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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

PROGRAM EVALUATION REPORT

Affordable Housing

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

January 30, 2001

Members
Legislative Audit Commission

In April 2000, the Legislative Audit Commission directed us to study factors that may be limiting the production of housing that is affordable to lower income people. Legislators asked us to help them understand why there is a shortage of affordable housing in Minnesota and what might be done to change the situation.

We found that building new housing—even basic housing—is expensive. Evidence suggests that land, labor, and material costs, which are heavily influenced by market forces outside of governments' direct control, are the primary contributors to the high cost of housing. On the other hand, some factors under governments' control, such as the state building code, taxes, and local zoning and land use policies, may also inhibit the development of new low-cost housing. These governmental programs and policies, however, exist to achieve important public objectives, and policy makers must weigh the benefits they produce against their potential to impede new affordable housing.

Finally, we identified several key components of successful affordable housing projects in Minnesota and elsewhere. Most important are public financial subsidies and, to a lesser extent, waivers from local regulations, such as lot size requirements and other zoning restrictions.

This report was researched and written by John Patterson (project manager) and Craig Helmstetter, with assistance from Lila Moberg, Susan Von Mosch, and Jo Vos. We received the full cooperation of the Minnesota Housing Finance Agency, the Metropolitan Council, local housing organizations, and private builders and developers.

Sincerely,

/s/ James Nobles

James Nobles
Legislative Auditor

/s/ Roger Brooks

Roger Brooks
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Major Findings

- Although the median statewide price for an existing home increased 61 percent in the last decade (pp. 8-9 of the full report), median priced homes were affordable for lower-income households in 70 of Minnesota's 87 counties in 1999, including Hennepin and Ramsey counties (p. 10). The 17 counties where the median priced homes were not affordable generally surround Hennepin and Ramsey counties.

- In the Twin Cities, however, lower-income households face a difficult rental market, with average apartment rent up 34 percent in the last decade but median renter income up only 9 percent (p. 14). In addition, the current vacancy rate is unusually low at 1.5 percent (p. 15).

It is extremely difficult to build affordable housing without public financial assistance or regulatory relief.

- In addition, without subsidies new homes and apartments are often unaffordable to lower-income households. Data from various sources suggest that a new starter home costs at least $116,000 and a new two-bedroom apartment rents for at least $950 a month (pp. 20-21).

- Developers, builders, and local housing organizations identified the cost of land, labor, and materials more frequently than any other factor as a significant impediment to the production of new affordable housing (pp. 26-28).

- Developers, builders, and local housing organizations also agree that they need government help—in the form of financial assistance and regulatory waivers—to build affordable housing in Minnesota (pp. 66-67).

- The Livable Communities Act has been only marginally successful in producing affordable housing in the Twin Cities area (p. 76).

Report Summary

The lack of affordable housing in Minnesota has received considerable attention recently. Building new affordable housing is one way to address the problem. But builders, developers, and local housing organizations believe that several factors significantly limit the production of affordable housing. Despite these impediments, some affordable housing is being built—mostly with financial assistance and waivers from government regulations that otherwise would increase the cost of housing. We prepared this report at the request of the Legislative Audit Commission. The report describes and analyzes issues related to affordable housing but does not make policy recommendations.

Many Minnesotans Lack Affordable Housing

Affordable housing is an important issue confronting Minnesota policy makers.

A lack of recent data makes it difficult to establish the full dimensions of the housing situation in Minnesota, but according to summary data from the 1990 census, approximately 18 percent of all Minnesota households were in the "lower income" bracket and paid more than 30 percent of their income on housing.[1]

When lower-income households spend more than 30 percent of their income on housing, little money is left over for other necessities. This benchmark is generally used, therefore, to define "affordable housing." In 2000, an "affordable home" is one that sells for $140,000 or less in metropolitan areas of Minnesota or $95,000 in non-metropolitan areas (where household incomes are lower). For renters, an "affordable" two-bedroom apartment is one that rents for $738 or less in metropolitan areas or $495 or less in other areas.

Home prices in Minnesota have risen much faster than inflation, which increased 27 percent between 1990 and 1999. During the same period, the median home sales price went up 61 percent statewide, and prices at the lower decile of the market increased 80 percent. Median household income, meanwhile, went up only 50 percent. Declining interest rates helped keep homes affordable during the 1990s, but available data suggest that some lower income households were having more difficulty buying a house. In addition, some people have difficulty finding affordable apartments. During the 1990s, average rent increased 34 percent in the Twin Cities area, while median renter income grew only 9 percent and the vacancy rate dropped to 1.5 percent.

Although far from definitive, some data suggest that the number of households having difficulty affording housing may be increasing. Individuals who earn the median wage in 13 of the 25 fastest growing occupations (including retail salespersons, cashiers, home health aides, receptionists, and food preparation workers) may have to pay more than 30 percent of their income for housing. For example, a retail salesperson who earns the statewide median wage ($8.06/hour) and lives alone could afford about $419 per month for rent

1 Homeowners are considered "lower income" if the household is at or below 80 percent of the median family income; renters are considered "lower income" if the household is at or below 50 percent of the median family income.

The cost of land is an especially significant factor that limits the production of affordable housing.

(30 percent of income). The average rent for a one-bedroom apartment in the Twin Cities, however, is currently about $664. While many salespersons, particularly in the Twin Cities, earn more than the statewide median wage, they would have to earn $12.77 per hour in order to afford the average Twin Cities apartment. Although there are numerous strategies for finding suitable housing, such as living with a roommate, finding an affordable apartment might be increasingly difficult for growing numbers of low-wage workers.

New Housing is Expensive to Build and Often Unaffordable to Lower-Income Households

According to the most recent data, existing homes are often affordable for lower-income households. In 1999, lower-income households in 70 of Minnesota's 87 countries (including Hennepin and Ramsey counties) could afford an existing home selling at the county's median sales price. But new housing is generally less affordable than existing housing. Data from several sources suggest that a new, single-family, detached home with 1,100 square feet of finished space would cost at least $116,000 in 2000. This price is more than the $95,000 affordability limit for non-metropolitan areas but lower than the $140,000 limit for Minnesota's metropolitan areas. But many developers and builders contend that it is difficult to build a house for less than $140,000 in the Twin Cities area because land prices are so high.

New rental housing is also expensive to build. A basic two-bedroom apartment would cost at least $74,000 to build, and it would need to rent for about $950 per month to attract investors. Such an apartment would not be affordable to lower-income households in non-metropolitan areas, where the affordability limit is $498 per month, nor in metropolitan areas, where the limit is $738.

Opinions Differ About Factors that Limit the Production of Affordable Housing

Many people wonder why new housing is so expensive and what, if anything, the Legislature can do to increase the production of affordable housing. We reviewed the housing literature and analyzed survey responses from 439 developers, builders, and housing organizations to identify and assess the key factors that may limit the production of affordable housing. The figure shows the main factors we identified. While developers, builders, and local housing organizations generally disagree about the significance of each factor, they agree that the cost of land, labor, and materials (especially land) significantly limits the production of affordable housing. The variation in opinions reflects each group's role in producing affordable housing. Land developers are most concerned about land use policies, such as zoning and subdivision ordinances and growth management policies. Builders rank the building and fire codes relatively high because these codes dictate how they build housing. Local housing organizations are primarily concerned with financing issues because they play a major role in financing many affordable housing projects.

Factors That Limit Affordable Housing Production

- The cost of land, labor, and materials.
- Local zoning and subdivision ordinances.
- Other land use policies.
- Development and construction fees.
- Building code standards.
- Financing issues.
- Taxes.
- Reaction from the community.
- Other government policies and programs.

While the factors noted above may limit the production of affordable housing, many factors serve an otherwise important public purpose. For example, zoning ordinances allow local governments to develop their communities based on local priorities. The building code ensures that housing is safe and well constructed. Taxes and development fees enable local and state governments to pay for necessary services. And the Metropolitan Council's growth management policy tries to encourage compact, orderly development in the seven-county Twin Cities area. In considering whether to remove or modify any of the identified impediments to the production of new housing, policy makers at all levels must balance competing goals.

Increasing the Production of Affordable Housing May Require Government Intervention

Minnesota rejected prescriptive affordable housing policies when it adopted the Livable Communities Act.

Despite the various factors that limit the production of affordable housing, some developers, builders, and local housing organizations *are* producing affordable housing in Minnesota and elsewhere. In many cases, government intervention allows them to do so. In fact, some developers, builders, and housing organizations say that obtaining government subsidies is a key ingredient to building affordable housing in Minnesota. While receiving zoning modifications and waivers from government regulation can also be an important strategy, it is used less frequently on a case-by-case basis.

Unlike Minnesota, some states have taken a prescriptive approach by *requiring* the development of affordable housing or *mandating* local governments to provide waivers from government regulations. In the mid 1990s, Minnesota rejected these types of policies in favor of an incentive-based, voluntary program for the seven-county Twin Cities area under the Livable Communities Act (LCA) of 1995. But the LCA has been only marginally successful in producing affordable housing. Specifically, the LCA rewards participation in the program instead of demonstrated progress in expanding the supply of affordable housing. Participating municipalities only have to negotiate affordable housing goals with the Metropolitan Council to become eligible to compete for funding provided under the program. Nevertheless, some Twin Cities area communities have focused additional attention on providing affordable housing because of the LCA. Currently, 104 of the area's 186 municipalities participate in the program, including Minneapolis, St. Paul, and nearly every major suburban city.

Introduction

Affordable housing is an important issue being debated by Minnesota policy makers. The rising cost of housing has received considerable attention in the last year. On June 13, 2000, both the *Minneapolis Star Tribune* and *St. Paul Pioneer Press* had front-page articles highlighting the issue. The *Star Tribune* headline said, "Home sale prices hit record high," while the *Pioneer Press* headline read, "Apartment rents skyrocket." In addition, several organizations have recently issued affordable housing studies. The Affordable Rental Housing Task Force, made up of local housing experts, issued a report in January 2000,[1] and the Mayors' Regional Housing Task Force, made up of metropolitan area mayors, issued its report in November 2000.[2] Both of these reports discussed factors that may limit the production of affordable housing.

We examined factors that may limit the production of affordable housing.

Although there is no dearth of research on affordable housing, there are still conflicting explanations for the shortage of affordable housing. Consequently, in April 2000, the Legislative Audit Commission directed the Office of the Legislative Auditor to study the factors that potentially limit the production of affordable housing. Our study focused on the following questions:

- **What is the need for affordable housing in Minnesota? How has the cost of housing changed over the last decade compared with household income?**
- **How much does it cost to build new housing, and how much new housing is being produced?**
- **What factors potentially limit the production of affordable housing?**
- **What strategies have policy makers, developers, builders, and local housing organizations used to overcome these potential impediments? How effective has the Livable Communities Act been in producing affordable housing in the Twin Cities metropolitan region?**

To address these questions, we reviewed the existing literature on the topic and analyzed data related to the current housing market. To examine why more affordable housing is not being built, we surveyed 1,106 developers, builders, and local housing organizations and received responses from 439 companies and organizations that produced at least one housing unit in 1999. We asked them to evaluate the significance of various factors that might limit the production of affordable housing and their strategies for overcoming the impediments they have

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1 Affordable Rental Housing Task Force, *Affordable Rental Housing: Opening Doors for Private Development and Preserving Existent Housing Stock* (January 2000).

2 Mayors' Regional Housing Task Force, *Affordable Housing for the Region: Strategies for Building Strong Communities* (St. Paul: Metropolitan Council, November 2000).

faced. In addition, we interviewed representatives of these companies and organizations and collected additional information about each potential impediment. Finally, we interviewed representatives from the United States Department of Housing and Urban Development (HUD), Minnesota Housing Finance Agency (MHFA), the Metropolitan Council, and various units of local government about their housing policies and programs.

In this study, we examine the broad issue of producing new affordable housing and how that production is affected by various state and local policies. As the Legislature considers the information and recommendations of various housing interest groups, we hope this report will serve as a guide that provides factual information on the factors that may limit the production of affordable housing. While we point to certain government policies as potential impediments, we recognize that state and local governments generally created these policies to achieve a valid public purpose. For example, the state building code might increase building costs, but code elements result in improved public safety.

We found that some factors that may limit affordable housing production are there to achieve important policy goals.

Because competing policy goals are involved and our study of each factor was limited, we do not make policy recommendations. This is not implying, however, that we do not think proposals for change merit consideration. We simply decided that we are not in a position to propose them.

In addition, we are aware that we did not address several issues that are important to the affordable housing debate. First, we did not analyze strategies for using the existing housing stock to meet Minnesota's need for affordable housing. However, we recognize that the existing housing stock is critical to the affordability issue because most low-income households live in—and will continue to live in—existing rather than new housing. Second, we did not examine strategies for making housing affordable by increasing household incomes, which involves everything from minimum wage levels to welfare and tax policies. Third, we did not assess the impact of property owners opting out of federal subsidy programs and converting their rents to market rate. In fact, the Minnesota Housing Finance Agency devotes a significant amount of its resources trying to keep these rental units affordable. Fourth, we did not examine the issue of recipients of federal rent subsidies having a difficult time finding property owners who will accept their rental applications. Finally, we did not analyze whether some Minnesotans, such as minorities, have equal access to affordable housing.

This report contains three chapters. Chapter 1 provides background information about affordable housing in Minnesota by examining information on costs, incomes, and production. Chapter 2 discusses factors that may limit the production of affordable housing. Finally, Chapter 3 discusses resources and strategies that policy makers, developers, builders, and local housing organizations use to build affordable housing.

1 Background

SUMMARY

A significant number of Minnesota households spend more than 30 percent of their income on housing. Low-income, rental, single-parent, minority, and older households are more likely to lack affordable housing than others. While household income in Minnesota increased rapidly in the past decade, home prices have increased even faster. Nonetheless, many of the existing homes for sale are still affordable. Vacant apartments are difficult to find in the Twin Cities, and average rents have increased considerably in recent years. New housing of all types is expensive to build and is often not affordable without subsidies. In recent years local builders and developers produced a lot of new single-family housing, but little multifamily housing.

In this chapter, we examine the current state of affordable housing in Minnesota. We address the following questions:

- **What is the need for affordable housing in Minnesota?**
- **How has the cost of housing changed over the last decade compared with household incomes?**
- **How much does it cost to build new housing, and how much new housing is Minnesota producing?**

To answer these questions, we reviewed the housing literature and analyzed data related to the current housing market.

"Affordable housing" means different things to different people. We relied on the definition used by the United States Department of Housing and Urban Development (HUD) and others, which defines housing as affordable if it costs less than 30 percent of a household's income. We focused on housing that is affordable to lower-income households. We define lower-income households as those with incomes at or below 80 percent of the median family income if they own their home and at or below 50 percent of the median if they rent.[1]

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1 This definition compares *household* income to median *family* income. Although many households are not families (e.g., single persons living alone or with roommates), we relied on the definition because housing data often use the 80 percent and 50 percent income limits.

Housing is generally considered affordable if it costs less than 30 percent of a household's income.

Table 1.1 shows the income and housing cost limits for 2000 under our definition of affordability.[2] For example, the most expensive home a metropolitan-area household earning $52,480 (80 percent of the median income) could afford without assistance is $140,000. Therefore, we consider metropolitan-area homes selling for $140,000 or less affordable. Similarly, we consider non-metropolitan area homes selling for $95,000 or less affordable.

Affordable home values depend on a variety of factors, including the size of the down payment, the available mortgage interest rate, and whether the purchaser qualifies for governmental assistance programs. For example, MHFA offered qualified households a mortgage interest rate of 6.5 percent in 2000. At this lower rate, rather than the 8.0 percent rate used in Table 1.1, a non-metropolitan area household earning 80 percent of the median income could afford a $106,000 home. In Chapter 2, we discuss interest rates and other financial issues in more detail.

Table 1.1: Minnesota's Income and Cost Limits for Affordable Housing, 2000

	Metropolitan Areas[a]	Non-Metropolitan Areas
Median family income[b]	$65,600	$44,300
Owner-Occupied Housing		
80 Percent of median family income	52,480	35,440
Affordable home value[c]	140,000	95,000
Rental Housing[d]		
50 Percent of median family income	32,800	22,150
Affordable monthly rent for an efficiency	574	388
Affordable monthly rent for a one-bedroom apartment	615	415
Affordable monthly rent for a two-bedroom apartment	738	498
Affordable monthly rent for a three-bedroom apartment	853	576

NOTE: These figures are different than those published by the Unites States Department of Housing and Urban Development (HUD). First, HUD provides data for individual metropolitan areas and counties. Second, when HUD calculates incomes at 80 and 50 percent of median family income, the formula includes factors other than just multiplying the median income by 0.8 or 0.5.

[a]Includes the metropolitan statistical areas of the Minneapolis-St.Paul, Duluth-Superior, Fargo-Moorhead, Grand Forks, LaCrosse, Rochester, and St. Cloud.

[b]Median family incomes are higher than median household incomes. Based on the 1990 Census, the median family income in Minnesota was $36,916 in 1989, while the median household income was $30,909.

[c]Assumes a 10 percent down payment and a standard 30-year mortgage with an 8 percent interest rate.

[d]Rental costs are adjusted for family size. For example, HUD adjusts the income limit for three-person households by 10 percent ($32,800 * .90 = $29,520) and sets the limit for a two-bedroom apartment based on the adjustment ($29,500 * .30 = $8,850 annually or $738 per month).

SOURCE: Office of the Legislative Auditor's analysis of data from HUD, *FY 2000 HUD Income Limits: Briefing Material* (Washington DC: HUD, February 20, 2000).

2 Government agencies like HUD and the Minnesota Housing Finance Agency (MHFA) use more complex criteria than the limits noted in Table 1.1, including the median incomes estimated for each metropolitan area or county as well as for different household sizes.

THE NEED FOR AFFORDABLE HOUSING IN MINNESOTA

Many media reports and advocacy groups have recently asserted a crisis-level need for affordable housing in Minnesota.[3] We do not dispute that affordable housing is a considerable problem for some Minnesotans, but we found little recent data that precisely identify the size of the problem and who it affects most, especially outside the Twin Cities metropolitan area. Part of the difficulty is that the best source of information on Minnesota's housing needs is the decennial U.S. Census. Unfortunately, data from the 2000 Census are not yet available.

According to the 1990 census, 23 percent of Minnesota's households spent at least 30 percent of their income on housing in 1989.[4] This percentage excludes those that may have lived in substandard or over-crowded housing to save money as well as homeless individuals and families. On the other hand, the 23 percent includes some households—including those with higher incomes—that chose to live in housing costing more than 30 percent of their income although they have access to less expensive homes.

