

AN UPDATE TO THE WORKFORCE HOUSING SHORTAGE

GETTING TO THE HEART OF THE ISSUE



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Providing housing for a community or region's population is complex and dynamic. A healthy housing market should be able to provide housing for most people and their diverse needs through a combination of natural churn and new construction.

In rural areas, however, economic and demographic forces are at work, creating a housing shortage that many communities say is keeping them from attracting much-needed new workers.

But while hundreds of for-profit, non-profit, and government organizations are doing great work around Minnesota to untangle these housing issues, the housing shortage is complex and not well understood by people outside the housing field. This report looks at two major factors as to why the housing market isn't naturally providing the housing needed in many rural communities:

- The considerable increase in construction costs that are pricing younger families out of the market for starter homes and skewing the market in strange ways; and
- The relatively higher percentage of seniors living in rural communities, which, combined with their tendency to want to age in place, the emphasis on helping them do so, and the lack of assisted living facilities in rural communities, is causing not only a bottleneck in houses coming on the market but also increasing the likelihood that the number of dilapidated housing will increase in the future.

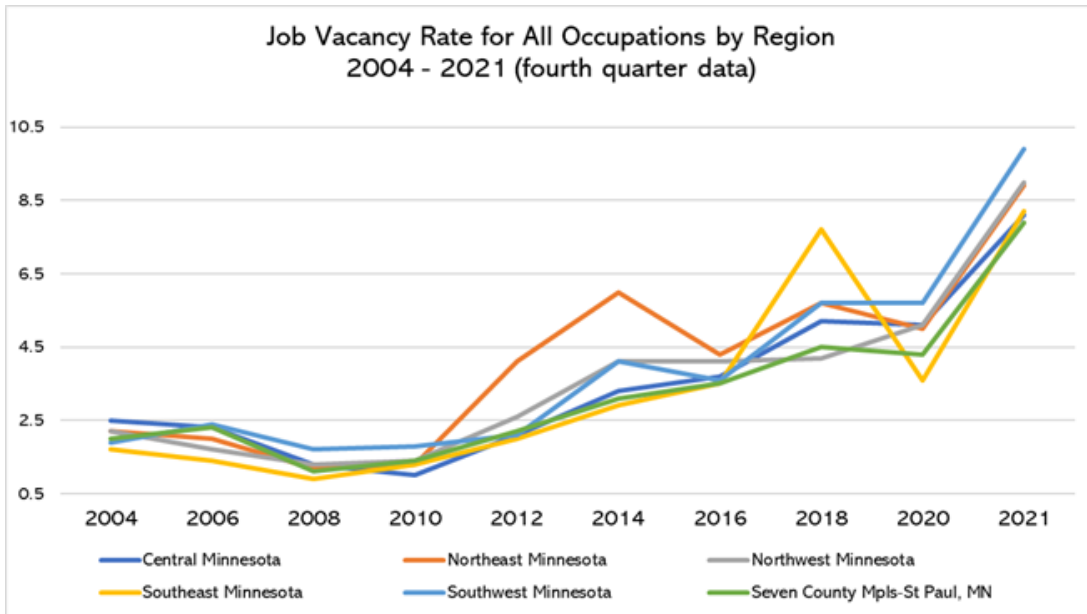
It is also important to note that not all rural areas are facing housing shortages. This issue is limited to regions where economic activity is growing and new workers are needed to fill an aging workforce, which constitutes a large segment of Greater Minnesota. Rural areas face other housing issues, such as vacant housing and/or severe dilapidation of their housing stock, which are not covered in this report.

This report separates counties into four categories as detailed in the appendix: entirely rural, town/rural mix, urban/town/rural mix, and entirely urban. However, within the entirely urban category exists five counties in Greater Minnesota with large cities at their core: Blue Earth (Mankato), Chisago (North Branch area), Clay (Fargo area), Dodge (Dodge Center), and Olmsted (Rochester). These counties continue to be impacted by the housing challenges described in this report.

WHO NEEDS HOUSING?

An increasing number of job vacancies (Figure 1) have employers demanding an in-migration of workers, and they are blaming the lack of appropriate housing as a significant reason they can't attract more workers. At the same time, rural development organizations across Greater Minnesota are feeling the pressure to add more housing to attract these new workers and new, "younger" families.

Figure 1



It might be difficult to believe that places with small increases in their population or overall declines would need new housing. However, population and housing are not as closely linked as one might expect. Families are smaller today than they were decades ago, but that doesn't necessarily equate to fewer households. Table 1 shows that for even our most rural counties (for the definitions of these categories, see the appendix titled "Definition of Four County Categories"), there has been an increase in the number of households despite a 7% drop in population compared to 1990. The table also highlights the growth in the number of households compared to the population in other rural county types.

