 20-year planning horizon. More specifically, the GMHB Order called out the City's Incentive Zoning program and indicated that the City had not provided sufficient evidence that the program would produce affordable units at the required affordability levels, given the voluntary nature of the program.

INCLUSIONARY ZONING

To address the requirements in the GMHB Order, the City will need to adopt a mandatory inclusionary zoning program that requires that a set percentage of housing units be income-restricted affordable housing. These requirements will replace the existing Incentive Zoning program in the Town Center. As the inclusionary zoning requirement is mandatory - requiring all new residential and mixed-use development to provide affordable units, rather than relying on voluntary, incentive-based regulation - the City can reliably estimate the number of units that will be produced. This will document the expected effect of the new program on addressing the City's affordable housing needs as required in the GMHB Order.

Land Capacity Analysis

City's consultant, Community Attributes Inc (CAI) conducted a Land Capacity Analysis, including estimating the potential production of affordable housing units from an inclusionary zoning requirement. CAI's analysis evaluates an inclusionary zoning requirement in the Phase I portion of the Station Subarea, including the existing Town Center and the adjacent multi-family zones. CAI's analysis is based on an inclusionary zoning requirement for 10% of the units to be affordable at 50% AMI (rental) or 80% AMI (ownership). The analysis shows that this requirement could produce 171 50-80% AMI units in the planning period.

The Land Capacity Analysis found that the planned increase in development capacity from the Phase I upzones is expected to provide sufficient capacity to address the City's affordable housing targets above 30% AMI. Additionally, the City has a projected gap in production of extremely low-income (0-30% AMI) housing of 510 units. The Inclusionary Zoning program described above produces 50-80% AMI units, which do not directly address this gap.

FEE IN LIEU

However, there is another way to utilize the Inclusionary Zoning requirement to support production of extremely low-income units. A fee in lieu program would provide developers the option to pay a fee rather than providing affordable units on-site. The City would place the resulting fee revenue into a Housing Fund, to be used to support production of extremely low-income units in other development projects, likely in partnership with A Regional Coalition for Housing (ARCH) and non-profit housing developer(s).

As a part of the Land Capacity Analysis, CAI also modeled the projected performance of a fee in lieu provision. The model assumes that the regulations provide the developer with flexibility to choose to satisfy the entire inclusionary requirement through fee in lieu. It further assumes a fee amount of $25 per square foot, an average unit size of 1,060 square feet, and that 95% of projects would opt to pay the fee rather than build affordable units as part of the project. This results in estimated revenue from in-lieu fees totaling $30.7 million. When leveraged with additional grants and loans, this revenue could support direct delivery of 170-200 units of extremely low-income housing, depending on the cost of construction.

To establish this program, the City must amend the code to enable fee in lieu as an alternative compliance option for the inclusionary zoning requirement. The City must also set the fee amount in the City's fee schedule. The City Council will amend the fee schedule to set the fee at a future meeting.

NEXUS STUDY

The first step in establishing an inclusionary zoning requirement is determining the percentage of units that must be affordable. Then, the affordability level for the units must also be established. The percentage and affordability level should be established such that the cost of providing the income-restricted affordable housing is equivalent to a portion of the potential return the developer will receive from the project.

CAI also conducted an Affordable Housing Nexus Study to evaluate the maximum affordable housing requirement that could feasibly be supported by developments in Mercer Island. The Nexus Study evaluated three rental housing types, including:

1. 7-story multi-family with ground floor retail (TC-7 development regulations)
2. 5-story multi-family with ground floor retail (TC-5 development regulations)
3. 4-story multi-family, primarily residential (TC-MF4 development regulations)

Data from existing comparable buildings in Mercer Island as well as nearby surrounding jurisdictions was evaluated to establish information on unit sizes, rents and other characteristics for each development type. ARCH also provided data on costs associated with construction and maintenance of affordable units as well as income and rent limits for this housing.