Twenty-three percent of Minnesota households spent at least 30 percent of their income on housing in 1989.

Some households in Minnesota are more likely to lack affordable housing than others. Using 1990 census data, we found that:

- **Low-income, rental, single-parent, older, and Twin Cities metropolitan area households were more likely than other households in Minnesota to spend at least 30 percent of their income on housing in 1989.**

Figure 1.1 summarizes the percentage of selected Minnesota households that spent at least 30 percent of their income on housing in 1989. The ability to afford housing is obviously related to household income. As shown in the figure, 53 percent of households with annual incomes below $20,000 spent more than 30 percent of their income on housing in 1989. By comparison, only 3 percent of those earning $50,000 or more in 1989 spent at least 30 percent.[5]

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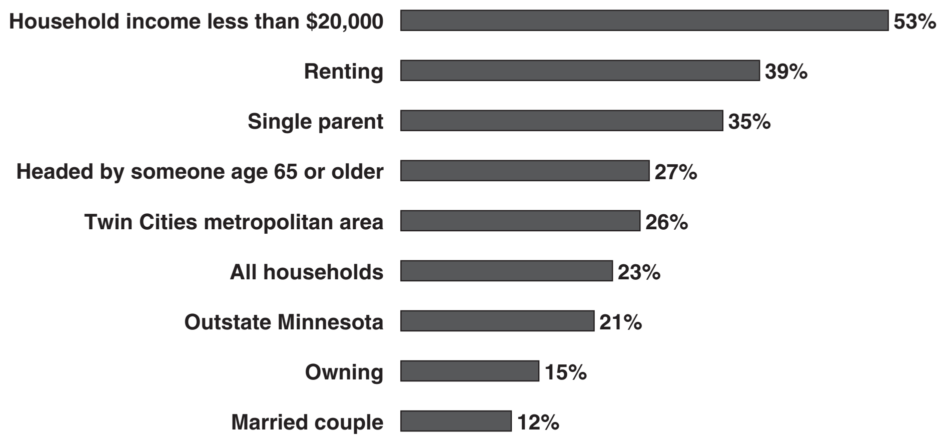
3 Kristin Gustafson, "An Invisible Crisis," *St. Paul Pioneer Press*, December 27, 2000, 1A; Karl J. Karlson, "$10 Million Fund OK'D for Affordable Housing," *St. Paul Pioneer Press*, November 29, 2000, 1A; St. Paul Pioneer Press, "Mayors Unite: Many Hands Needed in Quest for Housing," *St. Paul Pioneer Press*, November 30, 2000, 18A; Deborah Locke, "Handful of Hope," *St. Paul Pioneer Press*, November 30, 2000, 19A; Minnesota Housing Partnership, "About MHP," http://www.mhponline.org/; accessed December 26, 2000; Family Housing Fund, "The Need for Affordable Housing in the Twin Cities," http://www.fhfund.org/Research/need.htm; accessed December 26, 2000; Metropolitan Interfaith Council on Affordable Housing, "From the Director," http://www.micah.org/Newsletter%20Articles/from_the_director3.htm; accessed December 26, 2000.

4 United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H050 and H059, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed September 13, 2000.

5 Office of the Legislative Auditor's analysis of data from United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H050 and H059, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed September 13, 2000.

Figure 1.1: Percentage of Selected Minnesota Households Lacking Affordable Housing, 1989



NOTE: Percentages represent those spending at least 30 percent of household income on housing.

SOURCE: Office of the Legislative Auditor's analysis of data from United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H050, H051, H058, H059, H060, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed December 5, 2000.

Households that rent are more likely to lack affordable housing.

In 1989, the median income for households that rented ($17,800) was one-half the median income for home-owning households ($35,900). As shown in the Figure 1.1, 39 percent of rental households in Minnesota spent more than 30 percent of their household income on housing, compared with 15 percent of homeowners. Similarly, the median household income for single-parent families in 1989 ($22,100) was much lower than that of married-couple families ($39,400), and single parent families were much more likely to lack affordable housing.[6]

Older households were also somewhat more likely to lack affordable housing. As shown in Figure 1.1, 27 percent of all households headed by someone age 65 or older spent at least 30 percent of their income on housing, compared with 23 percent among all households statewide. Older homeowners lacked affordable housing at the same rate as all homeowners (15 percent). However, 55 percent of older households that rented spent at least 30 percent of their income on housing, compared with 37 percent of younger renting households.[7]

On a regional basis, households in the Twin Cities metropolitan area were more likely to lack affordable housing than households in most other parts of the state. Twenty-six percent of households in the seven-county metropolitan area spent at

6 Minnesota Housing Finance Agency (MHFA), *An Assessment of Minnesota's Housing Needs* (St. Paul, July 1995), 1-11, 1-13, 2-4, 2-9, 3-4, 3-9, 4-4, 4-9, 5-4, 5-9, 6-4, 6-9, 7-4, 7-9, 8-4, 8-9. MHFA inflated 1989 median household incomes using the CPI-U; we deflated back to 1989 dollars using the same index.

7 Office of the Legislative Auditor's analysis of data from United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H051 and H060, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed December 5, 2000. Older households accounted for 27 percent of all households in Minnesota in 1990.

least 30 percent of their income on housing in 1989, compared with 21 percent in outstate Minnesota. On the county level, the proportion of households spending at least 30 percent of their income on housing ranged from 27 percent or more in Beltrami, Ramsey, Clearwater, Blue Earth, and Hennepin counties to less than 15 percent in Swift, Lake, Rock, Lake of the Woods, Watonwon, and Traverse counties.[8]

Many minority households lack affordable housing.

Finally, minority-headed households were also more likely to lack affordable housing than non-minority households. The 1989 median income of Minnesota households headed by whites was about $30,600, compared with $21,700 for Asian-American households, $18,500 for Hispanic households, $16,800 for African-American households, and $16,000 for Native-American households.[9] According to the Minnesota Housing Finance Agency's (MHFA) analysis of 1990 census data covering northwestern Minnesota, 35 percent of households headed by Native Americans spent at least 30 percent of their income on housing, compared with 20 percent of white-headed households.[10] In a similar analysis of southeastern Minnesota, MHFA found that 22 percent of Hispanic-headed households lacked affordable housing, compared with 18 percent of non-Hispanic households.[11] A Census Bureau survey of the Twin Cities metropolitan area found that 46 percent of households headed by African Americans spent at least 30 percent of their income on housing, compared with 25 percent for the region as a whole.[12]

To estimate the magnitude of Minnesota's housing need for lower-income households, we relied on the definition of lower income noted previously—homeowners earning 80 percent or less of the median family income, and renters earning 50 percent or less of the median income. Based on summary data from the 1990 census, we estimated that:

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8 Office of the Legislative Auditor's analysis of data from United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H050 and H058, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed December 5, 2000.

9 MHFA, *An Assessment of Minnesota's Housing Need*, 1-13. The incomes reported by MHFA were inflated to 1994 dollars using the CPI-U. We deflated the incomes back to 1989 dollars, also using CPI-U, and rounded to the nearest $100.

10 MHFA, *An Assessment of Minnesota's Housing Needs*, 2-5, 2-9, 2-10. Northwestern Minnesota includes Beltrami, Clearwater, Hubbard, Kittson, Lake of the Woods, Mahnomen, Marshall, Norman, Pennington, Polk, Red Lake, and Roseau counties. This region had a higher proportion of Native-American households than any other region of the state (4 percent, compared with less that 1 percent statewide).

11 MHFA, *An Assessment of Minnesota's Housing Needs*, 7-4, 7-9. Southeast Minnesota includes Blue Earth, Brown, Dodge, Faribault, Fillmore, Freeborn, Goodhue, Houston, Le Sueur, Martin, Mower, Nicollet, Olmsted, Rice, Sibley, Steele, Wabasha, Waseca, Watonwan, and Winona counties. This region had a higher proportion of Hispanic households than any other region of the state (5 percent compared with 4 percent statewide).

12 Office of the Legislative Auditor's analysis of data from the United States Bureau of the Census and United States Department of Housing and Urban Development, *American Housing Survey for the Minneapolis—St. Paul Metropolitan Area in 1993* and *American Housing Survey for the Minneapolis—St. Paul Metropolitan Area in 1998* (Washington, DC: United States Bureau of the Census), Tables 2-20 and 5-20. Percentages are based on data combined from both years since relatively few African-American households are reported in either 1993 or 1998. The "current income" reported in Tables 2-20 and 5-20 of the American Housing Survey (AHS) differs slightly from the definition of household income.

- **Approximately 18 percent of *all* Minnesota households have lower incomes *and* spent at least 30 percent of their income on housing in 1989.**[13]

The Greater Minnesota Housing Fund conducted a similar analysis of 1990 census data and estimated that 18 percent of all Minnesota households—including 18 percent of households in the Twin Cities seven county metropolitan area and 17 percent of households outside the Twin Cities metropolitan area—earned less than 50 percent of the state median family income and spent more than 30 percent of their income on housing.[14] Using more recent housing and income data, the Metropolitan Council estimated that 22.6 percent of all households in the 13-county Twin Cities metropolitan statistical area have both lower incomes and spent at least 30 percent of their income on housing in 1998.[15]

RECENT TRENDS IN HOUSING COSTS AND INCOME

There are few recent statistics precisely identifying how many lower-income households lack affordable housing.

As mentioned earlier, there are little recent data precisely identifying how many lower-income households lack affordable housing; however, in this section we provide information on recent trends in home prices, rents, and income. As shown in Figure 1.2, home sales prices increased faster than household income during the last decade. Average rent in the Twin Cities metropolitan area increased faster than renters' incomes, which fell compared with inflation. We discuss these trends in greater detail in the following sections.

The Cost of Purchasing an Existing Home

The majority of housing transactions involve existing homes, as opposed to new homes which are typically more expensive. (We discuss new construction toward the end of the chapter.) We found that:

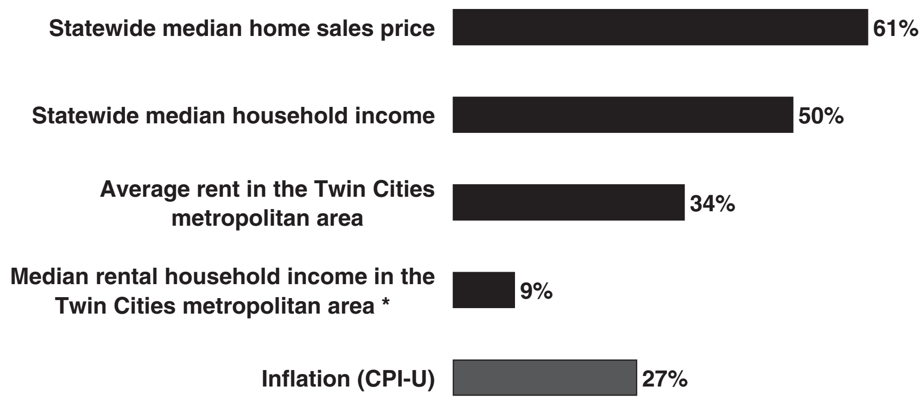
- **The sales prices of existing homes have increased substantially since 1990.**

13 Data indicating housing costs as a proportion of income and the proportion of renter and ownership households were taken from United States Bureau of the Census, *1990 Census of Population and Housing*, Summary Tape File 3, matrixes H050 and H059, http://factfinder.census.gov/java_prod/dads.ui.pbq.PopBuildQueryPage; accessed September 13, 2000. Data indicating the proportion of households below the 50 and 80 percent thresholds were taken from Minnesota Housing Finance Agency, *An Assessment of Minnesota's Housing Needs*, 2-6, 3-6, 4-6, 5-6, 6-6, 7-6, 8-6.

14 Greater Minnesota Housing Fund, *Facets of the Housing Need* (St. Paul, March 1999). The Greater Minnesota Housing Fund credits MHFA for supplying data used in their analysis.

15 Kathy Johnson (Metropolitan Council), memoranda to the Legislative Auditor's Office (November 11, 2000 and January 4, 2001). Ms. Johnson's analysis was based on the United States Bureau of the Census's *American Housing Survey for the Minneapolis—St. Paul Metropolitan Area in 1998*. Lower income was defined as below 80 percent of the 1998 area median family income for homeowners ($48,640), and below 50 percent of area median income for renters ($30,400).

Figure 1.2: Selected Economic Trends in Minnesota, Percentage Change 1990-99



* Median rental household income is for 1989 to 1998. Additionally, 1989 data covers the 11-county metropolitan statistical area (MSA; including 1 Wisconsin county), whereas 1998 data covers the 13-county MSA (including 2 Wisconsin counties).

SOURCES: Minnesota State Demographic Center, United States Bureau of the Census, Apartment Search, United States Bureau of Labor Statistics, United States Department of Housing and Urban Development.

According to the Office of Federal Housing Enterprise Oversight, Minnesota's housing price index (HPI) increased 70 percent from 1990 to 2000, compared with a 41 percent increase nationally.[16] The HPI is a strong indicator of the housing market since it is based on re-sales of the same homes over the years and is not affected by other factors, such as the increasing size of new homes or changing consumer preferences.

Statewide, home sales prices at the lower end of the market grew faster than the rest of the market.

In addition, a recent analysis by the State Demographic Center showed that the median sales price of existing homes in Minnesota grew 61 percent from 1990 to 1999.[17] In contrast, statewide median household income increased 50 percent. Furthermore, sales prices at the lower end of the market grew even faster, potentially making it more difficult for lower-income households to buy a home. For example, the sales price at the tenth percentile (the price below which only 10 percent of homes were sold) grew 80 percent between 1990 and 1999. But in the Twin Cities metropolitan area, the pattern was reversed, with the price at the tenth percentile growing only 39 percent while the median sales price grew 51 percent.

16 Office of the Legislative Auditor's analysis of data from the Office of Federal Housing Enterprise Oversight, "Housing Price Index," http://www.ofheo.gov/house/download.html; accessed November 29, 2000.

17 Martha McMurry, *Sales Prices of Existing Housing in Minnesota, 1998-1999* (St. Paul: State Demographic Center, June 2000). The data used in the report are from the Department of Revenue, and represent "arms length sales of existing homes" (excluding sales to family members and newly constructed homes). The median sales prices represent transactions over 21-month periods (i.e., January 1989 to September 1990 and January 1998 to September 1999).

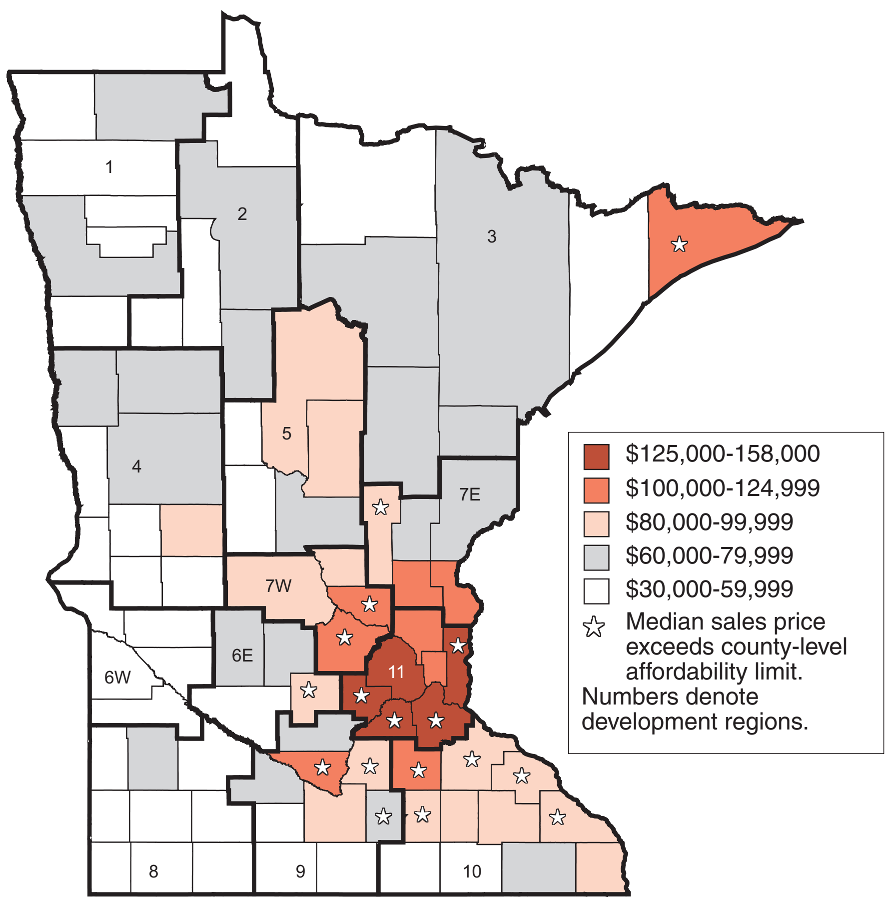
We found that:

- **Despite the rapid growth in sales prices, existing homes often sell for prices that are affordable to many lower-income households.**

Figure 1.3 shows the 17 counties where homes selling for the median sales price are unaffordable to households earning 80 percent of the county's median family income.[18] In most counties, the median home sales price was below the affordability limit. Figure 1.3 also shows that home sales prices vary widely across Minnesota. On the county level, median sales prices in 1999 ranged from a low of $31,000 in Kittson County to a high of $158,000 in Carver County. As shown in Figure 1.4, the Twin Cities seven-county area had the highest prices, and

Home sales prices are generally the highest around the Twin Cities.