Table 1: Percent change from 1970 to 2016 for each county group.

County group	% change in households	% change in housing units	% change in population
Entirely rural	9%	30%	-21%
Town/rural mix	50%	58%	12%
Urban/town/rural mix	73%	74%	31%
Entirely urban	106%	108%	62%

Adding pressure to this issue is the migration trend of middle-aged householders moving to rural areas in search of more affordable housing. Rural areas tend to see an in-migration of households in the 30- to 49-year-old age group, a trend typically overshadowed by the larger out-migration of 20- to 29-year-olds. But research by the University of Minnesota Extension's Center for Community Vitality shows that a significant contributing factor in choosing to migrate to rural areas has been to find more affordable housing.

APPROPRIATE HOUSING TIED UP WITH OLDER HOUSEHOLDS

A healthy churn in housing is a necessary part of a community's ability to meet its members' social and economic needs. Obviously, not every household moves, but there are life stages when relocation is more likely: new employment, career changes, children being born or leaving the house, old age, and/or due to health concerns. At different stages of life, householders often either choose or are forced to leave behind their current housing, freeing it up for those who need and can afford it (Figure 2).

Figure 2: The housing life stages in an ideal housing market. At each point in a family's life cycle, new units are built to meet their demand while their old units are left behind for the next set of buyers. Source: U of MN Extension | Center for Community Vitality - Ben Winchester

Age:	20s	30s	40s	50s	60s	70s
Housing Cycle:	Single- or multi-family rent	Single-family own	Upgrade	Downsize	Assisted living	
New Units Built:	Multi-family rent	Starter homes	Larger homes	Townhouse units	Assisted living units	
Old Units Left Behind:		Multi-family rentals	Starter homes or older single-family homes	Larger homes and older, single-family homes	Townhome units, larger homes, single-family homes	

In rural areas, however, older households tend to move less (Figure 3), while at the same time, they represent a larger percentage of total households (Figure 4). In addition, the longer elderly householders stay in their homes, the more likely it is for their homes to become dilapidated or at least not kept up to code, often because the elderly homeowner is unable because of income, health, or both to make the necessary improvements.

Figure 3

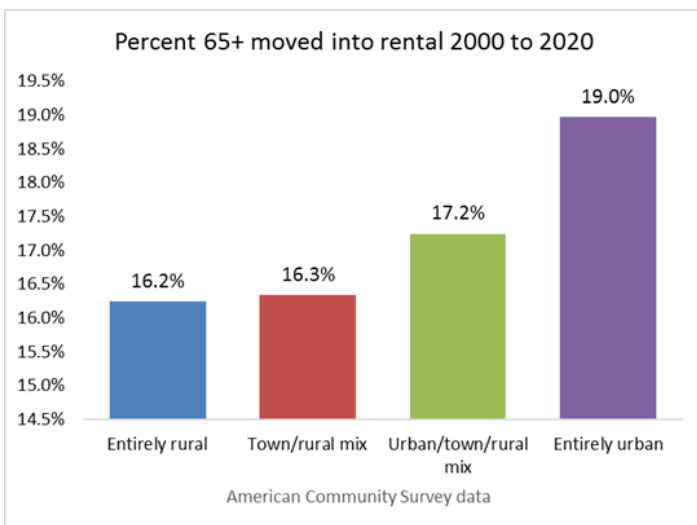
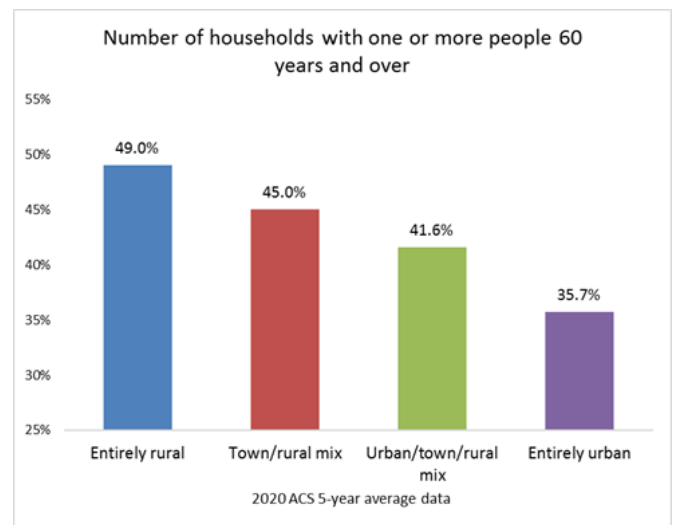


Figure 4



This lack of movement among older households creates something of a domino effect in the rural housing stock, freeing up fewer single-family homes for the new workforce and resulting in a shortage of housing across the entire life-cycle spectrum (Figure 5).