CAI's analysis shows that maximum supportable affordable housing requirements range from 13.1% to 16.4%, depending on rental housing type. Based on review of the inclusionary zoning programs in other nearby cities, as well as feasibility analysis, the recommended range for the City of Mercer Island's affordable housing requirement is 10-15%. The analysis and review of neighboring city programs shows that a 50%-80% AMI level requirement can be supported. However, Mercer Island has substantially higher housing needs at the 50% AMI level. Thus, it is recommended that 50% AMI for rental housing and 80% AMI for homeownership housing be maintained as the affordability level requirements.

<u>Review of Peer Jurisdiction Regulations</u>
The City of Seattle's Mandatory Housing Affordability (MHA) program defines both performance and fee in lieu requirements by zone and geographic area. Residential performance requirements range between 5% to 11% and require affordability levels of 40% of AMI for units less than 400 square feet and 60% of AMI for units greater than 400 square feet. The City of Seattle's program has generated just 10% of total units through the performance option.

The City of Bellevue has defined separate requirements for middle housing and mixed-use and multifamily structures. Middle housing, allowing the development of 6 units on any residential land use that would not otherwise allow 6, must provide at least 2 affordable units at 60% of AMI.

The City of Kirkland requires 10% of units in low-density residential zones at 80% of AMI for ownership units and 50% of AMI for rental units. For all other applicable zones, except those with height limits of 65 feet or greater, the City requires 10% affordable units at 50% of AMI for rental and 80% of AMI for ownership units. Zones with maximum heights of 65 feet or greater require 15% affordable units.

The City of Redmond has adopted a performance requirement of 10% of units at 80% of AMI. The City of Sammamish also requires 10% of units at 80% of AMI but allows for each unit at 50% of AMI to count for two units at 80% of AMI.

ALTERNATIVES AND ANALYSIS

INCLUSIONARY ZONING REQUIREMENT

There are two variables of inclusionary zoning that can be adjusted: (1) the percentage of units that must be affordable, and (2) the affordability level for the required affordable units. The City Council is asked to provide direction on the percentage of units; an analysis of these alternatives is provided below. The affordability level is recommended to remain at the levels currently established in the Town Center Incentive zoning program: 50% AMI for rental housing and 80% AMI for ownership housing.

Percentage of Units

The findings of the Nexus Study support a percentage up to a maximum of 13.1% – 16.4%, depending on the type of development. A review of other nearby cities' percentage requirements reveals that 10% of units is comparable to other inclusionary zoning programs. The following alternatives for setting a percentage of units required by the inclusionary zoning were analyzed:

<u>Alternatives</u>

A. **Set the inclusionary zoning requirement at 10% of units (recommended)**
B. Set the inclusionary zoning requirement at 15% of units

Alternative A: Set the inclusionary zoning requirement at 10% of units

Selecting this alternative would put the inclusionary zoning program in alignment with other cities in the region with a somewhat lower requirement than what is currently in the Town Center incentive zoning program. This will likely have a positive impact on project feasibility. Also, with the proposed Phase I upzones the area where the requirement applies and the size of potential projects is expanded, helping to offset the impact of selecting a smaller percentage.

Alternative B: Set the inclusionary zoning requirement at 15% of units

Selecting this alternative would maintain the 15% requirement from the existing Town Center incentive zoning program. While this higher requirement can theoretically produce more affordable units, its impact on project feasibility may counteract that potential. Compared with other King County jurisdictions with inclusionary zoning programs, this requirement is the very highest percentage currently being implemented.

Recommendation – Alternative A: Set the inclusionary zoning requirement at 10% of units

The City's 2026 Land Capacity Analysis shows that the scale of the development capacity increase in Station Subarea Plan Phase 1 will generate adequate capacity for households at the 50 percent AMI affordability level when requiring 10 percent of units to be affordable. Setting the required percentage of affordable units in the inclusionary zone at 10 percent should make projects more economically feasible, which should help the City reach its affordable housing goals. When combined with a fee in lieu affordable housing program, the 10% inclusionary zoning requirement can also help to achieve housing goals for the lower affordability levels from 0-50 percent AMI because developers will often elect to pay the fee, and in so doing, grow the City's funding for extremely low-income housing.

STAFF RECOMMENDATION

Set the inclusionary zoning requirement at 10 percent of units to be affordable at 50 percent AMI.