Figure 1.3: Median Sales Prices of Existing Homes by County, 1999

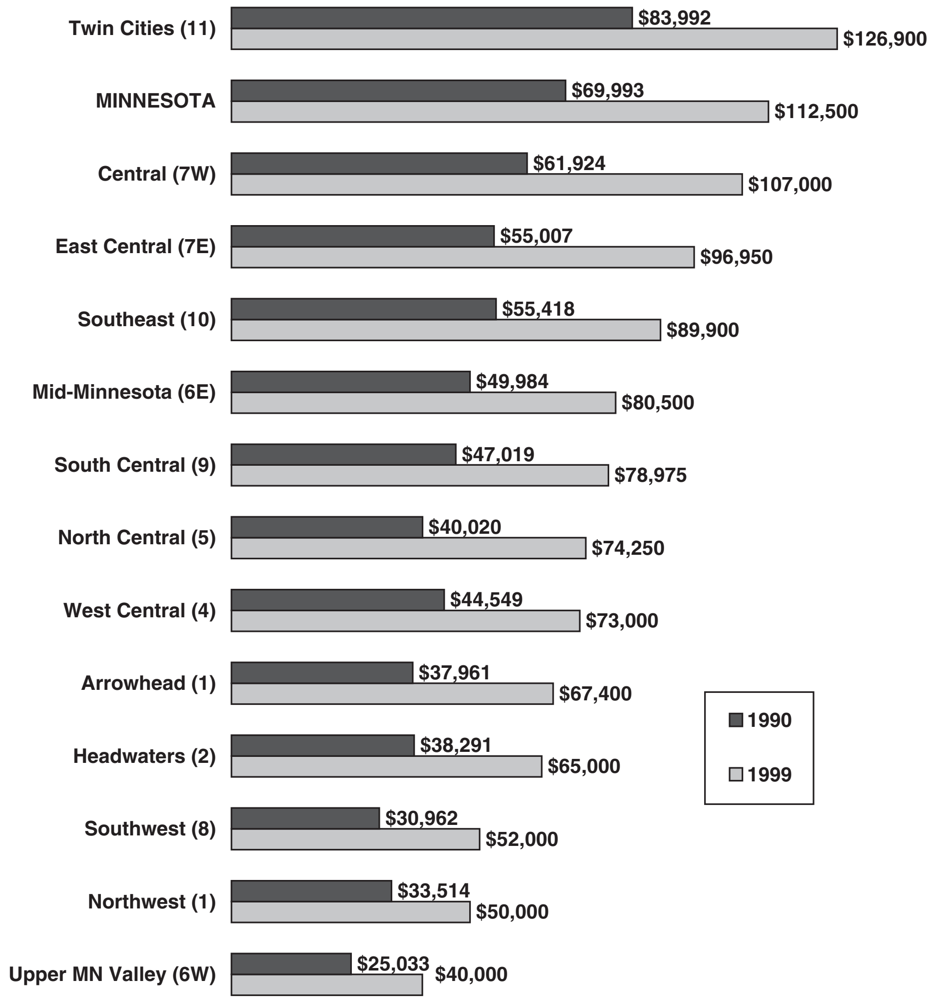


SOURCE: Martha McMurry, *Sales Prices of Existing Housing in Minnesota, 1998-1999* (St. Paul: State Demographic Center, June 2000), United States Department of Housing and Urban Development.

18 HUD estimates median incomes for metropolitan areas and individual counties outside of metropolitan areas (see Figure 1.8 on page 17).

Home sales prices grew rapidly in every region of the state.

Figure 1.4: Median Sales Prices of Existing Homes by Region, 1990-99



NOTE: The numbers next to each regional name correspond to the regional boundaries shown in Figure 1.3.

SOURCE: Martha McMurry, *Sales Prices of Existing Housing in Minnesota, 1998-1999* (St. Paul: State Demographic Center, June 2000).

regions bordering the seven-county area (central, east central, southeast, mid-Minnesota, and south central) had the next highest prices. As indicated in the figure, median sales prices increased significantly from 1990 to 1999 in every region of the state, with the north-central region showing the largest increase (86 percent).

Median sales prices are related to population size and growth rates. Table 1.2 shows median sales prices in Minnesota's largest and fastest growing cities. In 1999, all of the listed Twin Cities suburbs had median home sales prices above the statewide median ($112,500). Eden Prairie, Lakeville, Plymouth, and Woodbury had median sales prices above $150,000. Outside the Twin Cities

Table 1.2: Median Home Sales Prices for Minnesota's Largest and Fastest Growing Cities, 1999

	Median Home Sales Price		Population	
	1999	Percentage Change 1990-99	10 Largest, 1999	10 Fastest Growing, 1990-99
Twin Cities Seven-County Metropolitan Area				
Apple Valley	$132,900	42%		✓
Bloomington	132,000	40	✓	
Brooklyn Park	119,529	44	✓	
Coon Rapids	112,900	46	✓	✓
Eagan	136,000	45	✓	✓
Eden Prairie	165,000	49		✓
Lakeville	153,050	66		✓
Maple Grove	139,900	57		✓
Minneapolis	100,000	43	✓	
Plymouth	176,000	47	✓	✓
St. Paul	95,000	37	✓	
Woodbury	155,000	57		✓
Outside Seven-County Metropolitan Area[a]				
Austin	$ 57,900	60%		
Duluth	73,000	74	✓	
Mankato	88,250	63		
Moorhead	79,500	39		
Owatonna	96,000	63		
Rochester	97,500	48	✓	✓
St. Cloud	84,900	54	✓	✓
Winona	88,250	92		
Minnesota	**$112,500**	**61**%		

[a]Includes all cities outside the Twin Cities metropolitan area with 1999 estimated population size greater than 20,000.

NOTE: "Fastest Growing" refers to the change in number of households from 1990 to 1999.

SOURCE: Martha McMurry, *Sales Prices of Existing Housing in Minnesota, 1998-1999* (St. Paul: State Demographic Center, June 2000).

Large and fast-growing cities often have high home sales prices.

seven-county area, median home sales prices for existing homes approached $100,000 in Owatonna and Rochester in 1999 and grew particularly rapidly in Winona.

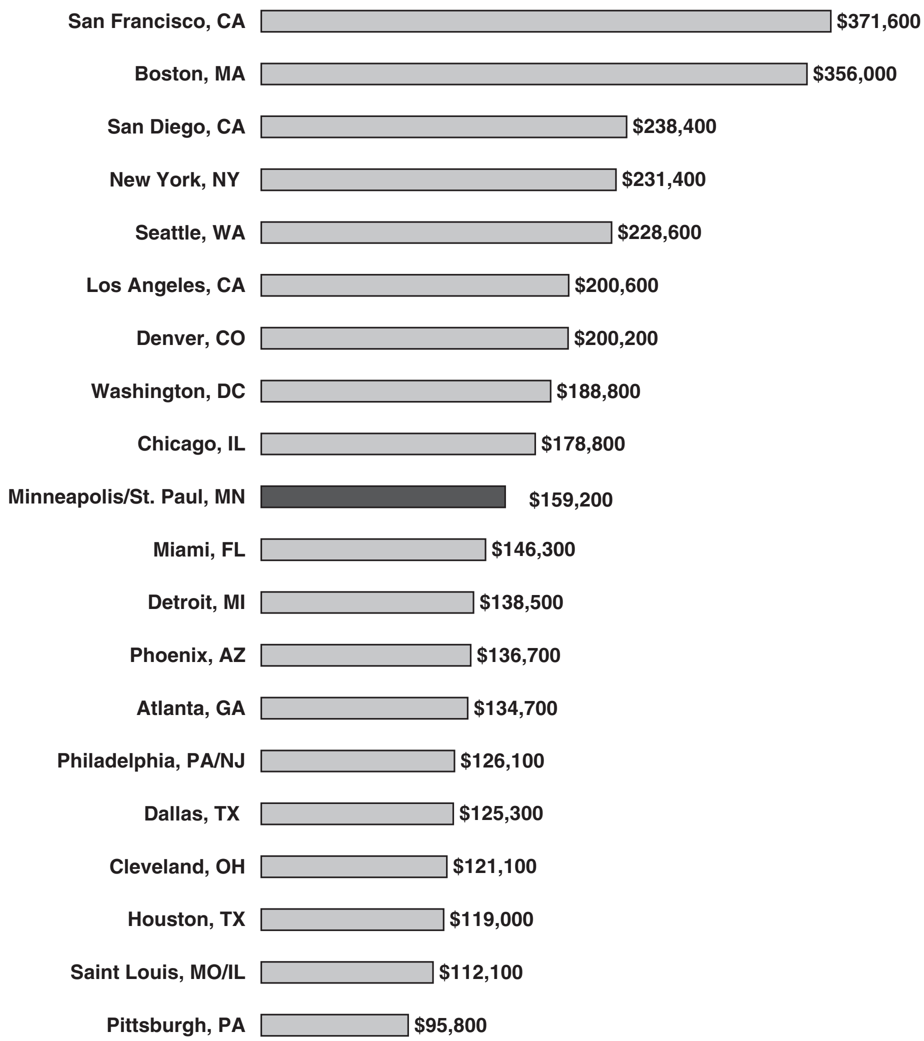
Figure 1.5 shows the median sales price of existing homes for the 20 largest metropolitan areas nationwide. We found that:

- **In 2000, home sales prices in the Twin Cities metropolitan area were average compared with other large metropolitan areas.**

The median sales price in the Twin Cities metropolitan area for the third quarter of 2000 was in the middle of the rankings—the tenth highest of the 20 largest

Home sales prices for the Twin Cities area are typical for a large metropolitan area in the U.S.

Figure 1.5: Median Sales Price of Existing Homes for the 20 Largest Metropolitan Areas, 2000



SOURCE: National Association of Realtors, *Existing Home Sales, Metropolitan Prices, Third Quarter, 2000*, http://nar.realtor.com/databank/ehsmet.htm; accessed November 7, 2000.

metropolitan areas.[19] Sales prices for the Twin Cities area were somewhat lower than in Chicago and somewhat higher than in Detroit. Median sales prices of other midwestern metropolitan areas included $154,900 in Madison, $143,300 in Milwaukee, and $120,500 in Des Moines. Despite having a typical median sales

19 The median sales price indicated for the Twin Cities in Figure 1.4 is from a 21-month period during 1998 and 1999. The median sales price indicated in Figure 1.5 is for July through September of 2000. Although the two figures have different data sources, and the data cover somewhat different areas (7 counties in Figure 1.4 versus 13 counties in Figure 1.5), the main reason for the difference appears to be inflation. The data source for the Figure 1.5 reported median sales prices of $128,000 in 1998 and 137,800 in 1999, which is closer to the $126,900 sales price shown in Figure 1.4.

price, the Twin Cities had the third highest growth rate among large metropolitan areas between 1997 and the third quarter of 2000.[20]

Despite Minnesota's rapid increase in home sales prices in recent years:

- **Minnesota has one of the highest rates of homeownership in the country.**

According to census data, 76 percent of all households in Minnesota and 73 of households in the Twin Cities metropolitan area owned their homes in 1999.[21] Minnesota, along with Maine, South Carolina, and Michigan, had the highest rate of homeownership in the nation. In addition, only 3 of the country's 75 major metropolitan areas had a higher homeownership rate than the Twin Cities area.[22]

Rental Costs and Availability

The best data on rental costs since the 1990 census are limited to the Twin Cities area. Based on these data, we found that:

- **Rental prices grew much faster than renter incomes in the Twin Cities metropolitan area over the last decade.**

Average rent in the Twin Cities area grew 11 percent between 1999 and 2000.

As shown earlier in Figure 1.2, average rent in the Twin Cities metropolitan area increased 34 percent between 1990 and 1999, while the median income for rental households grew by only 9 percent over roughly the same period. The trend in rising rental prices accelerated in the past year, with an 11 percent increase in average rent from June 1999 to June 2000, as shown in Table 1.3. Average rent grew rapidly for all sizes of apartments over the last year, and rents for all sizes of apartments except efficiencies are above the affordability limits for metropolitan area lower-income households (see Table 1.1). Currently, average rents in the Twin Cities area are highest in Minneapolis and the western suburbs and lowest in the northern suburbs.[23]

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20 Office of the Legislative Auditor's analysis of data from the National Association of Realtors, *Existing Home Sales, Metropolitan Prices, Third Quarter, 2000*, http://nar.realtor.com/databank/ehsmet.htm; accessed November 7, 2000. The annual median sales price in 1997 was $118,400.

21 United States Bureau of the Census, "Table 13. Homeownership Rates by State, 1984 to 1999" and "Table 14. Homeownership Rates for the 75 Largest Metropolitan Areas, 1986 to 1999" (standard errors are noted in tables B-3 and B-4), http://www.census.gov/hhes/www/housing/hvs/annual99/ann99ind.html; accessed September 13, 2000. Over the past decade homeownership rates have grown somewhat faster in Minnesota (4 to 8 percentage points) compared to the nation (2.9 percentage points). On October 26, 2000, the Census Bureau released a nationwide homeownership estimate of 66.7 percent, the highest nationwide rate ever estimated.

22 The three metropolitan areas with significantly higher rates of homeownership are Monmouth-Ocean, New Jersey (83.4 percent homeownership); Grand Rapids, Michigan (79.8 percent); and Nassau-Suffolk, New York (78.6 percent). Looking only at estimated homeownership rates, Minnesota ranks fourth and the Twin Cities metropolitan area ranks ninth. However, these rankings disregard the margin of error in Census Bureau estimates; once sampling error is taken into account the "rankings" are as noted.

23 Minneapolis Star-Tribune, "Rent Sampler," November 11, 2000 (data from Apartment Search, *Profiles 2000 Quarterly Review*). As of third quarter 2000, the average one bedroom rented for $680 per month in the western suburbs, compared with $602 in the northern suburbs; the average two bedroom rent was $876 in Minneapolis, compared with $709 in the northern suburbs.

Table 1.3: Average Rents for Twin Cities Area Apartments, 1999 and 2000

	Average Rent		Percentage
	1999	2000	Change
All sizes	**$678**	**$751**	**11%**
Efficiency	465	504	8
One-Bedroom	603	664	10
Two-Bedroom	753	815	8
Three-Bedroom	1,002	1,090	9

NOTE: Starting in 2000, apartments with dens were noted separately from other apartments, and are only included in the average rent for apartments of all sizes. Including apartments with dens increases the average rent for one- to three-bedroom apartments by approximately $10.

SOURCE: Apartment Search, *Profiles 2000 Quarterly Review* (Edina, Minnesota: Second Quarter, 1999 and 2000).

Experts define 5 percent vacancy as the desirable "market equilibrium" for the rental market.[24] Vacancy rates lower than 5 percent can lead to higher rents as property owners respond to increased demand. According to Apartment Search (a market research company):

- **Rental vacancy rates are extremely low in the Twin Cities area—estimated at 1.5 percent during 2000.**[25]

As shown in Figure1.6, vacancy rates in the Twin Cities area dropped steadily over the last decade, but average rents did not rise dramatically until the last few years. Local rental market analysts suggest that the Twin Cities rental market could become even tighter over the next decade as the number of young adults and seniors, the two groups most likely to rent, increase.[26]

Rental vacancy rates in the Twin Cities area and Minnesota as a whole are among the lowest in the nation. According to Census Bureau estimates,

- **Only 3 of the nation's 75 largest metropolitan areas had significantly lower rental vacancy rates than the Twin Cities metropolitan area in 1999, and only two states, Vermont and New Jersey, had lower rental vacancy rates than Minnesota.**

Vacancy rates in the Twin Cities area and the state as a whole have been below the national vacancy rates for the last decade, indicating that Minnesota's rental

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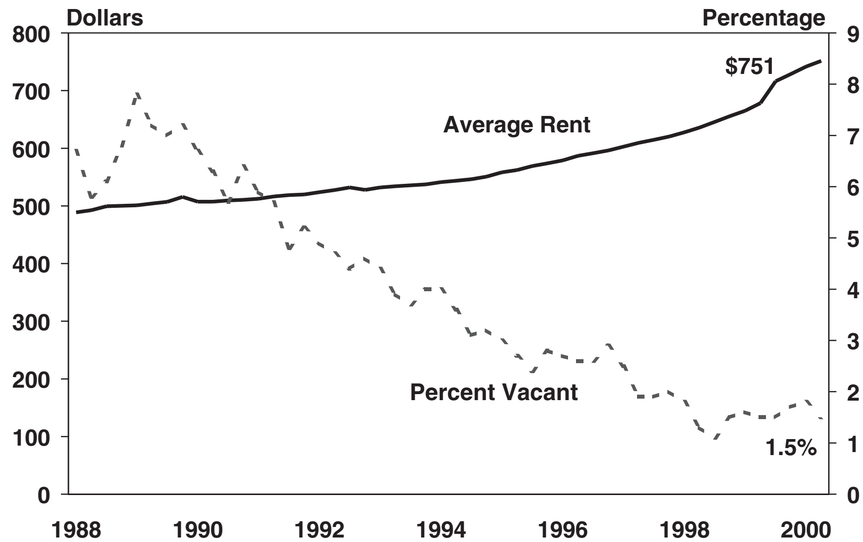
24 Laurence C. Harmon, *Apartment Market Report 2000* (Minneapolis: Maxfield Research, Incorporated, 2000), 11.

25 Apartment Search, *Profiles 2000 Quarterly Review* (Edina, Minnesota: Apartment Search, Second Quarter 2000).

26 Harmon, *Apartment Market Report 2000*, 11-12. Metropolitan Council, *Opening Doors to Affordable/Life Cycle Housing* (St. Paul, March 1995), 20.

Figure 1.6: Vacancy Rates and Average Rent for Twin Cities Area Apartments, 1988-2000



SOURCE: Office of the Legislative Auditor's analysis of data from Apartment Search, *Profiles 2000 Quarterly Review* (Edina, Minnesota).

Experts define a 5 percent rent vacancy rate as the desirable market equilibrium.

market has been tighter than most other markets for at least ten years.[27]

Income, Jobs, and Wages

Minnesota has a robust economy. As shown earlier in Figure 1.2:

- **The state's median household income increased significantly in the last decade.**

Minnesota has a robust economy, but incomes vary widely.

Median household income in Minnesota grew 50 percent over the last decade, to $47,240 in 1999.[28] By comparison, median household income for the entire nation grew only 36 percent although the median household income of nearby states (Iowa, South Dakota, and Wisconsin) also grew approximately 50 percent. According to Census Bureau estimates, only three states, Alaska, Maryland, and

27 United States Bureau of the Census, "Table 3. Rental Vacancy Rates, by State: 1986 to 1999" and "Table 5. Rental Vacancy Rates for the 75 Largest Metropolitan Areas: 1986 to 1999" (standard errors listed in tables B-3 and B-4), http://www.census.gov/hhes/www/housing/hvs/annual99/ann99ind.html; accessed September 13, 2000. The three metropolitan areas with significantly lower vacancy rates are Ventura, California (1.3 percent vacancy); Nassau-Suffolk, New York (1.9 percent); and San Jose, California (2.1 percent). (Ignoring sampling error, the Twin Cities is tied for the ninth lowest rental vacancy rate of all major metropolitan areas, and Minnesota has the eighth lowest rental vacancy rate of all states.)

28 United States Bureau of the Census, "Table H-8. Median Household Income by State: 1984 to 1999," http://www.census.gov/hhes/income/histinc/h08.html; accessed November 10, 2000.