The data is beginning to show evidence that this lack of housing churn in rural areas is tightening both the rental (Figure 6) and the for-sale home market (Figure 7).

Figure 5: The housing life stages as they exist in many rural communities today. Modified Source: U of MN Extension | Center for Community Vitality - Ben Winchester

Age:	20s	30s	40s	50s	60s	70s
Housing Cycle:	Single- or multi-family rent		Single-family own		Assisted living	
New Units Built:	Few multi-family rent	No starter homes	A few larger homes		A few townhouse units	A few assisted living units
Old Units Left Behind:	A few multi-family rentals		A few older, single-family homes			

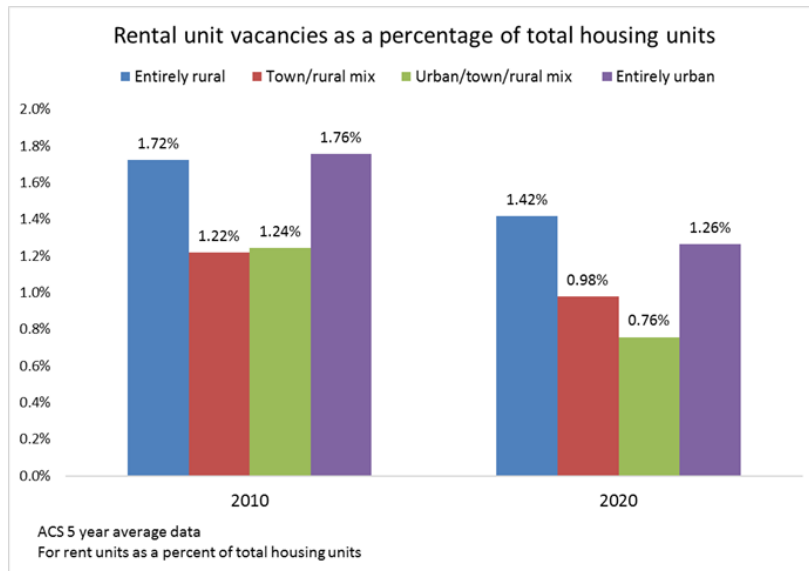


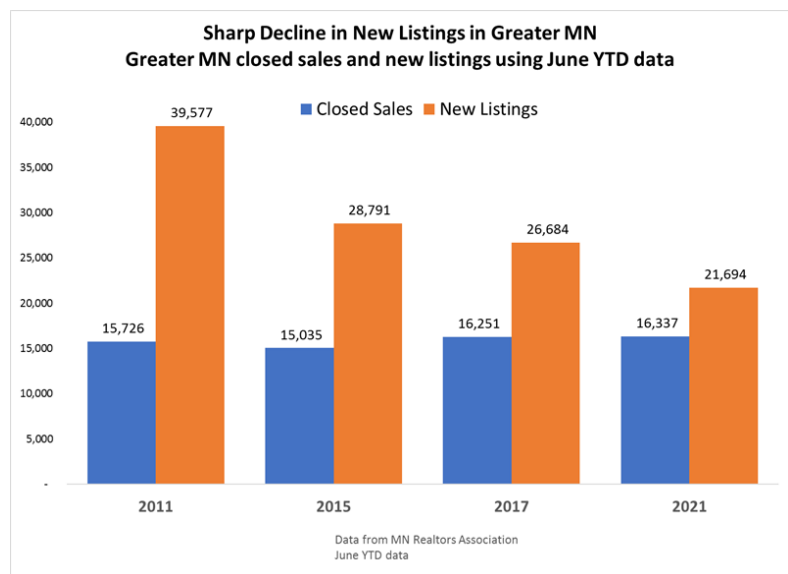
Figure 6 (left)

Figure 6 illustrates the significant drop in rental unit vacancies since 2010, which showed significantly low vacancy rates to begin with. A rental vacancy rate below 3% signals a significant need for rental housing in the community.

Figure 7 (right)

Notes: Number of home sale listings and closings in entirely rural and town/rural mix counties combined.

Figure 7 shows this decline in new listings is making it even harder for the workforce in Greater Minnesota to access housing.



INCREASING COSTS OF CONSTRUCTION

Despite growing pressure on community leaders to rehab substandard housing and/or build new units to meet demand, increasing construction costs make both strategies challenging.

Housing professionals give several reasons for the sharp increase in construction costs:

- Supply chain issues;
- The increasing cost of materials;
- The increasing price of land to build on;
- The increasing cost to prep build-sites with water, sewer, and other infrastructure;
- A sluggish recovery in the number of home-building companies since the Great Recession, forcing up prices for their services;
- A competitive retail construction market in larger communities that can pay more for projects, forcing up "bids";
- Labor shortages in the trades industries resulting in higher wages; and,
- The increasing number and complexity of building codes.

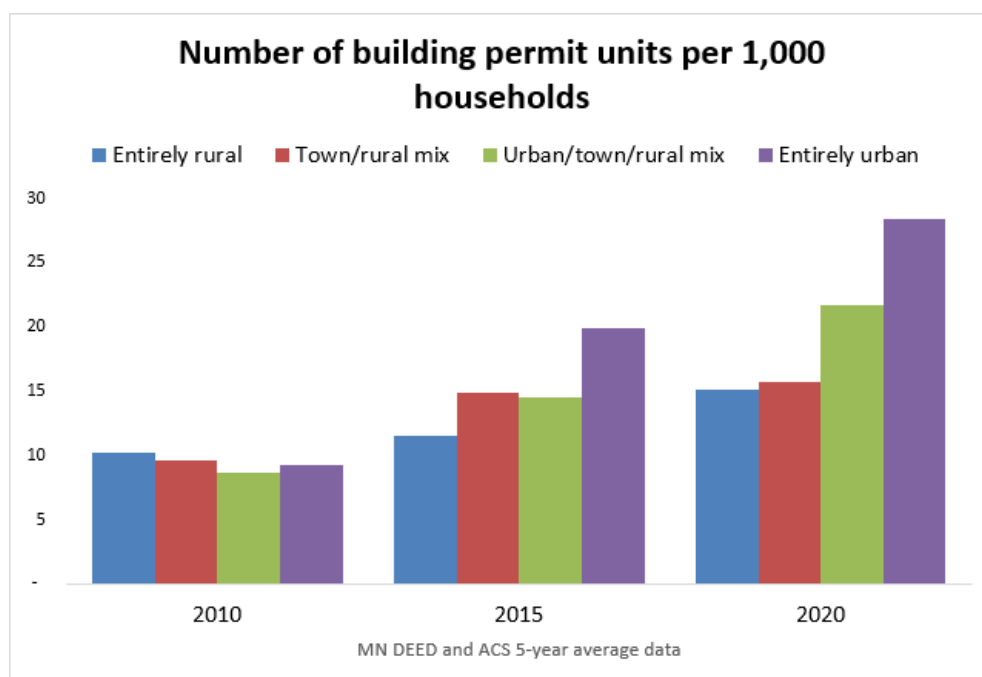
Specific data confirming each of these reasons is limited. Still, employment and business data confirm a lower number of businesses and employees in the home-building industry compared to pre-recession years.

Of course, the reasons for construction and rehab cost increases affect rural and urban areas alike, but what makes this issue uniquely rural is their impact on the mismatch between construction costs and home values in rural areas.

NEW CONSTRUCTION "STARTER HOMES" ARE OUT OF REACH

Despite the demand for housing and a lack of available older housing, high construction costs are contributing to the fact that the rate of housing unit construction is not recovering in rural areas since 2010 (Figure 8).

Figure 8



The lack of housing development in rural areas is not due to a decrease in rural household incomes. In fact, median household incomes, median home sale prices, and mortgage and homeowner costs have been growing, particularly in counties outside of those that fall under the entirely urban category (**Table 2**).

Table 2

Notes: Median income, rent costs, and housing costs are American Community Survey 2020 data.

	% change in median household income since 2010	Contract median rent % change since 2010	Monthly housing costs for people with a mortgage % change since 2010
Entirely rural	24%	29%	14%
Town/rural mix	28%	27%	10%
Urban/town/rural mix	27%	26%	4%
Entirely urban	27%	33%	5%

While the median household income gap between rural and urban areas has narrowed, the monthly housing costs are still out of reach for these regions, and the development of housing in these areas is lagging. Many housing professionals have reported building costs increasing by 60% to 90% since 2000, a much faster rate than incomes across the state.

Chad Adams is the CEO of Southwest Minnesota Housing Partnership, a non-profit community development corporation serving Southwest and South-Central Minnesota communities. According to Adams, every community he meets with has said there is a dire need for housing.