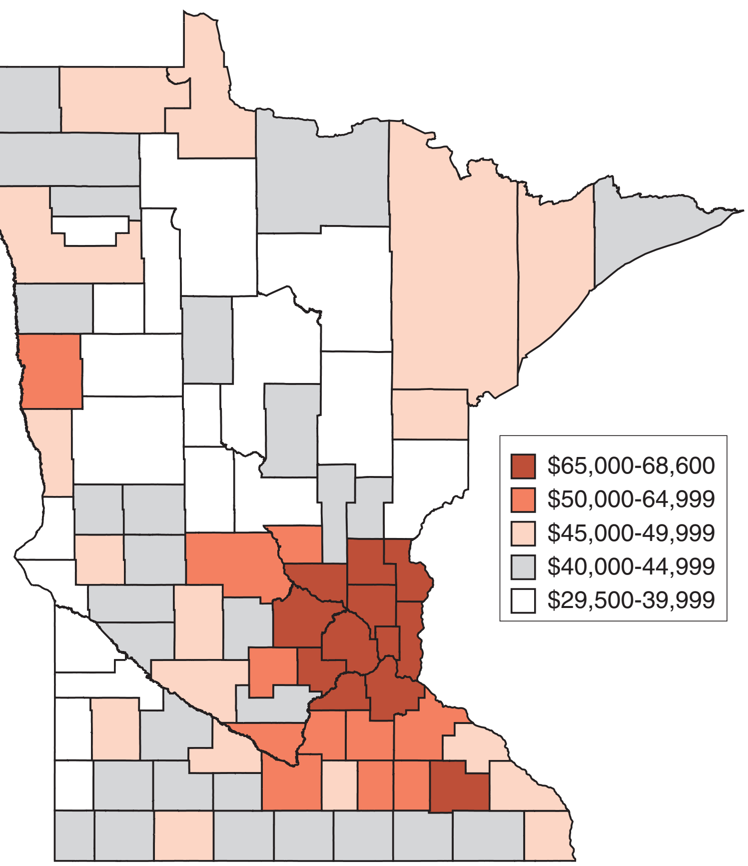
New Jersey, had significantly higher median household incomes than Minnesota in 1999.[29]

Income levels vary widely within Minnesota. As shown in Figure 1.7, the Twin Cities metropolitan area had the state's highest estimated median family income ($68,600), while Mahnomen County, most of which is in the White Earth Reservation, had the lowest ($29,500).[30]

The relatively high family and household incomes in much of the state are partially due to Minnesota's high rate of labor force participation. Minnesota's unemployment rate is consistently among the lowest in the nation. The

Family incomes are generally the highest around the Twin Cities.

Figure 1.7: Median Family Income by County, 2000



SOURCE: United States Department of Housing and Urban Development.

29 United States Bureau of the Census, "Table H-8B. Median Household Income by State: 1984 to 1999," http://www.census.gov/hhes/income/histinc/h08.html; accessed November 10, 2000. We used three year moving averages (Table H-8B) and included standard errors in our state to state comparisons. (Ignoring sampling error, Minnesota ranks sixth highest in median income, 1997-99.)

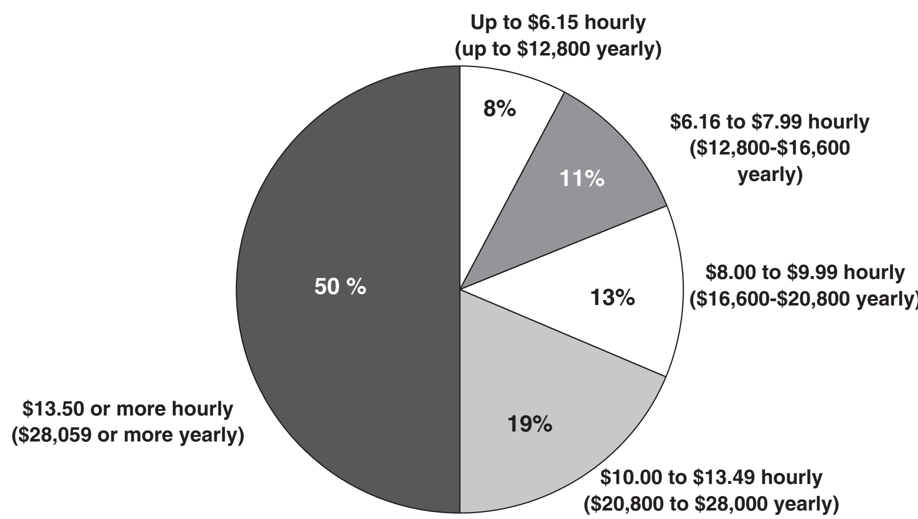
30 United States Department of Housing and Urban Development, "FY 2000 Income Limits and Fair Market Rents," http://www.huduser.org/datasets/il/fmr00/index.html; accessed June 19, 2000. HUD-defined median family incomes are adjusted according to family size, using a family of four as the baseline.

unemployment rate in Minnesota has been below 4 percent since 1996 and was at or below 3 percent for three years, starting in October 1997.[31] According to the Bureau of Labor Statistics' estimates for 1999, Minnesota's unemployment rate (2.8 percent) was the lowest in the nation, and Minnesota's labor force participation rate (73 percent of all adults aged 16 and over) was the highest in the nation.[32] Labor force participation for women is also higher in Minnesota (68 percent) than any other state, which indicates that Minnesota may have a large proportion of two-income families.

Minnesota has a very high rate of labor force participation, but many jobs pay low wages.

While Minnesota has high labor force participation rates, many jobs pay relatively low wages. As shown in Figure 1.8, about one-half of all jobs in Minnesota paid less than $13.50 per hour in 1999, including 32 percent that paid less than $10.00 per hour. By comparison, in 2000 a single wage-earner had to work full time and make at least $12.77 per hour to afford an average one-bedroom apartment in the Twin Cities metropolitan area ($664) and $15.67 per hour to afford an average two bedroom apartment ($815).[33]

Figure 1.8: Distribution of Hourly Wages in Minnesota, 1999



SOURCE: Minnesota Department of Economic Security, "Table 1: Distribution of Hourly Wages of Minnesota Workers in Second Quarter of 1999" (St. Paul, May 1999).

31 Minnesota Department of Economic Security, "Minnesota Unemployment Statistics," http://www.mnworkforcecenter.org/lmi/laus/mn_s_adj.htm; accessed November 22, 2000.

32 United States Bureau of Labor Statistics, "Employment Status of the Civilian Noninstitutional Population in States by Sex, Age, Race, and Hispanic Origin," http://stats.bls.gov/laus/laustdem.pdf; accessed November 10, 200. Labor force participation rates refer to the percentage of the civilian, non-institutionalized population that is age 16 and over and actively involved in the workforce (the percentages reported here include only the employed).

33 Apartment Search, *Profiles 2000 Quarterly Review* (Edina, Minnesota: Apartment Search, Second Quarter 2000) (average rents).

Furthermore, the Department of Economic Security projects that many of the jobs that will be added to Minnesota's economy in coming years are in low-paying occupations. We found that:

- **People in 13 of the 25 fastest growing occupations, including retail salespersons, cashiers, home health aides, receptionists, and food preparation workers, would have to spend more than 30 percent of their income on rent to live in an average one-bedroom apartment in the Twin Cities area.**

Table 1.4 lists the 25 fastest-growing occupations in Minnesota, the statewide median wages associated with each type of job, and the maximum affordable rents and homes for each occupation, assuming a full-time position at the median wage and only one wage earner in a given household. Sixteen of the occupations could

Some of the fastest growing occupations pay relatively low wages.

Table 1.4: Twenty-Five Fastest Growing Occupations in Minnesota, Hourly Wages, Maximum Affordable Rents and Home Values, 2000

	Estimated Employment 1996	Projected Job Growth 1996-2006	**Median Hourly Wage**	Maximum Affordable Rent	Maximum Affordable Home
General Managers & Top Executives	72,240	13,501	**$28.48**	$1,481	$159,000
Retail Salespersons	78,857	12,553	**8.06**	419	45,000
Cashiers	62,350	12,065	**7.31**	380	41,000
Computer Systems Analysts	10,428	10,227	**27.87**	1,449	156,000
Home Health Aides	12,506	8,606	**8.61**	448	48,000
Receptionists & Information Clerks	25,360	6,452	**9.92**	516	55,000
Computer Engineers	3,986	5,614	**30.76**	1,599	172,000
General Office Clerks	55,179	5,492	**11.00**	572	61,000
Supervisors, Sales & Related Workers	36,255	5,480	**15.26**	793	85,000
Sales Reps, Except Scientific Products	31,119	5,328	**21.14**	1,099	118,000
Registered Nurses	36,221	5,181	**22.50**	1,170	126,000
Hand Packers & Packagers	18,875	5,071	**8.10**	421	45,000
Supervisors, Clerical & Admin. Support	24,762	5,035	**16.35**	850	91,000
Food Preparation Workers	29,179	4,972	**6.61**	343	37,000
Human Services Workers	7,249	4,750	**11.16**	581	62,000
Truck Drivers, Light	23,936	4,749	**10.72**	557	60,000
Maintenance Repairers, General Utility	23,742	4,686	**12.78**	664	71,000
Adjustment Clerks	8,767	4,671	**11.93**	621	67,000
Nursing Aides, Orderlies, & Attendants	31,398	4,389	**9.48**	493	53,000
Elementary School Teachers	24,807	4,345	**18.97**	987	106,000
Marketing & Advertising Managers	13,061	4,337	**33.00**	1,716	184,000
Waiters & Waitresses	47,408	4,327	**6.12**	318	34,000
Truck Drivers, Heavy	30,300	4,038	**14.58**	758	81,000
Amusement & Recreation Attendants	14,007	4,019	**6.99**	363	39,000
Financial Managers	17,413	3,744	**30.89**	1,606	173,000

NOTE: Median wage is inflated to year 2000 dollars from 1998 wages using CPI-U. "Maximum affordable rent" assumes spending 30 percent of pre-tax income on rent. "Maximum affordable home" assumes a conventional 30 year mortgage with an 8 percent interest rate and 10 percent down. Home values are rounded to nearest thousand and represent approximations. Many lower income families could not afford a 10 percent down payment, and many could qualify for mortgage assistance programs. Both rents and home values assume a household with one wage-earner working full-time.

SOURCE: Office of the Legislative Auditor's analysis of data from Minnesota Department of Economic Security, *Minnesota Employment Outlook to 2006*, and *1998 Minnesota Salary Survey* (St. Paul, May 1999).

not afford an average two-bedroom apartment in the Twin Cities, including truck drivers and supervisors of sales and clerical workers. Eighteen of the occupations, including elementary school teachers, could not afford mortgage payments on a median-priced existing home ($112,500).

COST OF BUILDING NEW HOUSING

In general, new housing is more expensive than existing housing. We found that:

- **Without subsidies, new homes and apartments are often unaffordable to lower-income households.**

Data suggest that a new, starter home would have cost at least $116,000 in 2000.

We estimated that a new, single-family, detached home with 1,100 square feet of finished space would have cost at least $116,000 in 2000 to develop and build. We based our estimate on the following information:

- According to several builders and developers and trade publications, starter homes generally cost $105 to $125 per square foot in 2000 to construct, including land, labor, materials, fees, overhead, and profit. This estimate assumes that land costs accounted for 25 percent of the overall cost, which is a standard assumption in the construction industry.

- Assuming total costs of $105 per square foot, a 1,100 square foot home would have cost $116,000.

New starter homes are often unaffordable.

This price is more than the $95,000 affordability limit listed in Table 1.1 for the state's non-metropolitan areas, but less than the $140,000 affordability limit for the state's metropolitan areas. However, it would have been very difficult to build such a home in the Twin Cities seven-county area because the price assumed that the land would have cost $29,000 (which is 25 percent of the overall price). Builders told us that it was very difficult to find a $29,000 lot in the seven county area in 2000. It would have been easier to build a $116,000 home in the greater Twin Cities area, including Chisago, Isanti, Sherburne, and Wright counties, where land is less expensive. Within the seven-county area, most of the affordable homes constructed in recent years have been townhomes.[34]

In addition, we estimated that a basic, new, two-bedroom apartment in a large-scale development would have cost at least $74,000 in 2000 to develop and construct. We based this estimate on the following information:

- According to several developers and builders that we interviewed and MHFA data, multifamily housing would have generally cost $70 to $110 per square foot in 2000 to develop and construct.

- Assuming total costs of $70 per square foot, a 1,059-square foot apartment (900 square feet of rentable space when common areas are excluded) would have cost $74,000.

Both the Minnesota Housing Finance Agency (MHFA) and the Metropolitan Council told us that it would have been very difficult to build an apartment in 2000 at this low cost, especially in the Twin Cities metropolitan area. MHFA generally assumes that multifamily housing costs $75 to $85 per square foot, but we identified an apartment complex in Rochester that was recently built at a cost of $70 per square foot. In addition, we present the estimate as an example of the *minimum* cost, not the *typical* cost.

Even basic new apartments are unaffordable without subsidies.

If apartment rent is not high enough to cover operating expenses and provide an adequate rate of return for investors, no one will build the apartment because it will cost more than it is worth. We estimated that this basic apartment would have had to rent for about $950 per month in order for the market value to at least equal its cost.[35] According to our definition of affordability, two-bedroom apartments should have rented for no more than $738 a month in metropolitan areas and $498 in other areas. Consequently, even this low-cost, new apartment would have been unaffordable without subsidies.

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34 Office of the Legislative Auditor's analysis of data from Metropolitan Council, *Report to the Minnesota Legislature on Affordable and Life-Cycle Housing in the Metropolitan Area* (St. Paul, December 1999). About 71 percent of the new, affordable, owner-occupied homes in the Twin Cities in 1998 were multifamily homes—generally townhouses, quads, and duplexes.

35 This assumes a capitalization rate on net operating income of 8 percent. According to market experts that we interviewed, this is a typical rate for new apartments. We calculated net operating income using information from a couple sources. Data on operating expenses (excluding property taxes) came from the Institute of Real Estate Management, *Income Expense Analysis: Conventional Apartments, 1999 Edition* (Chicago: Institute for Real Estate Management of the National Association of Realtors, 1999), 92-93. They conduct an annual survey of apartment buildings in the Twin Cities area. Data on effective property tax rates came from the Minnesota House of Representatives Research Department, *House Research Issues & Information: Property Tax, Changes in Property Tax Burdens Since 1991* (St. Paul, 2000).

HOUSING PRODUCTION AND DEMOLITION

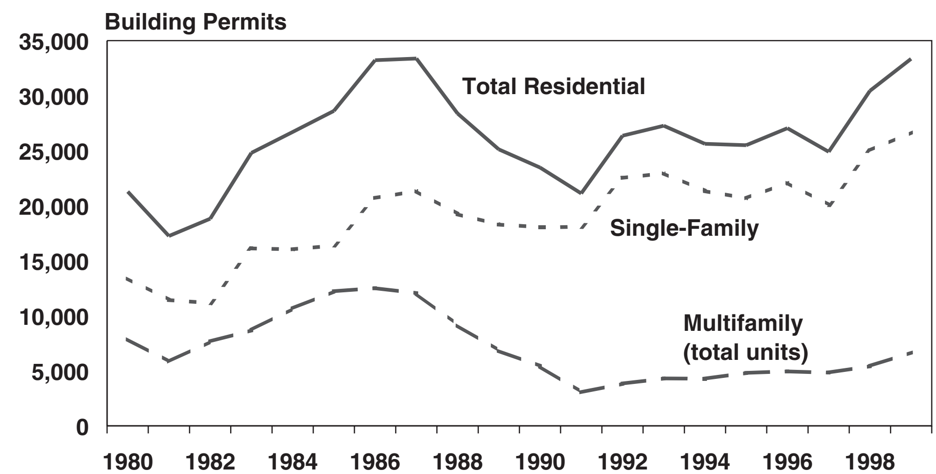
Although it is difficult to construct affordable housing, Minnesota has seen an increase in the production of residential housing in recent years. However, we found that:

- **The production of multifamily housing in Minnesota declined dramatically in the late 1980s and has only partially recovered.**

As shown in Figure 1.9, trends in the production of multifamily housing differ greatly from trends in single-family production. Between 1990 and 1999, the number of permits issued for multifamily units grew at less than half the rate for single-family housing—23 percent compared with 48 percent.

During the 1990s, the production of single-family housing grew at twice the rate of multifamily housing.

Figure 1.9: Residential Building Permits in Minnesota, 1980-99



NOTE: The Census Bureau defines some townhomes as single-family units.

SOURCE: Office of the Legislative Auditor's analysis of data from United States Bureau of the Census, Manufacturing and Construction Division (C40 Series), http://www.census.gov/const/www/C40/table2.html; accessed October 14, 2000.

The decline in multifamily housing production after 1986 coincided with the federal Tax Reform Act of 1986, which reduced or eliminated many tax incentives to build multifamily rental housing, such as accelerated depreciation and deductibility of construction-period interest and taxes. (We discuss the 1986 tax act in more detail in Chapter 2.) According to developers, it is difficult to build multifamily housing because market-rate rents may not support development costs. As shown above, we estimated that a new, basic, two-bedroom apartment needed to rent for about $950 per month in 2000 to be financially viable. However, according to market experts we interviewed, such an apartment would have probably rented for about $900 per month in 2000, depending on its location.

Consequently, a developer might not have gotten the rent he or she needed to make the apartment viable.

Some housing is lost every year through demolitions. While the Metropolitan Council described much of this housing as uninhabitable prior to demolition, some might be defined as affordable housing. The state lacks good data on the number of units that are demolished annually; however, the Metropolitan Council tracks demolitions in the seven-county Twin Cities area. Its data indicate that the number of units lost through demolitions is a fraction of the number gained through new construction. According to the Council's data, 1,326 housing units were demolished in 1998, compared with the construction of 12,663 new units. Just under half of the demolitions in 1998, were single-family homes. Additionally, in 1998, about two-thirds of all residential demolitions reported for the seven-county region were in either Minneapolis or St. Paul, including 40 percent of all single-family demolitions and nearly all multifamily demolitions.[36]

36 Kathy Johnson (Metropolitan Council), memorandum to the Legislative Auditor's Office (January 8, 2001).

2 Factors that May Limit the Production of Affordable Housing

SUMMARY

Recently, considerable attention has been given to factors that potentially limit the production of affordable housing. Producers of housing assess these factors differently, depending on their role in producing housing. Developers emphasize land use and zoning restrictions, while local housing organizations emphasize financing problems. However, almost everyone agrees that the cost of land, labor, and materials—particularly land—limits the production of affordable housing. Many of the potential impediments were created for valid policy reasons. For example, while building code standards may add to the cost of housing, the code ensures that housing is safe and well constructed. Consequently, efforts to address these factors will require policy makers to balance competing policy objectives.