The Southwest Housing Partnership has traditionally built a lot of single-family housing in the communities of Waseca, Worthington, Windom, Fairmont, St. Peter, and Luverne. However, as a non-profit organization, they are anticipating a slowing of single-family production due to uncertainty of construction, supply chain issues (taking 16-18 weeks to get windows, for example), and dramatically increasing interest rates affecting buying power. As these issues worsen, they will continue to compress and impact the housing market in these communities.

Staff at the Southwest Housing Partnership say that twelve years ago, they could build a 3-bedroom, 3-bath house for \$120,000 in the city of Worthington. Today, that same floor plan costs about \$375,000 to build in that community. That is a significant cost increase in a 12-year period, where incomes do not match that growth. Communities are seeking homes built at or under \$200,000 to reach affordability.

Some businesses are taking the solution into their own hands to fight the housing shortage. For example, a major employer in Worthington, JBS Pork, has begun to build housing for its employees due to the significant shortage of single-family homes in the city.

According to recent housing surveys in Southwest Minnesota, even communities under 2,000 in population are short by 5-10 housing units. Many housing studies in regional centers show that in the next five years, there will be a need for an additional 30 to 70 single-family homes, exacerbating the problem even further.

LACK OF MARKET FOR NEW CONSTRUCTION "STARTER HOMES"

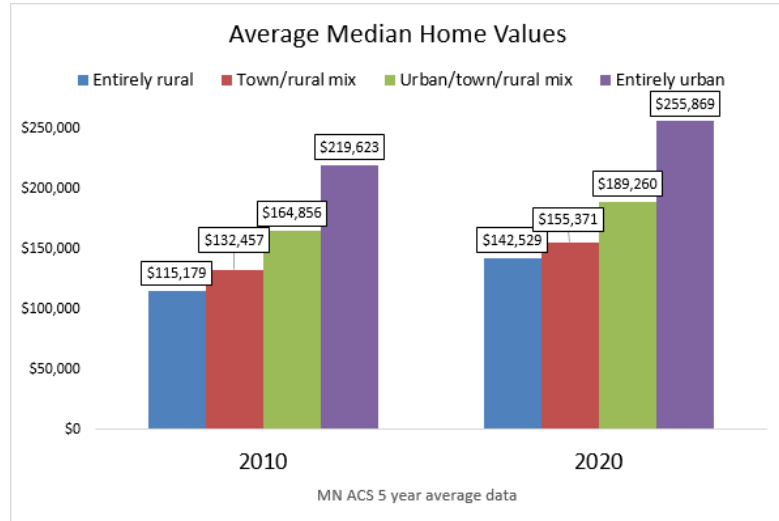
Not only are the available homes unaffordable for the new or younger workers, but the perception among households that can afford this cost is that it "isn't much house" for the price.

At \$225,000, a new-built home would cost 20%-40% more than the median value of existing homes in the area (**Figure 9**). Even if a family could afford to build a new starter home at this price, it could be difficult to convince them, knowing that they could buy an existing home in their area at the same price, and which would likely be larger, have more character and be in a more desirable location.

And to add insult to injury, when construction is completed, the new house would likely be appraised at a lower selling price than what it costs to build.

This leaves very few households demanding newly built starter homes and makes it challenging for developers to build these projects, even in areas where there might be high demand for workforce housing.