After the federal Advisory Commission on Regulatory Barriers to Affordable Housing released a report in 1991, the issue of government policies and other factors that potentially limit the production of affordable housing received new attention. In creating the Commission, then President Bush observed:

> [At] all levels of government, we have got to take a second look at some of the well-intended housing policies that actually decrease our housing supply. I'm talking about the excessive rules, regulations, and red tape that add unnecessarily to the cost of housing – by tens of thousands of dollars…[1]

In response, the United States Department of Housing and Urban Development issued a guide in 1994 for states to assess these factors in their states.[2] Based on these and other reports and interviews with Minnesota housing experts, we tried to create a comprehensive list of factors that might impede the production of affordable housing in Minnesota. This chapter addresses the following question:

- **According to the people who produce housing in Minnesota, how significant are the various factors that may limit the production of affordable housing?**

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1 Advisory Commission on Regulatory Barriers to Affordable Housing, *"Not In My Back Yard," Removing Barriers to Affordable Housing* (Washington DC: United States Department of Housing and Urban Development, 1991), 1.

2 Council of State Community Development Agencies and the National Conference of States on Building Codes & Standards, *Making Housing Affordable: Breaking Down Regulatory Barriers, A Self-Assessment Guide for States* (Washington DC: United States Department of Housing and Urban Development, March 1994).

We sent surveys to 1,106 developers, builders, and local housing organizations.

To answer this question, we took a two-step approach. First, we sent surveys to 1,106 land developers, builders, companies that both develop and build, and local housing organizations. (Local housing organizations are public and nonprofit agencies that work to provide affordable housing.) We used mailing lists from the Minnesota Housing Finance Agency and several trade associations to identify these organizations. We received surveys from 613 of these organizations but only analyzed the surveys from the 439 that produced at least one housing unit in 1999. Appendix A provides more details about our survey methodology. Second, realizing that many of these survey respondents express subjective opinions, we conducted interviews and obtained information from other studies and data sources to assess and qualify the survey results.

Overall, our survey results show that:

- **Although there is otherwise little consensus about what factors significantly limit the production of affordable housing, all four types of organizations that we surveyed agreed that the cost of land, labor, and materials – particularly land – is a significant limitation.**

Tables 2.1 and 2.2 show how the survey groups assessed the significance of each factor. The variation in survey responses reflects each group’s role in producing affordable housing. Land developers acquire land and prepare it for residential use by subdividing the parcel into lots, grading the site, and installing infrastructure, such as water and sewer lines and streets. Consequently, they were most concerned about land use policies, such as zoning and subdivision ordinances, growth management policies, and wetland regulations. Builders ranked the building and fire codes relatively high because these codes dictate how they build housing. Finally, local housing organizations were primarily concerned with financing issues because they play a major role in financing many affordable housing projects. However, federal, state, and local governments created many of these factors to achieve valid policy objectives. For example, while building permit fees increase the cost of housing, municipalities use the revenue to enforce the building code. In the following sections, we discuss the survey results for these factors in more detail, along with other data and information.

COST OF LAND, LABOR, AND MATERIALS

Land, labor, and materials are the primary components of constructing housing, and their costs are heavily influenced by market forces outside governments’ direct control. A tight labor market drives up labor costs; a construction boom increases the demand and price for lumber, concrete, and drywall; and a desire to live in growing, vibrant communities increases the demand and price for land. At the same time, government policies can affect these costs, particularly land costs. For example, zoning and subdivision ordinances and growth management policies can limit the supply of land available for residential development and consequently inflate prices.

Of all the factors shown in Tables 2.1 and 2.2, the cost of land, labor, and materials is the only factor that a majority of respondents from all four survey groups identified as a significant limitation. While we did not ask survey

Table 2.1: Ranking of Impediments to Single-Family Housing by Type of Organization

	More Frequently Cited Impediments Receive More Stars			
	Developers (*N* = 30)	Developers/ Builders (*N* = 87)	Builders (*N* =138)	Local Housing Organizations (*N* = 118)
Cost of labor, materials, or land	****	****	***	***
Local zoning or subdivision ordinances or development standards	***	***	**	*
Land-use policies other than local zoning or subdivision ordinances	***	***	*	*
Development or construction fees	***	***	**	**
Standards from the state building or fire codes	**	***	**	*
Financing issues	*	**	*	***
Taxes	*	**	*	*
Reaction from the community	**	**	*	*
Other government policies or programs	**	**	*	*

NOTE: We asked survey respondents to “indicate the extent to which each of the factors listed … limits the production of affordable single-family housing in Minnesota.” We provided four possible options: (1) does not limit production, (2) limits production marginally, (3) limits production significantly, and (4) don’t know.

**** 75 to 100 percent of respondents indicated “limits production significantly.”
*** 50 to 74 percent of respondents indicated “limits production significantly.”
** 25 to 49 percent of respondents indicated “limits production significantly.”
* 0 to 24 percent of respondents indicated “limits production significantly.”

Rankings only include respondents who produced at least one single-family unit in 1999.

SOURCE: Office of the Legislative Auditor’s survey of developers, builders, and local housing organizations, July and August 2000.

Respondents pointed to land costs as an especially significant factor that limits the production of affordable housing.

respondents to evaluate land, labor, and materials costs separately, two pieces of information suggest that land is particularly important. First, when we asked respondents to provide specific examples of how the cost of land, labor, and materials limits the production of affordable housing, they cited land the most often, as shown in Figure 2.1.[3] For example, a company that develops land and builds housing stated, “Land has at LEAST doubled in cost over the last 5 years (emphasis in original).” Second, when we asked developers and builders that did not produce affordable housing in 1999 why they did not, those involved in multifamily housing cited land costs the most often, while those involved in single-family housing cited land only slightly less frequently than general responses, such as “we don’t produce houses in that price range.”[4]

3 Each survey group by itself cited land the most often. In some cases, land was tied with labor costs.

4 Office of the Legislative Auditor’s survey of developers and builders, July and August 2000.

Table 2.2: Ranking of Impediments to Multifamily Housing by Type of Organization

	More Frequently Cited Impediments Receive More Stars			
	Developers (*N*= 35)	Developers/ Builders (*N*= 48)	Builders (*N*= 22)	Local Housing Organizations (*N*= 83)
Cost of labor, materials, or land	***	***	***	***
Local zoning or subdivision ordinances or development standards	***	****	**	**
Land-use policies other than local zoning or subdivision ordinances	***	***	**	*
Development or construction fees	**	***	**	**
Standards from the state building or fire codes	**	***	**	*
Financing issues	***	**	*	***
Taxes	***	**	**	**
Reaction from the community	****	***	**	***
Other government policies or programs	***	**	*	**

NOTE: We asked survey respondents to "indicate the extent to which each of the factors listed … limits the production of affordable multifamily housing in Minnesota." We provided four possible options: (1) does not limit production, (2) limits production marginally, (3) limits production significantly, and (4) don't know.

**** 75 to 100 percent of respondents indicated "limits production significantly."
*** 50 to 74 percent of respondents indicated "limits production significantly."
** 25 to 49 percent of respondents indicated "limits production significantly."
* 0 to 24 percent of respondents indicated "limits production significantly."

Rankings only include respondents who produced at least one multifamily unit in 1999.

SOURCE: Office of the Legislative Auditor's survey of developers, builders, and local housing organizations, July and August 2000.

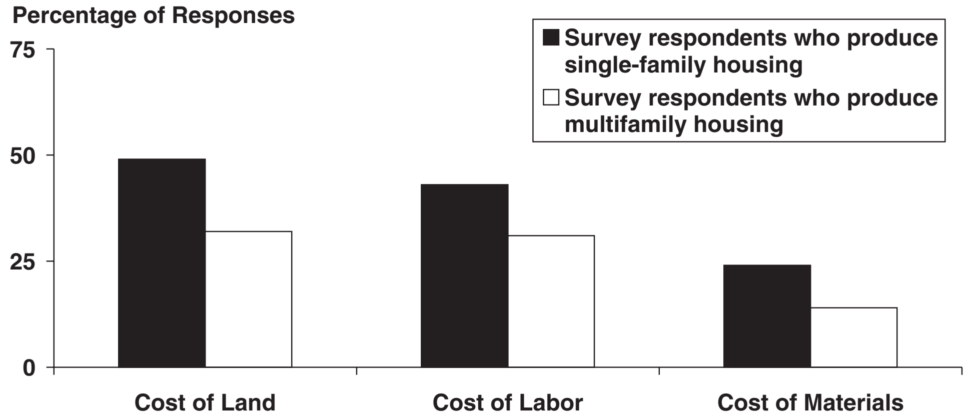
Data suggest that the costs of land, labor, and materials have increased substantially over the last five years.

We found only limited data on how much land, labor, and material costs have increased in recent years. Consequently, we can only provide limited examples. According to the RS Means Company (a publisher of construction data), the combined cost of labor and materials increased 17 to 24 percent in Minneapolis, Rochester, and Duluth between 1995 and 2000.[5] In the same three cities, the cost of skilled trade labor increased 20 to 36 percent.[6] In addition, there are no statewide data on the cost of developed lots—those with infrastructure, such as streets and water and sewer lines. The Hennepin County Assessor's Department examined the sales price of developed lots in five growing suburbs (Brooklyn Park, Champlin, Eden Prairie, Maple Grove, and Plymouth) and found that

5 RS Means Company Inc., *Means Construction Cost Indexes,* 26, no. 1 (January 2000), 34.

6 RS Means Company Inc., *Labor Rates for the Construction Industry, 22nd Annual Edition* (Kingston Massachusetts: RS Means Company Inc., 1994), 139-142; and RS Means Company Inc., *Labor Rates for the Construction Industry, 27th Annual Edition* (Kingston Massachusetts: RS Means Company Inc., 1999), 139-142.

Figure 2.1: Percentage of Respondents who Cited Various Housing Cost Components as an Impediment



NOTE: We asked survey respondents who identified the cost of land, labor, or materials as a marginal or significant impediment to provide at least one example. This graph shows the percentage of respondents who reported each housing component as an example. Due to our sampling method, we are unable to provide a precise margin of error for each response rate. See Appendix A. *N* = 209 for organizations producing single-family housing and 94 for organizations producing multifamily housing.

SOURCE: Office of the Legislative Auditor's survey of developers, builders, and local housing organizations, July and August 2000.

average prices increased 22 to 53 percent between 1995 and 2000.[7] The Olmsted County Assessor did a similar analysis and found that prices increased 38 percent in Rochester and about 65 percent in Byron and Stewartville during this period.[8] During these years, the consumer price index increased only 13 percent.[9]

ZONING AND SUBDIVISION ORDINANCES AND DEVELOPMENT STANDARDS

Local governments direct how land is developed through zoning and subdivision ordinances. Zoning ordinances determine (1) the density and distribution of a community's population, (2) the uses of land and buildings, (3) the location and size of buildings, (4) the percentage of a lot that may be occupied by buildings or structures, and (5) the size of yards and other open spaces.[10] Subdivision ordinances determine how undeveloped land is subdivided and platted by

7 Hennepin County Assessor's Department, table titled "Residential Single Family Detached Land Sales," undated.

8 Olmsted County Assessor, table titled "Residential Single Family Detached Land Sales," undated. The Olmsted County Assessor provided more detail about his estimates. For each city and year, the average sale price is only based on three to nine sales. The Rochester sales occurred in the North Park subdivisions. In addition, between 1995 and 2000, the average lot size increased by 28 percent in Bryon and less than 1 percent in Rochester, but declined by 15 percent in Stewartville.

9 United States Bureau of Labor Statistics, *Consumer Price Index – All Urban Consumers*, http://146.142.24/cgi-bin/surveymost; accessed October 25, 2000. Because the annual price index for 2000 was not available, we used price indices for July of 1995 and 2000.

10 *Minn. Stat*. (2000) §462.357, subd. 1.

regulating (1) site planning and (2) the size, location, and improvement of lots, streets, curbs, utilities, and other infrastructure.[11] Local governments use zoning and subdivision ordinances to carry out their comprehensive plans, which guide the physical, social, and economic development of a community.[12] In addition, local governments use development standards in ordinances to control how housing is built. For example, some cities require single-family homes to have two enclosed garage spaces.

In our survey (see Tables 2.1 and 2.2),

- **Developers consistently indicated that zoning and subdivision ordinances significantly limit the production of affordable housing.**

When we asked them to provide specific examples, a little over half of the developers commented on (1) land being zoned for low densities or large lots or (2) a lack of land made available for residential development. For example, one developer stated, "Restrictions on lot sizes and density result in bigger and costlier units, and less of them. This drives up the cost of housing." Another developer commented, "[There is a] lack of land zoned for multifamily property in every metro county. There are very few vocal local city officials who will promote multifamily development." In general, builders indicated less often than developers that local ordinances were a problem, but when they did report a problem, they frequently cited development standards. For example, one builder wrote in his survey, "Ordinances set down rules for [the] square footage, roof pitch, [and] exterior finish…[of homes]."[13]

Zoning and subdivision ordinances affect the price of developed lots because they control how much land is available for residential development and determine the density at which development occurs. The cost of a developed lot is a major component of the overall price of a home. The building industry generally estimates that the cost of a developed lot accounts for about 25 percent of a single-family home's value.[14] The percentage for multifamily housing is less.

Housing in higher density developments is generally less expensive.

One of the simplest ways to reduce the cost of a developed lot is to divide it in half and create two lots. While doubling a development's density will reduce lot costs significantly, it will not cut costs in half for two reasons. First, as density increases, the overall value of the land increases, which partially offsets savings from developing smaller lots. According to land developers that we interviewed, undeveloped land that is zoned for four units per acre is generally more valuable than an equivalent piece of land zoned for two units per acre. Second, while higher density development requires less infrastructure (streets and water and sewer lines) per lot, the cost is not cut in half by doubling the density. Using actual cost information for a metropolitan community, the Builders Association of the Twin Cities calculated that infrastructure costs and fees associated with

11 *Minn. Stat*. (2000) §462.358, subd. 1 - 2(a).

12 *Minn. Stat*. (2000) §462.352.

13 Office of the Legislative Auditor's survey of developers and builders, July and August 2000.

14 Interviews with several housing experts.

In some areas, zoning ordinances allow apartments above commercial space.

developing single-family lots declined 50 percent when the development's density more than doubled (increasing 144 percent from 1.6 units per acre to 3.9).[15]

In theory, the state can control local government's land use decisions and require them to zone for small lots to accommodate affordable housing. However, when reviewing state statutes, we found that:

- **Minnesota gives local governments considerable discretion in determining how their communities develop, including if and how they accommodate affordable housing.**

The state encourages communities to accommodate affordable housing in their zoning and subdivision ordinances.

The state encourages local governments to accommodate affordable housing by implementing policies consistent with the goals of the Community-Based Planning Act of 1997, which include developing and preserving affordable housing throughout the state.[16] In addition, statutes say that promoting "the availability of housing affordable to persons and families of all income levels" is a primary objective of subdivision ordinances.[17]

Land use planning in the seven-county Twin Cities area is more formal than it is in outstate because the Metropolitan Council reviews all local comprehensive plans. As mentioned earlier, comprehensive plans guide the physical, social, and economic development of a community through zoning and subdivision

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15 Builders Association of the Twin Cities, *Fees, Infrastructure Costs, and Density…Their Impact Upon the Twin Cities' Regional Growth Strategy & Life-Cycle Housing Goals* (Roseville, MN: Builders Association of the Twin Cities, 2000), appendix tables. The analysis applies to City B when switching from plat #1 to plat #2.

16 *Minn. Stat.* (2000) §394.232, subd. 1 and §462.3535, subd. 1.

17 *Minn. Stat.* (2000) §462.358, subd. 1a.

Land use planning in the Twin Cities area is more formal than it is in outstate Minnesota.

ordinances and other policies. The Metropolitan Council is the regional planning agency and develops affordable housing policies and goals. Under state law, metropolitan communities must include housing and implementation elements in their comprehensive plans that promote the development of low- and moderate-income housing and meet the community's share of the region's need for affordable housing.[18] While the Council reviews these plans, it lacks the legal authority to require communities to comply with the Council's housing policies and goals.[19]

Because Twin Cities area communities have significant control over their land use decisions, we found that:

- **Land use patterns vary significantly across the Twin Cities metropolitan area, even among developing suburbs.**

We analyzed the Metropolitan Council's land use data, focusing on the region's 63 developing suburbs because the Council estimates that 64 percent of the region's household growth between 2000 and 2020 will occur in these communities.[20] Therefore, land use policies and patterns of the developing suburbs will largely dictate how the region grows over the next 20 years. As discussed previously, developers contend that zoning and subdivision ordinances that restrict high-density developments significantly limit the production of affordable housing.

Residential land use patterns in the developing suburbs vary in three ways – single-family densities, multifamily densities, and the percentage of land used for multifamily housing.

- Single-family densities ranged from 3.2 units per acre in Osseo to 0.5 in Woodland in 1990.[21]

- Multifamily housing densities ranged from 42 units per acre in Osseo to 1.1 in Deephaven in 1990.[22]

- The percentage of residential land used for multifamily housing in 1997 ranged from 34 percent in Spring Park to 0 percent in Woodland, Sunfish Lake, Pine Springs, Minnetonka Beach, and Birchwood Village.[23]

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18 *Minn. Stat.* (2000) §473.859, subd. 2 and 4; §473.86; and §473.861.

19 According to Metropolitan Council staff, they cannot require compliance with their housing goals because housing is not a metropolitan system, which includes sewer, transportation, recreation, and aviation services. Under *Minn. Stat.* (2000) §473.175, subd. 1, "The council may require a local government unit to modify any comprehensive plan or part thereof which may have a substantial impact on or contain a substantial departure from metropolitan system plans."

20 Metropolitan Council, spreadsheet titled "Metro Council 2000 Household Forecast Comparisons," received November 28, 2000.

21 Metropolitan Council, unpublished table titled "Residential Density by County," undated. Landfall, a developing suburb in Washington County, has a density of 8.5 units per acre for single-family homes. It is excluded from the comparison because the entire municipality is only 53 acres.

22 *Ibid.*

23 Metropolitan Council, "Metropolitan Council Geographic Systems," http://www.metrocouncil.org/metroarea/gismain.htm; accessed September 14, 2000.

The cities of Chaska and Victoria provide an interesting example of varying land use in the developing suburbs. The two communities are adjacent developing suburbs in the southwestern part of the metropolitan region. They share a school district and are both on the edge of urban development, with the border of the metropolitan urban services area (the area in which the Metropolitan Council provides urban services) cutting through them. Despite these similarities, the two cities have very different development patterns and types of housing. As shown in Table 2.3, Chaska has higher single-family and multifamily densities and more multifamily and affordable housing.

Zoning policies helped create these land use patterns. Chaska is an older freestanding community with a mix of residential, commercial, and industrial development that originally developed single-family lots as small as 7,200 square feet. However, under current zoning policies, new single-family lots must be at least 11,500 square feet.[24] In contrast, Victoria is a relatively new bedroom

The cities of Chaska and Victoria have developed very differently.

Table 2.3: Land Use and Zoning Information from Chaska and Victoria

	Chaska	Victoria
Land Uses in 1997 (Acres)[a]		
Single-family housing	1,634	750
Multifamily housing	174	22
Commercial	139	15
Industrial	568	8
Public or recreational	1,612	1,556
Vacant or agricultural	3,887	1,689
Other	1,182	1,429
Total	9,196	5,469
Housing Densities in 1990 (Units per Acre)[b]		
Single-family	2.6	1.1
Multifamily	8.9	3.7
Affordable Housing Measures[c] — Percentage of:		
Owner occupied homes that are affordable	75%	39%
Rental housing that is affordable	49	52
The housing stock that is multifamily	49	13
The housing stock that is rental	31	11
Requirements in the City's Highest Density Zoning District for Single-Family Homes[d]		
Minimum lot size (square feet)	7,200	15,000
Minimum number of covered garage spaces	0	2

SOURCES: As specified in the following footnotes.

[a]Metropolitan Council, "Metropolitan Council Geographic Systems," http://www.metrocouncil.org/metroarea/gismain.htm; accessed on September 14, 2000.

[b]Metropolitan Council, unpublished table titled "Residential Density by County," undated.

[c]Metropolitan Council, *Report to the Minnesota Legislature on Affordable and Life-Cycle Housing in the Metropolitan Area* (St. Paul, December 1999), Appendix 2. The information is based on data from 1990 and 1994.

[d]Cities of Chaska and Victoria. The minimum lot size for new homes in Chaska is now 11,500 square feet.

24 City of Chaska Planning Department.

community. Its smallest standard single-family lots are 15,000 square feet.[25] In addition to smaller lots, Chaska does not require garages in its highest-density, single-family zoning district, while Victoria requires two enclosed garages per home in its highest-density district.

State statutes protect individual property owners from zoning changes in their neighborhoods.

Besides giving communities considerable control over their land use decisions, Minnesota protects individual property owners from zoning changes in their neighborhoods. To increase housing density and accommodate affordable housing, developers and local housing organizations sometimes ask city councils to rezone land. Rezoning can be difficult for two reasons. First, state statute requires that two-thirds of a city council, rather than a simple majority, agree to adopt or revise a zoning ordinance.[26] As we discuss later in this chapter, zoning changes to provide affordable housing can be very contentious. Getting four members of a five-person city council or five members of a seven-person council to agree can be very difficult. Second, in cities of the first class (Duluth, Minneapolis, and St. Paul), state statute requires that two-thirds of the property owners within 100 feet of the property being rezoned consent to the change if less than 40 acres are rezoned.[27] While these three cities can preempt this requirement by providing an alternative procedure in their home rule charters, none of the cities have done so.

State requirements limiting zoning changes serve a valid function. Land use decisions can last generations, while political power and influence may only last a few years. According to zoning experts that we interviewed, these requirements are intended to protect the rights of property owners from the ebb and flow of political philosophy and power. However, the policies make it difficult to rezone land for smaller lots and multifamily housing. Consequently, in a recent affordable housing report, a group of Twin Cities area mayors called for the repeal of these provisions.[28]

OTHER LAND USE POLICIES

As shown earlier in Tables 2.1 and 2.2, according to our survey:

- **Other land use policies—such as environmental regulations and the Metropolitan Council's management of the metropolitan urban services area (MUSA)—are a major concern primarily of developers.[29]**

For example, one developer stated, "Wetland preservation requirements have become too onerous. Preserving small isolated wetlands is expensive and illogical." With respect to the MUSA, another developer commented, "[The] MUSA line has created an artificial shortage of land."

25 City of Victoria Planning Department.

26 *Minn. Stat.* (2000) §462.357, subd. 2.

27 *Minn. Stat.* (2000) §462.357, subd. 5. If two-thirds of the property owners within a 100 feet consent, the city council can adopt the amendment with only a simple majority.

28 Mayors' Regional Housing Task Force, *Affordable Housing for the Region: Strategies for Building Strong Communities* (St. Paul: Metropolitan Council, November 2000), 18.

29 Office of the Legislative Auditor's survey of developers and builders, July and August 2000.

Because of time constraints, we did not examine the effect that environmental regulations have on affordable housing. However, wetland preservation is another good example of an important public policy that may have adverse effects on the production of affordable housing.

But, we did examine the Metropolitan Council's MUSA policy because it was a topic of considerable debate during the fall of 2000. The Metropolitan Council's Housing and Land Use Advisory Committee made this issue the centerpiece of its fall meetings, and the Builders Association of the Twin Cities recently released a high profile report on the issue.

Metropolitan Urban Services Area

The Metropolitan Council tries to facilitate orderly and compact development.

The MUSA is the area in the seven-county Twin Cities region where the Metropolitan Council provides infrastructure—primarily wastewater treatment facilities and transit—to serve urban development. The Metropolitan Council's MUSA policy is intended to: (1) provide sufficient land to accommodate future development and redevelopment, (2) manage the cost of providing public services, (3) encourage efficient use of land, (4) prevent artificial increases in land prices, (5) meet future affordable and other housing needs, (6) protect resources, and (7) support regional economic competitiveness.[30] To achieve its MUSA goals, the Council's staff forecasts household and employment growth through 2020 and then allocates the new households and jobs to each of the region's 188 municipalities. Municipalities provide feedback, and the Council and municipalities work to resolve any forecast differences. Finally, the Council and municipalities use the projections to determine how, when, and where to add land to the MUSA.[31] Municipalities on the edge of the MUSA develop plans, under the review of the Council, to accommodate the expected growth through staged expansions of the MUSA through 2020.[32]

To ensure that the MUSA policy does not inflate land prices by significantly restricting the supply of land, the MUSA is expanded when the supply of developable land drops below a 10-year supply. The Council currently allows development within the MUSA designated for 2010, assuming regional infrastructure is available. However, the Builders Association of the Twin Cities contends that the Council's estimates of developable land are flawed. For example, the Council estimated that 97,000 acres within the 2000 MUSA were vacant or agricultural land, and the Builders Association believes this estimate overstated the amount land available for development. According to a recent study by the Builders Association, no more than 43 percent of the vacant and agricultural land was potentially available. The analysis identified various types of land that were not available for future development, including (1) conservation

30 Metropolitan Council, *Regional Blueprint* (St. Paul, December 1996), p. 49; and Metropolitan Council staff presentation to the Council's Housing and Land Use Advisory Committee, September 14, 2000.

31 *Minn. Stat*. (2000) §462.352, subd. 18 defines an urban growth area as an "area around an urban area within which there is a sufficient supply of developable land for at least a prospective 20-year period, based on demographic forecasts and the time reasonably required to effectively provide municipal services to the identified area."

32 Metropolitan Council staff presentation to the Council's Housing and Land Use Advisory Committee, September 14, 2000.

easements, (2) areas of current residential development, (3) areas planned for commercial, office, and industrial development, (4) park and recreational areas, (5) institutional- and city-owned properties, (6) buffer zones, (7) land fills, and (8) overhead easements. In a follow-up analysis, the Builders Association plans to identify additional land that is not available for development, including floodplains, steep slopes, and areas with poor soil.[33]

How much land is available for development in the Twin Cities area is a subject of considerable debate.

In estimating that there were 97,000 acres of vacant and agricultural land within the 2000 MUSA, the Council conducted a land inventory but not an assessment of which acres were actually developable. Consequently, the Council also does not believe that all 97,000 acres were developable. The Council bases its determination of how much land is developable primarily on input from localities during the planning process. According to local planning documents, municipalities intend to develop 42,000 acres within the 2000 MUSA. In addition, municipalities identified another 58,000 acres for development in MUSA expansions through 2020.[34]

After reviewing the literature about this issue, we found that:

- **Although the price of land is a major issue in the region, evidence that the Metropolitan Council's MUSA policy significantly inflates the price is inconclusive.**

Since 1995, several studies by the Metropolitan Council and the Builders Association of the Twin Cities have examined the impact of the Council's MUSA policy on land prices.[35] All of the studies found that land inside the MUSA is generally more expensive than land outside the area. However, the studies differ with respect to the size and cause of the difference.

The Builders Association contends that the Council's MUSA policy is too restrictive and has led to a "serious shortage" of land available for development and inflated prices within the MUSA.[36] Under economic theory, if the supply of a product is reduced, its price increases. As evidence of price inflation caused by the MUSA policy, the Builders Association asserts that (1) land prices inside the MUSA are increasing, (2) land prices inside the MUSA are significantly higher than prices outside the MUSA, and (3) people are moving to communities just

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33 Dahlgren, Shardlow, and Uban, Inc. *Builders Association of the Twin Cities Study 2000* (Roseville, MN: Builders Association of the Twin Cities, November 2000), 3; and supporting documents about the study.

34 Michael Munson (Metropolitan Council), memorandum to John Patterson (Office of the Legislative Auditor), January 9, 2001.

35 Metropolitan Council, *MUSA Expansion and Land Values* (St. Paul, December 1995); The Builders Association of the Twin Cities, *The High Cost of Sprawl: A Twin Cities Metropolitan Area Urban Services Land Supply Analysis and Recommendation for Managing Growth* (St. Paul, April 1996); and Builders Association of the Twin Cities, "Executive Summary: Builders Association of the Twin Cities Public Policy Committee Presentation to the Metropolitan Council Livable Communities Committee" (February 22, 2000). The Metropolitan Council analyzed the issue again during the summer of 2000 but has not released a report.

36 Dahlgren, Shardlow, and Uban, Inc. *Builders Association of the Twin Cities Study 2000*, cover letter.

outside the seven-county region to avoid the high cost of land.[37] Consequently, the Builders Association wants the Metropolitan Council to immediately make available a 20-year supply of developable land to ensure that prices are not inflated.[38]

No one has systematically analyzed the impact that the Metropolitan Council's land use policy has on land prices.

The Metropolitan Council contends that urban services and other amenities associated with an urban environment account for most of the difference in land prices inside and outside the MUSA.[39] Regardless of how much land is available for development, land that has access to wastewater treatment and is near transportation systems, jobs, shopping, entertainment, parks, and schools is more expensive. In any event, there is currently no published analysis that systematically examines the price of land inside and outside the MUSA and controls for all of the other factors that affect the price of land.

In developing its MUSA policy, the Metropolitan Council is trying to balance competing policy objectives. On the one hand, it wants to facilitate compact and orderly development, but on the other hand, it wants to avoid price inflation. This task is a complex endeavor that requires complete and accurate data and sophisticated analyses. We believe the Council should continue to work with municipalities and other parties, including the Builders Association, to refine its data and analyses.

DEVELOPMENT AND CONSTRUCTION FEES

Municipal governments provide a variety of services related to the growth and development of their communities, including enforcing the building code, administering zoning and subdivision ordinances, providing infrastructure, and offering recreational opportunities. In addition to collecting taxes from residents to pay for these services, communities often assess a variety of fees on development.

As shown earlier in Tables 2.1 and 2.2, we found that:

- **Many builders and developers that we surveyed indicated that development or construction fees significantly limit the production of affordable single-family and multifamily housing.**

Many of the builders and developers mentioned specific fees, including permit and plan review fees, park dedication fees, and sewer and water access charges. For example, one respondent wrote, "[The] cost of water, sewer, plan review, &

37 Bugbee, Anton & Associates, "Twin Cities Housing and the Impact of the MUSA Line" in *The High Cost of Sprawl: The Twin Cities Metropolitan Area Urban Land Supply Analysis and Recommendations for Managing Growth* (St. Paul: Builders Association of the Twin Cities, April 1996), 4 - 8 in Appendix A.

38 Dahlgren, Shardlow, and Uban, Inc. *Builders Association of the Twin Cities Study 2000*, cover letter.

39 Metropolitan Council, *MUSA Expansion and Land Values* (St. Paul, December 1995), 1; and telephone interview with the report's coordinator, September 7, 2000.

building permits represent up to 10 percent of [the] cost to build a modest 1,500 sq. ft. house." Another commented, "Always a fee for something! If you build 100 townhomes exactly the same, they still charge you $800…for a plan review on each permit even though they have already reviewed it."

Fees charged by the state are minimal.

In this section, we largely focus on the fees that municipalities charge for two reasons. First, state fees are limited to relatively small surcharges on building, electrical, plumbing, and mechanical permits.[40] Second, although the Metropolitan Council's service availability charge (SAC) is currently $1,100 per single family dwelling and $880 per apartment or condominium, the Council annually adopts the SAC fee at public meetings, and according to staff, the Council does not typically receive any comment on its fees. Additionally, unlike any municipal fees of which we are aware, the Metropolitan Council lowers the SAC for public housing that does not have garbage disposals, dishwashers, or individual laundry facilities. Furthermore, the Council is currently experimenting with a SAC waiver program for new units meeting affordable housing criteria.

We briefly examined the costs associated with government fees and found that:

- **Although development and construction fees can vary significantly among cities, it is not clear whether these fees are unreasonably high.**

Under state law, municipalities have broad discretion to establish their own fees.[41] For example, municipalities can follow the schedule for building permit fees provided in the *Uniform Building Code*, but are not required to do so.[42] Consequently, municipalities have adopted widely varying fee schedules. According to the Association of Metropolitan Municipalities' annual *Municipal License and Permit Fee Survey*, building permit fees in the Twin Cities ranged from $508 to roughly $1,000 in 1999, sewer access charges from $20 to $1,900, water access charges from $0 to over $2,150, and park dedication fees from 0 to 10 percent of a property's land value.[43]

Fees charged by municipalities are substantial.

A recent study by the Builders Association of the Twin Cities also reveals substantial variation in the fees charged by different cities. The Builders Association compared the fees in four cities for an identical 1,152 square foot house. As shown in Table 2.4, overall fees varied from $5,036 to $9,259. Building permit fees ranged from $844 to $1,134, city sewer access charges from $25 to $825, city water access charges from $0 to $2,392, and park dedication

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40 State surcharges on building permits are based on a home's value, equaling approximately $50 for a $100,000 home. Surcharges on electrical, plumbing, and mechanical permits are $.50 per permit.

41 City authority to collect fees follows from the general welfare powers provided in *Minn. Stat*. (2000) §412.221, subd. 32. Also, see Country Joe v. City of Eagan (Minn. 1997); http://www.state.mn.us/courts/library/archive/supct/ 9703/c8952289.htm; accessed November 22, 2000).

42 Minnesota adopts the *Uniform Building Code*, subject to various modifications. Modifications to the *Uniform Building Code* include capping the building plan review fees at 65 percent of the building permit fees. Permit fees, however, are not capped (see *Minn. Rules*, chapter 1305, section 107).

43 Association of Metropolitan Municipalities (AMM), *Municipal License and Permit Fee Survey* (St. Paul: AMM, 1999), 26, 45, 59, and 152. The permit fees reported in the AMM survey are for a single family home valued at $100,000.

Municipalities charge a variety of fees.

Table 2.4: Development and Construction Fees in Selected Cities

	Fees per Home or Lot			
	City A	City B	City C	City D
Building and Related Permit Fees				
Park dedication	$1,117	$1,325	$1,200	$1,000
City water access charge	N/A	2,392	500	565
Metropolitan service availability charge	1,050	1,050	1,050	1,050
Building permit	924	987	1,134	844
Plan review	508	543	737	548
City sewer access charge	25	825	410	510
Water meter	50	N/A	N/A	110
Building electrical inspection	85	85	15	85
Plumbing	30	85	36	95
Heat/air permit	30	85	40	80
Water connection	50	85	31	60
State surcharge - building permit	45	50	63	47
Storm sewer connection	50	N/A	N/A	N/A
Electrical permit	N/A	1	75	60
Certificate of occupancy	N/A	25	63	N/A
Windows	N/A	25	N/A	N/A
Gas piping permit	30	N/A	20	N/A
Total Building Permit-Related Fees	3,994	7,562	5,372	5,053
Plat Fees				
GIS fee	N/A	34	N/A	N/A
Base map preparation and recording	N/A	25	N/A	N/A
Preliminary plat	1	6	8	7
Final plat	1	6	1	6
Site plan review	N/A	N/A	N/A	2
Title review	N/A	N/A	1	N/A
Partial release of developer's agreement	N/A	N/A	0	N/A
Assessment search	N/A	N/A	0	N/A
Total Plat Fees	2	71	9	14
City Engineering Fees				
Storm water trunk, storage, and treatment	N/A	N/A	655	1,148
Storm sewer trunk area charge	29	1,360	655	N/A
Watermain trunk area charge	586	N/A	N/A	472
Sanitary sewer trunk area charge	53	N/A	291	412
Engineering administration	289	213	241	213
Legal and assessing	83	35	N/A	N/A
Grading, erosion, or filling	N/A	0	74	4
Sketch plan review - preliminary	N/A	16	N/A	N/A
Sketch plan review - final	N/A	3	N/A	N/A
Grading plan review fee	N/A	N/A	N/A	1
Total Engineering Fees	1,039	1,627	1,915	2,250
Total Fees	**$5,036**	**$9,259**	**$7,297**	**$7,317**

NOTE: The table is based on cost information from four cities in the Twin Cities metropolitan area. The fee data is based on a 1,152 square foot home and plat #2 from the Builders Association study. The Builders Association kept the cities anonymous to ensure their cooperation. N/A means not applicable.

SOURCE: Builders Association of the Twin Cities, *Fees, Infrastructure Costs, and Density… their impact upon the Twin Cities regional growth strategy and life-cycle housing goals* (Roseville, MN: Builders Association of the Twin Cities, 2000), appendix tables.

fees from $1,000 to $1,325.[44] The $4,223 difference in overall fees between the highest and lowest-charging cities adds costs to a home.[45]

Without more extensive research, we can not conclusively determine whether the fees in some communities are unreasonably high. Communities can finance growth and development in a number of ways. For example, one community may charge high initial water access fees and lower quarterly water bills, while another may charge low initial fees with higher on-going bills. However,

- **According to the Minnesota Attorney General's Office, fees are not intended to be a source of general revenue but should cover the costs of associated services.**

In 1991, Minnesota's Department of Administration requested that the Attorney General offer an opinion on the department's position that, "revenue received by municipalities for building permits and plan review services should approximate the cost incurred by the municipality to administer the building code."[46] The Attorney General's Office responded in the affirmative and based its decision upon case law relating to license fees rather than building permits, which suggests that *all* fees and surcharges—not just the building permit fees mentioned in the Department of Administration's original inquiry—must bear a reasonable connection to the costs of regulation.[47]

Evidence suggests that some municipal fees are excessive.