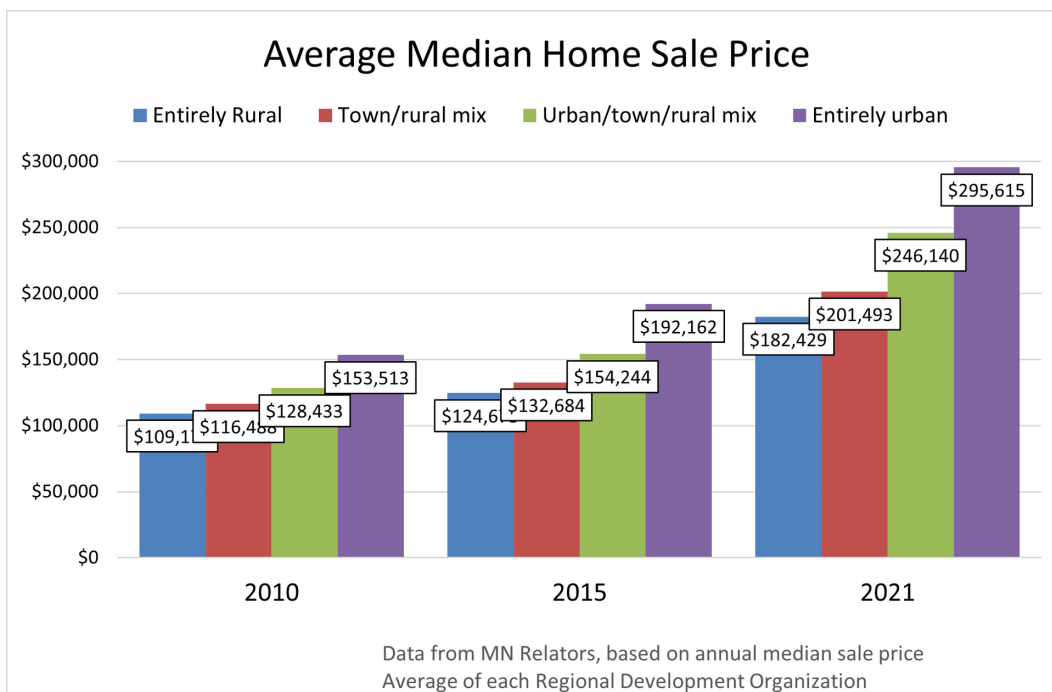
Figure 9



SKYROCKETING HOME SALE PRICES

While median home values are increasing across the state, median home sale prices are also rising. In the chart below, you can see a significant increase in sale prices. From 2010 to 2021, home sale prices have increased by 67% to 92% (**Figure 10**) in Greater Minnesota, making the problem of accessible workforce housing even worse. Getting financing on a mortgage at increased rates also creates a significant barrier to entry into the market. Buyers are seeing mortgage rates reach above 6%, almost double what they saw in early 2022.

Figure 10



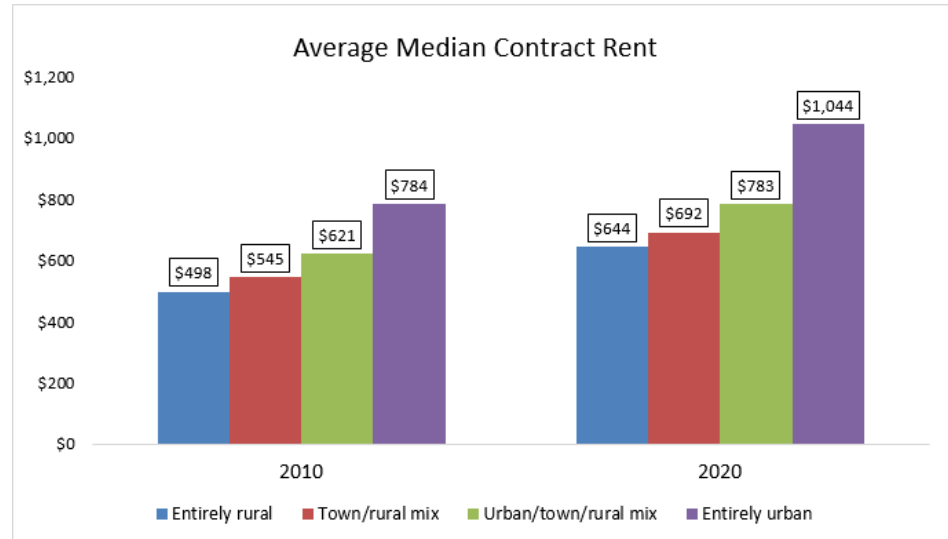
LOW RENTS AND INABILITY TO TAKE RISK

If new workforce or younger households can't afford to build new starter homes, there is hope that building rental units, where efficiencies can make the financial model more manageable, can be a solution.

Here the issue is a bit more nuanced. The challenge is overcoming significantly lower rents in rural areas. For apartment buildings, there are long waiting lists for rentable units, and workers often can't qualify for affordable housing.

At the same time, no market-rate homes are being built. Many Greater Minnesota communities are used to spending around \$800 per month on a 1-to-2-bedroom apartment. However, a builder needs to charge \$1,200 to \$1,500 per month to make a project work financially (Figure 11), even with the support of grants and relying on small non-profit margins.