Evidence suggests that some municipalities use fees to generate revenues beyond what is necessary to administer codes, enforce ordinances, and provide services. An advisory group to the Minnesota Construction Codes Advisory Council (CCAC) recently found that only 11 of 34 cities surveyed spent approximately the same amount on building code enforcement that they brought in through building permit fees.[48] Seven of the 34 cities reported permit fee revenues twice the size of their building code expenditures. While this evidence should be considered

44 Because some fees are based on a home's value (particularly permit fees), part of the variation is explained by variations in assessed value. Although the home was identical in all cases, the city valuations varied from $90,968 to $125,100. Builders Association of the Twin Cities, *Fees, Infrastructure, Costs, and Density*, appendix tables.

45 BATC did not name the cities used in their analysis in order to maintain cooperation with the cities and focus it report on the effects of municipal ordinances on costs, rather than the policies of particular cities. An earlier study by Barbara Lukermann and Michael Kane provides similar evidence regarding variation in fees among ten suburbs in the Twin Cities area. According to Lukermann and Kane, selected fees per unit on a hypothetical 40-acre single-family development were highest in Lakeville ($5,035) and lowest in Edina ($1,225); *Land Use Practices: Exclusionary Zoning, de Facto or de Jure?* (Minneapolis: University of Minnesota Center for Urban and Regional Affairs, 1994), 24.

46 Charlene W. Hatcher, Special Assistant, Office of the Attorney General, to B. Michael Godfrey, Building Code Representative, Department of Administration, *Municipal Building Permit Fees and Municipal Building Code Administration Costs*, February 6, 1991, memorandum.

47 The case law cited in the Attorney General's Office opinion states, "Unless, however the amount is manifestly unreasonable in view of its purpose as a regulation, the court will not adjudge it a tax" and, therefore, illegal. State of Minnesota v. Northern Raceway Corporation, 381 N.W.2d 526, 529 (Minn. 1986). Also see Country Joe v. City of Eagan (Minn. 1997).

48 Fee Technical Advisory Group, *The Use of Building Construction Fees by Minnesota's Governments* (St. Paul: Construction Codes Advisory Council, August 1999). The CCAC consists of representatives of state agencies, private industry, and local government, and is staffed by the Department of Administration (*Minn. Stat*. (2000) §16B.76).

incomplete, it raises the possibility that some cities may be charging fees that inappropriately add to the cost of new housing.

Because of its study, the CCAC recommended that the state require municipalities to segregate permit fee revenues in a fund specially dedicated for administering and enforcing the state building code.[49] Dedicated funds of this type are not uncommon. For example, the Department of Administration must place the fees it collects for building code enforcement in an account designated for those purposes,[50] and municipalities must place park fees in a dedicated fund.[51] Extending this mandate to building permit and other fees collected by local governments would help ensure that fees are commensurate with the services for which they are intended.

It is important to realize that development and construction fees serve a valid function—financing municipal operations. While it may be appropriate to ensure that municipalities limit their fees to the cost of providing associated services, any reduction in fees will mean a loss of revenue for municipalities that will have to be made up elsewhere in their budgets.[52]

STATE BUILDING AND FIRE CODES

The state building code is a compilation of minimum uniform standards and requirements for constructing new buildings and remodeling existing ones. These standards govern design, construction, materials, fire protection, energy conservation, health, safety, and sanitation.[53] Minnesota's code was originally adopted to help lower construction costs and is meant to permit building construction at the least possible cost consistent with recognized health and safety standards.[54]

The state building code is meant to allow construction at the least possible cost consistent with recognized health and safety standards.

State statutes require that the building code conform as much as possible to model codes that are generally accepted and used nationally. In addition, the Department of Administration uses the Administrative Procedure Act to amend the building code every three years. This allows Minnesota to keep its code as current as possible. Finally, although the state building code is not mandatory throughout Minnesota, most of the state's residents are covered by the code. Statutes require that all counties in the seven-county metropolitan area adopt the state building

49 Fee Technical Advisory Group, *The Use of Building Construction Fees by Minnesota's Governments*. Appendix E of the report contains proposed legislation.

50 *Minn. Stat.* (2000) §16B.70, subd. 2.

51 *Minn. Stat.* (2000) §462.358, subd. 2b.

52 Following a recommendation from the Mayors' Regional Housing Task Force (*Affordable Housing for the Region: Strategies for Building Strong Communities*, 20), the Metropolitan Council, the Association of Metropolitan Municipalities, and the Builders Association of the Twin Cities currently plan to collaborate on a study of fees in late 2001.

53 State fire code provisions regarding constructing and remodeling housing overlap with identical provisions in the state building code.

54 *Minn. Stat*. (2000) §16B.59.

The state building code dictates how housing is constructed or remodeled.

code.[55] Ten other counties in southeastern Minnesota and about 170 cities and townships throughout the rest of the state have voluntarily adopted the state building code. Although only 20 percent of the state's counties, 44 percent of its cities, and 12 percent of its townships are covered by the building code, about 80 percent of the state's population live in these jurisdictions. In addition, local jurisdictions that are not required to adopt the building code may not adopt another code in its place, nor can adopting jurisdictions amend building code provisions. Thus, builders can use stock housing plans because they do not have to accommodate different building standards across communities.[56]

As shown earlier in Tables 2.1 and 2.2,

- **Many builders that we surveyed said that the building code significantly limits the production of affordable housing in Minnesota, especially single-family homes.**

The state's new energy code is of particular concern to builders.

When asked to be more specific, nearly two-thirds of builders who responded identified the building code's new energy provisions for single-family housing as an example. In fact, one builder commented, "[The] new energy code is regressive when you view it as a percentage of total price, meaning it is felt hardest by the lowest priced housing market."

Unlike most of the building code's other provisions, those related to energy conservation are not based on a national model code. The 1991 Legislature

55 *Minn. Stat.* (2000) §16B.62. Because the state fire code is mandatory throughout the state, the building code's fire protection provisions are mandatory statewide.

56 As we discussed earlier, cities are still free to adopt zoning ordinances that place additional restrictions on homes or the construction process.

required that the building code's energy provisions be equal to or exceed the most stringent requirements adopted by any other state.[57] Presently, builders can choose between two sets of energy standards when constructing one- and two-family housing; a third set of standards governs multifamily housing. The newest provisions for one- and two-family housing became effective in April 2000. These regulations are designed to address indoor air quality problems in detached one- and two-family homes by requiring additional ventilation and measures to prevent backdrafting of gas appliances that were previously optional.

The Minnesota Department of Commerce estimates that the new energy provisions that became effective in April 2000 add about $3,000 to $5,000 to the cost of a new home. Some local builders estimate increased costs of $3,000 to $8,000, while others say it costs more. Responding to concerns about increased cost, the 2000 Legislature required the Department of Administration to examine the cost-effectiveness of the building code's energy provisions and the feasibility of establishing new criteria for various types of housing. The report is due December 2001.[58]

Although builders did not discuss whether the building code limits their ability to rehabilitate existing buildings, we noted that:

- **The state building code lacks provisions specific to the rehabilitation of existing buildings, which may lead to increased costs.**

The Legislature has required the state to adopt specific code provisions for the rehabilitation of existing buildings.

Major remodeling or changes in an existing building's occupancy or use require builders to comply with code provisions for new structures. This might deter builders from rehabilitating or converting abandoned, condemned, or existing buildings to housing units. In 1999, the Legislature required the state to adopt building code provisions for existing buildings, also referred to as building conservation.[59] The Department of Administration is currently examining some model codes for existing buildings. These codes typically give building officials more guidance and flexibility to make trade-offs that do not require existing buildings to meet all of the requirements of new buildings. The department plans to include building conservation provisions in the code when it adopts the updated version of the *Uniform Building Code* in 2002.

Finally, a number of builders also said that inconsistent enforcement has made it difficult to build affordable housing. We found that:

- **How the state building code is administered and enforced locally can increase housing costs by reducing uniformity for builders.**

Some building code provisions are optional. For example, municipalities can choose to adopt Chapter 1306, which sets forth more stringent fire protection requirements. This optional chapter requires that sprinkler systems be installed in apartment buildings with 8,500 or more gross square feet of floor area or with dwelling units on three or more floors. In contrast, the state building code simply

57 *Minn. Laws* (1991), ch. 149, sec. 4. The 1999 Legislature repealed this requirement; the current energy provisions were developed before the repeal. See *Minn. Laws* (1999), ch. 135, sec. 10.

58 *Minn. Laws* (2000), ch. 407.

59 *Minn. Laws* (1999), ch. 135, sec. 1.

requires sprinklers when buildings are at least three stories high or have at least 16 units. According to the Department of Administration, at least 19 cities, mostly in the seven-county metropolitan area, have adopted the more stringent fire protection requirements in Chapter 1306. In our survey, some builders indicated that the state building code significantly limits the production of affordable housing in part because additional fire protection requirements in some cities make it more expensive to build there.

Local building officials have considerable discretion in enforcing and interpreting the code.

Also, local building officials have considerable discretion in enforcing and interpreting building code provisions, and this can lead to variation across and within municipalities. For example, the code encourages builders to seek new ways to meet the code's goals, and building officials are given wide latitude to grant "equivalencies."[60] Building officials also have considerable discretion in how they interpret unclear or ambiguous portions of the code. Therefore, builders may not receive the same equivalencies or interpretations from building officials in different jurisdictions and consequently builders may not be able to build homes for the same cost in different communities.

In addition, local fire officials might not approve or be aware of equivalencies or interpretations that local building officials have made regarding building code provisions that overlap with the state fire code. In these instances, fire officials might determine that buildings do not comply with the fire code—a necessary condition for a certificate of occupancy. Builders may have to make last minute changes to satisfy fire officials. One builder told us that builders are reluctant to appeal such actions because of the time and money involved.

At the request of the Legislature, the Department of Administration is addressing issues related to the building code, such as energy code requirements and building conservation. Possible solutions to builders' concerns about inconsistent enforcement have been discussed in a previous report from our office on the state building code.[61] That report presented a variety of options to address inconsistent enforcement. Also, the Department of Administration plans to include an updated appeals process in the building code when it adopts the new version of the *Uniform Building Code* in 2002. The department is also proposing legislation to upgrade the criteria for disciplining building officials who are not administering the code uniformly.

FINANCING

As discussed in Chapter 1, new housing is often unaffordable without subsidies. As shown earlier in Tables 2.1 and 2.2, we found that:

- **A majority of local housing organizations cited financing issues as a factor that significantly limits the production of affordable housing.**

60 An equivalency is a measure other than a code requirement that provides essentially the same protection as a code requirement.

61 Office of the Legislative Auditor, *State Building Code* (St. Paul, January 1999).

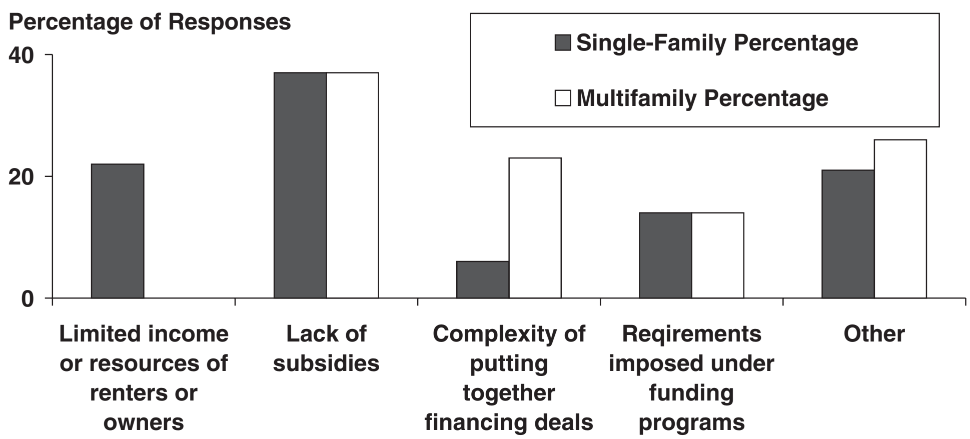
Local housing organizations believe there are not enough subsidies and that housing finance packages are too complex.

A lack of subsidies and the complexity of putting together a financing package were the most often cited examples of this impediment. For example, one local housing organization wrote in its survey, "Never enough money," while another commented, "Financing of affordable housing is unbelievably complex and time consuming." Figure 2.2 shows the most frequently mentioned examples of financing issues that local housing organizations cited.

In the last two years, applicants for multifamily housing assistance requested 3.8 times as much money as the Minnesota Housing Finance Agency (MFHA) could provide, a sign that there is a demand for more assistance.[62] In addition, as discussed in Chapter 1, approximately 18 percent of all Minnesota households were lower income and spend more than 30 percent of their income on housing in 1989. Some housing advocates are calling for the state to devote 1 percent of the general fund to housing programs.[63] Currently, the state devotes about one-half of 1 percent to these programs.[64]

The following example illustrates why many people believe that more financial assistance is needed to make new housing affordable. Most owners of single-family homes pay mortgages. As Table 2.5 shows, at 2000 interest rates (around 8 percent), a family living in a non-metropolitan area with an income at 80 percent of the median could afford a $95,000 house. But, the family could not

Figure 2.2: Percentage of Local Housing Organizations that Cited Various Financing Issues as Impediments



NOTE: We asked local housing organizations who identified financing as a marginal or significant barrier to provide an example. This graph shows the percentage of respondents who reported each of the identified examples. Due to our sampling method, we are unable to provide a precise margin of error for each response rate. See Appendix A. *N* = 65 for single-family organizations and 43 for multifamily organizations.

SOURCE: Office of the Legislative Auditor's survey of local housing organizations, July and August 2000.

62 Minnesota Housing Finance Agency, unpublished table titled "Multifamily RFP: Requests vs. funded last 4 rounds," received November 27, 2000.

63 Family Housing Fund, "Policy Initiatives," http://www.fhfund.org/Policy/1percent.htm; accessed March 13, 2000.

64 Minnesota Department of Finance, *Fund Balance Analysis: General Fund, End of 2000 Legislative Session* (St. Paul: May 31, 2000), 1 and 7.

Table 2.5: Maximum Home Values that Households with 80 Percent of Median Family Income Could Afford in 2000

Mortgage Interest Rates	Non-Metropolitan Areas ($35,440 Income)	Metropolitan Areas ($52,480 Income)
6.50%	$106,000	$157,000
7.00	102,000	151,000
7.50	98,000	146,000
8.00	95,000	140,000
8.50	91,000	136,000
9.00	88,000	131,000
9.50	85,000	126,000
10.00	82,000	122,000
10.50	80,000	118,000

NOTE: The affordable home values are based on a 30-year, fixed-rate mortgage at the specified interest rate and a 10 percent down payment. The calculations also assume that house payments cannot exceed 28 percent of a household's income.

SOURCE: Office of the Legislative Auditor's analysis using a mortgage payment model provided by the Minnesota Housing Finance Agency.

afford the new $116,000 starter home discussed in Chapter 1 even with a low-interest MHFA loan.[65] In 2000, MHFA offered 6.5 percent mortgages (about 1.5 percentage points below market rates), which would allow the family to buy a $106,000 home. The $116,000 home would only be affordable if the housing project received additional subsidies, such as deferred loans and grants. This affordability gap occurs even when the nation has historically low interest rates. As shown in Figure 2.3, interest rates have been as high as 16 percent in the last 20 years. While this $116,000 starter home would be affordable in metropolitan areas, developers and builders told us that it would be difficult to built a home at this price in some areas because of the high price of land.

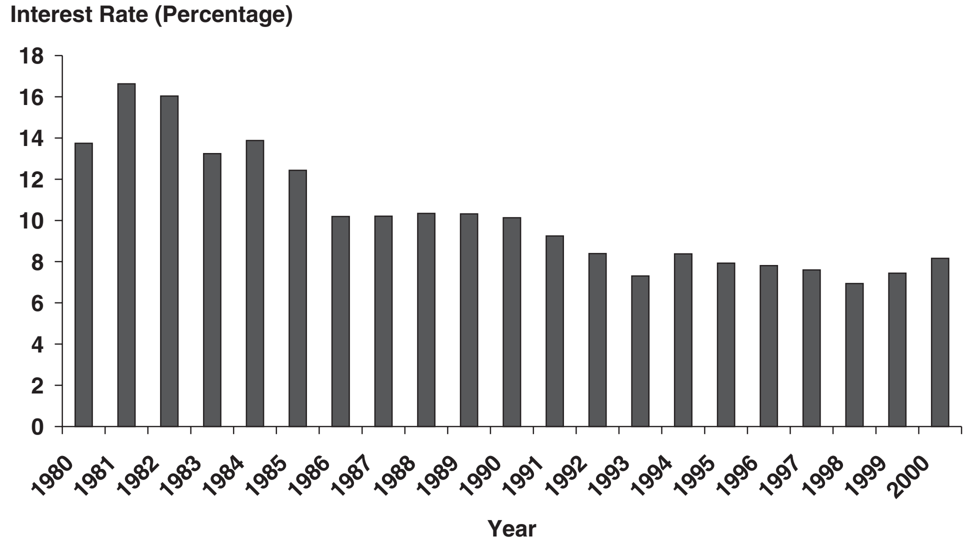
During interviews, we asked local housing officials about the complexity of housing financing packages. They told us that a typical project receives funding from six or more sources, which may have different applications, funding cycles, and program requirements. In addition, many funding sources want their funds to leverage other funds and consequently require projects to receive funding from multiple sources. Therefore, losing one source of funds can jeopardize an entire project, which makes investing time and money into affordable housing risky.

The Minnesota Housing Finance Agency has tried to simplify its funding process.

MHFA has tried to address these issues by establishing a simplified funding process—commonly referred to as a "super request for proposals (RFP)." The agency combines funding from some of its programs into a single pool with one application along with funding from the Metropolitan Council, Family Housing Fund, and Greater Minnesota Housing Fund. (The last two organizations are non-profit housing finance agencies). Minneapolis and St. Paul have also tried to

65 The Minnesota Housing Finance Agency's mortgage programs have cost limits for new homes. For 2000, this $116,000 home would exceed the limit for the Minnesota Mortgage Program but fall below the $131,070 limit for the Community Activity Set-Aside Program.