Figure 11



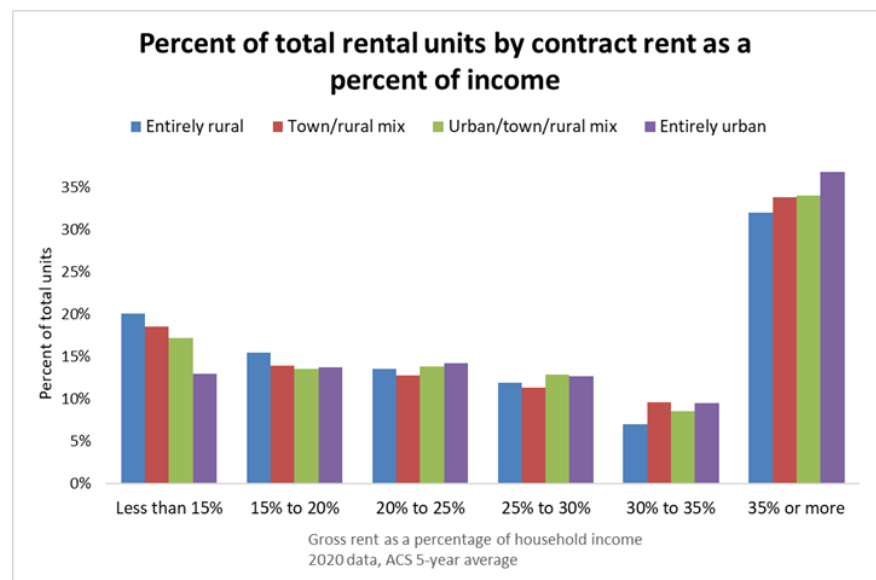
On an exclusively for-profit project, it is an even worse margin between affordability and financial feasibility. Private investors cannot do it independently – they need state grants and community funds to support the effort.

Some developers believe there is a market for higher rent prices, but the data to prove it is mixed. 30% or less of income going toward housing costs is considered the “affordable” threshold, and Figure 12 shows that 61% of rural households are paying less than 30% of their income toward rent, including around 36% of households paying 20% or less of their income on rent.

Still, given the general increase in building costs, the rule of thumb on affordability may not be enough anymore, as indicated by how many households are paying more than 35%.

The lack of concrete proof of the ability to pay higher rent leaves median contract rents as the only data point, making it challenging to convince investors that rental projects are feasible. Lenders also don't have the flexibility to provide resources when data indicates that these projects carry significant risks.

Figure 12



RISING CONSTRUCTION COST IMPACT SUBSTANDARD HOUSING INVESTMENTS

Counter to unaffordable housing (particularly in regions with lakes), the other end of the spectrum consists of very inexpensive housing, albeit in various states of dilapidation.

Communities trying to attract younger families consider dilapidation a significant problem because these families often don't have the means to make a considerable investment in home renovations. The smaller and more rural the community, the more limited the housing stock, and thus the bigger the problem of dilapidation becomes.

Rural leaders in regions with a demand for a larger workforce often lament the condition of existing homes available in their communities. In urban areas with a growing workforce and where home values are higher, this type of older housing can make perfect starter homes for families willing to invest in their rehab and can be great for folks who don't have a lot of extra cash saved for a down payment.

In rural areas, however, increases in construction costs, coupled with lower home values, mean there is no guarantee that rehab work will increase a home's value. This becomes a major barrier for banks offering mortgage products to families that don't have the funds.

As Nick Dalton from United MN Bank in New London explains, if an applicant wants to purchase a property needing repair, they may incur rehab costs that aren't supported by a market value appraisal. Buying a home and then investing in its rehabilitation yet having the appraisal come short of the value invested makes the home purchase nearly impossible to finance.

Very little data highlights how many substandard homes there are in rural Minnesota. Still, the stage is set for the amount of dilapidated housing to increase significantly over the next 10 to 20 years as the population continues to age. Results from a survey commissioned by the Minnesota Department of Human Services in their *Aging 2030* report showed that baby boomers in rural areas and small towns were most likely to prefer to age in their current homes.

Not only is there a greater preference, but many baby boomers in rural areas may not have a choice. As highlighted in a 2015 report by the Center for Rural Policy and Development, assisted living facilities are being developed at a slower rate in rural areas than in metropolitan areas due to shortages in the healthcare workforce and financial feasibility challenges.

FUTURE RESEARCH

Construction costs, low home values, and the aging population all combine to create the environment that is fostering the housing shortage in Greater Minnesota today. However, there is little research on the current and future impacts of these issues, making it challenging to develop long-lasting solutions to these two knotty issues.

A closer look at the causes of the increases in construction costs will hopefully reveal areas where the market breakdown can be fixed. At the same time, a careful examination of how we can help our seniors keep their homes in good repair or move to quality assisted living nearby could help find ways to loosen the bottlenecks in the rural housing cycle. Understanding the overall picture better should help policymakers, community leaders, and builders maintain a healthy supply of homes for workers in our growing rural businesses.

Definition of 4 County Categories

The Minnesota State Demographic Center defines the four categories of counties using the U.S. Census Rural-Urban Community Area (RUCA) codes. The definition of RUCA can be found in Minnesota State Demographic Center's report "*Greater Minnesota: Refined & Revisited*." The state demographer's office analyzes the census tracts in each county to determine the type of "mix." Each county is then categorized (see below).

Urban Definition

- 1 Census tract is situated at the metropolitan area's core and the primary commuting flow is within an urbanized area of 50,000 residents or more
- 2 Census tract is within a metropolitan area and has higher primary commuting (30% or more) to an urbanized area of 50,000 residents or more
- 3 Census tract is within a metropolitan area and has lower primary commuting (10-30%) to an urbanized area of 50,000 residents or more

Large Town Definition

- 4 Census tract is situated at a micropolitan area's core and the primary commuting flow is within a larger urban cluster of 10,000 to 49,999 residents
- 5 Census tract is within a micropolitan area and has higher primary commuting (30% or more) to a larger urban cluster of 10,000 to 49,999 residents
- 6 Census tract is within a micropolitan area and has lower primary commuting (10-30%) to a larger urban cluster of 10,000 to 49,999 residents

Small Town Definition

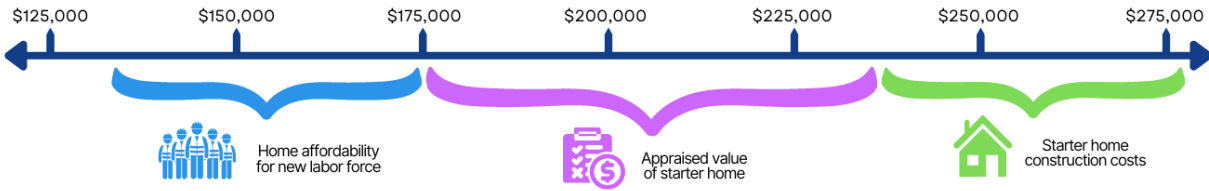
- 7 Census tract has a primary commuting flow within a small urban cluster of 2,500 to 9,999 residents
- 8 Census tract has higher primary commuting (30% or more) to a small urban cluster of 2,500 to 9,999 residents
- 9 Census tract has lower primary commuting (10-30%) to a small urban cluster of 2,500 to 9,999 residents

Rural Definition

- 10 Census tract has a primary commuting flow outside of urban areas and urban clusters.

Notes: The number of counties within each category are; i) entirely rural: 14; ii) town/rural mix: 35; iii) urban/town/rural mix: 25; and iv) entirely urban: 13.

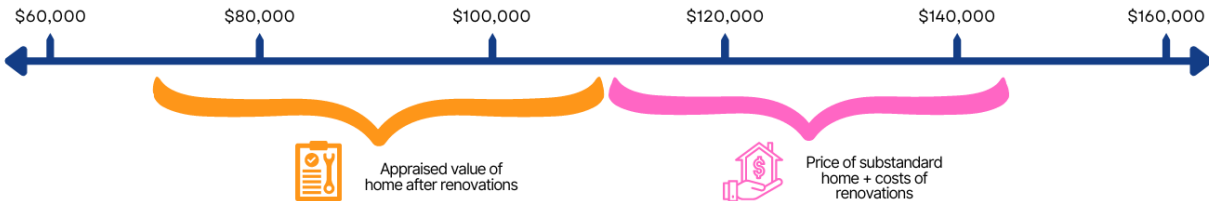
SUMMARY: HOUSING INFOGRAPHIC



Low rents make it challenging to recruit lenders & investors for the development of multi-family housing.



The lower values of substandard homes coupled with the high cost of renovations makes them a poor investment for families & creates significant challenges for banks looking to lend on this type of home.



*Home affordability estimate is based on a median income of \$39,718 from ACS 2020 data & home affordability threshold of under 30% of income to mortgage payment.
 **Median rent in rural areas come from ACS 2020 data.
 ***Data for the appraised value of starter home & home after renovations, starter home construction costs, rent needed for multi-family housing development, & price of substandard home + renovations all come from the Southwest Housing Partnership.

Since 2018, many of these figures have gotten much worse. For example, starter home construction costs were around \$200,000 in 2018; now, they are up to \$275,000. Rent needed for multi-family housing development went from \$800-\$1,000 to \$1,000-\$1,400 in these four years. Additionally, the price of a substandard home plus the cost of renovations increased from a range of \$80,000 – 100,000 to \$115,000 – \$140,000!

Despite the growing costs of building housing, the ability of a homeowner or renter to afford that home has not shifted significantly. Home affordability for a new labor force remains far below the cost of constructing a starter home or renovating an older one. This disparity in growth has widened the gap between the production of rental housing and single-family, owner-occupied housing.