Figure 2.3: Average Annual Interest Rates for 30-Year Fixed-Rate Mortgages



SOURCE: Federal Home Mortgage Corporation, table titled "Primary Mortgage Market Survey: 30-Year Fixed-Rate Mortgages Since 1971," http://www.freddiemac.com/pmms.abtpmms.htm; accessed December 4, 2000. The rate for 2000 is the average for the first 10 months of the year.

link their application processes and priorities into the super RFP. Yet, in interviews, local housing officials told us that while the super RFP has helped, it has not solved the problem because it is still just one piece of the funding puzzle.

MHFA has also tried to increase the flexibility of its funding selection process. For example, the agency allocated 2001 tax credits (which help subsidize affordable housing) in the fall of 2000 so that they would be ready for the 2001 construction season. The agency also eliminated preferences previously given developments with certain architectural amenities, such as units with both an eat-in kitchen and dining room.[66]

Subsidies for affordable housing projects can come from several sources – federal, state, or local governments or nonprofit or philanthropic organizations. In the following three sections, we provide a brief discussion of each of these sources.

The focus of federal housing policy has shifted several times over the last 60 years.

Federal Financing

The federal government's role in subsidizing housing started during the Great Depression when it took steps to stabilize the nation's housing stock, encourage home construction, and promote home ownership. To help create construction

66 Minnesota Housing Finance Agency (MHFA), "Report, Multifamily Development Cost Review," unpublished memorandum to MHFA board, September 24, 1998; MHFA, "Review of Roundtable Discussion," unpublished summary of a roundtable discussion of MHFA's customers, August 20, 1998; and interviews with MHFA staff.

jobs, Congress also passed the Housing Act of 1937, which allowed states to establish local public housing authorities to build, own, and manage housing. Since then, the focus of federal policy first shifted from constructing public housing to subsidizing the construction of low-income private housing and finally to providing rent subsidies that recipients can take with them when they move. Table 2.6 describes the federal government's major programs.

When we examined federal spending on housing programs, we found that:

- **Despite a large reduction in federal *appropriations* in the late 1970s and early 1980s, federal *spending* on housing has remained relatively constant after adjusting for inflation.**

Figure 2.4 shows federal appropriations and spending for housing programs since 1976. According to the United States Office of Management and Budget, the large differential between housing appropriations and spending in the late 1970s and early 1980s is due to the way the federal government funded the Section 8 New Construction/Substantial Rehabilitation program.[67] At that time, Congress appropriated all the funding needed for 20- or 40-year contracts up front, and the U.S. Department of Housing and Urban Development (HUD) then spent the appropriation over the term of the contract. Consequently, Congress appropriated money that was not needed for another 10, 20, or even 40 years. When Congress revoked HUD's authority to enter into additional contracts in 1983, the differential largely disappeared. Housing advocates content that if the federal government had maintained its housing appropriations at the level from the late 1970s, federal housing spending would have eventually risen to over $100 billion annually. Nevertheless, the federal government kept spending relatively constant during this period (around $30 billion annually). Housing advocates also claim that more money is needed because housing needs have increased over the last 25 years.

We also found that:

- **With respect to tax policy, the federal government's involvement in affordable housing has declined significantly.**

The federal Tax Reform Act of 1986 had a significant effect on multifamily housing production.

The federal Tax Reform Act of 1986 reduced or eliminated many tax incentives to build multifamily rental housing, some of which were only enacted five years earlier with the 1981 Economic Recovery Tax Act. Among other things, the 1986 act (1) eliminated accelerated depreciation, (2) ended the deductibility of construction-period interest and taxes in the year they were incurred, and (3) restricted the deductibility of passive losses.[68] As Figure 1.9 in Chapter 1 showed, the production of multifamily housing in Minnesota dropped off around 1986.[69]

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67 Steve Redburn (Chief of the Housing Branch, United State Office of Management and Budget), telephone interview by author, August 1, 2000.

68 Janet Larsen and Joane Vail, *The Effects of the 1986 Tax-Reform Act on Affordable Multifamily Housing in the Twin Cities Area* (St. Paul: Metropolitan Council, April 1989), 7; and Advisory Commission on Regulatory Barriers to Affordable Housing, *"Not in My Back Yard," Removing Barriers to Affordable Housing* (Washington, DC: United States Department of Housing and Urban Development, 1991) 5-4 and 5-5.

69 National production of multifamily housing experienced a similar decline.

Table 2.6: Major Federal Housing Programs

- **Public housing** is owned, operated, and managed by Public Housing Authorities. While the federal government no longer subsidizes the construction of new public housing, it still subsidizes the operation and modernization of existing buildings, with most tenants paying 30 percent of their income on rent. In 1999, Minnesota received $70 million in operating and modernization funding.

- **Section 8 new construction/substantial rehabilitation** (often referred to as project-based assistance) provides long-term subsidy contracts (up to 20 or 40 years) for parties that build affordable rental housing. While Congress revoked HUD's authority to enter additional contracts in 1983, the federal government still provides subsidies under existing and renewed contracts. Tenants usually pay 30 percent of their income for rent. In 1999, Minnesota received about $130 million in subsidies.

- **Section 8 certificates and vouchers** are rent subsidies that recipients can take with them when they move, rather than being tied to specific housing. Tenants pay about 30 percent of their income on rent. In 1999, Minnesota received $88 million in rent subsidies.

- **HOME** (the Home Investment Partnership Program) is a grant program for states and local governments to acquire, rehabilitate, or construct affordable housing for low-income renters or owners. In 1999, Minnesota received $20 million in grants.

- **Community Development Block Grants (CDBG)** fund community development efforts, including housing. Local governments that receive funding have wide discretion in its use. In 1999, Minnesota received $70 million in grants.

- **The Federal Housing Administration (FHA) and Department of Veterans Affairs (VA)** insure and guarantee loans, which increase housing market access for some families. Based on loan values, these two programs insured or guaranteed 12 percent of the nation's mortgages for family homes and 7 percent of the mortgages for multifamily properties in 1997.

- **Rural Housing Service** in the United States Department of Agriculture provides rent subsidies, direct loans, and loan guarantees in rural areas. In 1999, they provided $29 million in interest and rental subsidies in Minnesota.

- **Low-Income Housing Tax Credits** are federal income tax credits for people or companies that invest in the construction or substantial rehabilitation of rental housing. Developers of rental housing sell the credits to investors. Proceeds from credit sales can cover nearly two-thirds of a project's development and construction costs.

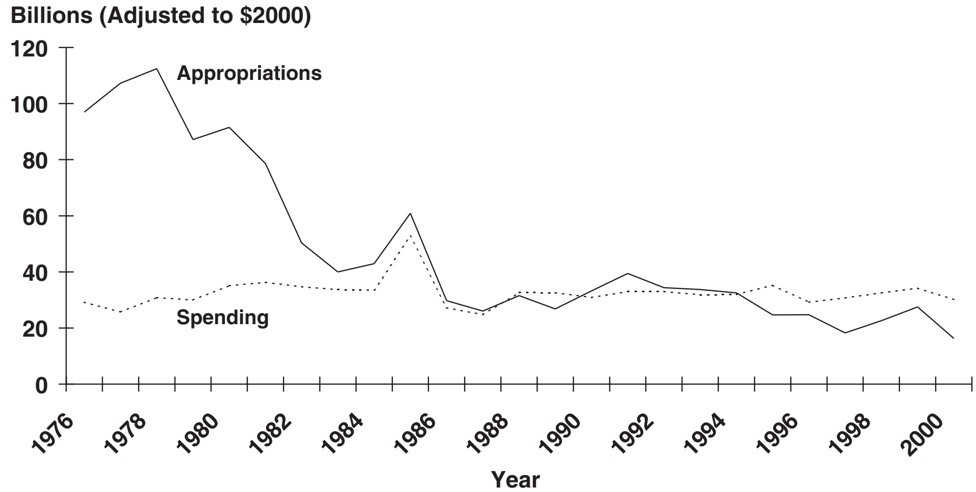
- **Tax exempt bonds** are sold by state and local governments. Buyers accept a lower interest payment because it is not taxable income. State and local housing agencies use the bond proceeds to finance mortgages with below-market interest rates.

- **Income tax deductions for mortgage interest and property taxes** are additional subsidies for homeownership.

- **Federal Home Loan Banks** provide credit to more than 7,600 member financial institutions. Federal law requires the 12 District Home Loan Banks to establish affordable housing and community investment programs, under which the district banks provide low-cost funds for affordable housing and community investment programs.

SOURCES: All funding information came from the Minneapolis Office of the United States Department of Housing and Urban Development (HUD), except for: (1) data on FHA and VA loan volumes, which came from HUD, "Survey of Mortgage Lending Activity Report: Annual 1997," http://www.hud.gov/fha/comp/rpts/smla/gf97ann4.html, accessed on August 11, 2000; and (2) data on the Rural Housing Service which came from the St. Paul Office of the Rural Housing Service.

Figure 2.4: Federal Funding for Housing Programs, 1976-2000



NOTE: Funding figures come from three federal budget categories, housing assistance, community development, and mortgage credit. Not all community development funding is for housing programs.

SOURCE: United States Office of Management and Budget, *Historical Tables: Budget of the United States Government, Fiscal Year 2001* (Washington DC: U.S. Government Printing Office, 2000), 50-90.

The federal government recently increased Minnesota's allocation of tax credits and tax-exempt bonds.

The Tax Reform Act of 1986 also created low-income housing tax credits but capped their use along with the use of tax-exempt bonds. The act capped each state's allocation of low-income housing tax credits at $1.25 per capita and certain tax-exempt bonds at $50 per capita. Both allocations have since declined 25 percent, after adjusting for inflation.[70] However, in December of 2000, Congress increased the caps for both programs for the first time. For example, in 2001, the federal government will cap tax credits at $1.50 per capita and tax-exempt bonds at $62.50 per capita.[71]

Tax-exempt bonds and tax credits are important sources of financing for affordable housing in Minnesota. The state received a tax-exempt bond allocation of $239 million in 2000 from the federal government, only a portion of which was used for housing. In 1999, the state used 43 percent of its bond allocation for single-family housing and 17 percent for rental housing.[72] In addition, the state received $6 million in tax credits under the federal cap in 2000.[73] The value of low-income housing tax credits is greater than the allocation because investors use them for ten years. For example, if a housing project sells $100,000 of credits, investors receive $100,000 in tax breaks for each of the next ten years, for a total

70 Office of the Legislative Auditor's analysis of data from the Minnesota Department of Finance and Minnesota Housing Finance Agency.

71 Katherine G. Hadley (Minnesota Housing Finance Agency), "Affordable Housing Increases in the Omnibus Spending Bill," memorandum to Leonard Inskip, December 20, 2000.

72 Office of the Legislative Auditor's analysis of data from the Minnesota Department of Finance, tables titled "Minnesota Tax Exempt Bond Allocations – 1999: State Cap & Pool Status" (January 1, 1999) and "Minnesota Tax Exempt Bond Allocations – 2000: State Cap & Pool Status" (August 7, 2000).

73 Minnesota Housing Finance Agency staff.

of $1 million dollars in savings. However, investors will only pay about $700,000 for the credits because the tax breaks will be used over ten years.[74] A $100,000 tax break ten years from now is not worth $100,000 today.

State Financing

The state administers an assortment of housing programs through the Minnesota Housing Finance Agency.

The most visible role that the state of Minnesota plays in providing housing to low- and moderate-income households is through the Minnesota Housing Finance Agency. The agency's principal activity is to finance loans that have below-market interest rates with tax-exempt bonds. The agency also provides rental assistance payments, primarily through the federal government's Section 8 program, and other forms of assistance, including deferred loans, grants, and tax credits.

During the 1998-99 biennium, MHFA's largest source of funding was bond proceeds, accounting for 57 percent of its budget. The federal government contributed another 16 percent, the state provided 10 percent, and agency reserves accounted for the remaining 17 percent.[75] Through these revenue sources, MHFA provided $292 million of assistance to 29,000 households in 1999. As Figure 2.5 shows, home mortgage programs accounted for nearly half of all assistance, while rental and home improvement programs accounted for 38 and 14 percent respectively.[76] Tables 2.7 and 2.8 describe the agency's major programs.

As Figure 2.6 shows, MHFA experienced a drop in state appropriations in the early 1980s just like federal agencies. However, unlike federal agencies, MHFA experienced a dramatic increase during the last two bienniums. For the 2000-01 biennium, the agency's appropriation increased from $83 million to $143 million, a 63 percent increase after adjusting for inflation. MHFA accounts for most but not all state appropriations for housing programs. According to the House of Representatives Research Department, $121 million of the $129 million originally appropriated for housing for the 2000-01 biennium went to MHFA. The other $8 million went to various other agencies, primarily to assist people with special needs.[77] During the 2000 session, the Legislature appropriated an additional $23 million for the biennium to MHFA and another $30 million for fiscal year 2002 in the next biennium.[78]

During the 1999 session, the Legislature created two new MHFA programs aimed at overcoming financial and regulatory factors that limit the production of affordable housing—the Innovative and Inclusionary Housing Program and the Economic Development and Housing Challenge Program. Under the Innovative and Inclusionary Housing Program, the Legislature appropriated $8 million to fund housing developments that demonstrate innovative building techniques or

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74 According to MHFA staff, credits usually sell for 70 cents on the dollar.

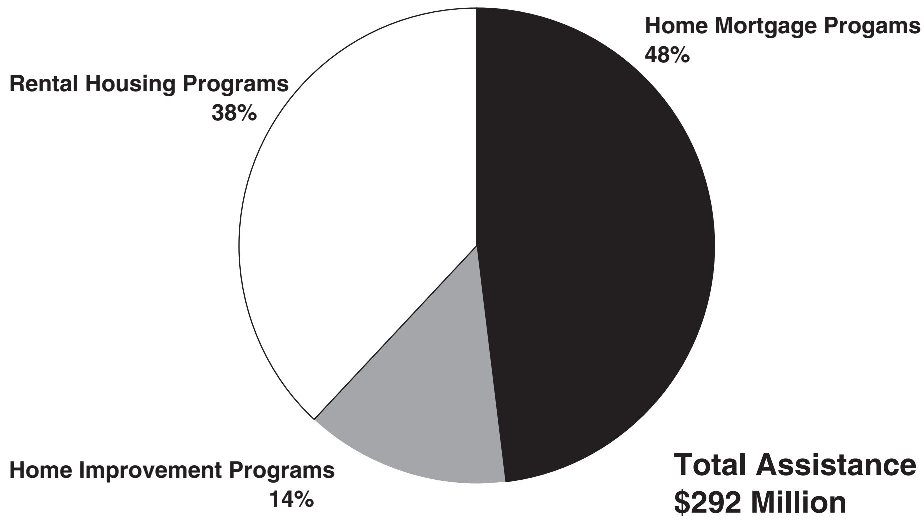
75 Minnesota Department of Finance, *Minnesota Biennial Budget: Economic Development, 2000-01* (St. Paul, 1999), E-143.

76 Minnesota Housing Finance Agency, *2000 Program Assessment: October 1, 1998 – September 30, 1999* (St. Paul, 2000), 12-18.

77 Wendy L. Simons and Deborah McKnight, *Housing Legislation 1999: A Summary* (St. Paul: Minnesota House of Representatives Research Department, September 1999), 3-5.

78 Minnesota Housing Finance Agency, unpublished document titled "REVIEW, 2000 LEGISLATIVE SESSION," May 24, 2000.

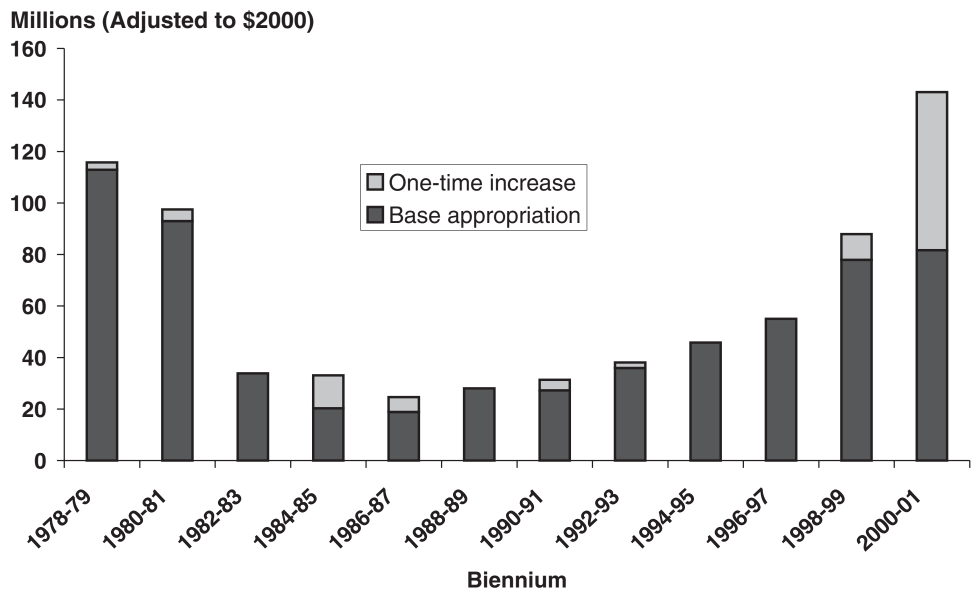
Figure 2.5: MHFA Assistance by Program Type, 1999



SOURCE: Minnesota Housing Finance Agency, *2000 Program Assessment: October 1, 1998 - September 30, 1999* (St. Paul, 2000), 14-18.

The Minnesota Housing Finance Agency's appropriation has increased substantially in recent years.

Figure 2.6: State Appropriations to MHFA,1978-79 to 2000-01



SOURCE: Minnesota Housing Financing Agency, unpublished budget documents.

The principal activity of the Minnesota Housing Finance Agency is to finance loans with below-market interest rates.

Table 2.7: Major State Housing Programs

Home Mortgages

- **Minnesota Mortgage Program** provides mortgages with below-market interest rates to first-time homebuyers through the sale of mortgage revenue bonds.
- **Minnesota City Participation Program** is part of the Minnesota Mortgage Program, in which MHFA sets aside funds from the sale of mortgage revenue bonds for cities to meet locally identified housing needs.
- **Community Activity Set-Aside** is a third part of the Minnesota Mortgage Program, in which MHFA sets aside funds from the sale of mortgage revenue bonds for lenders, local governments, or nonprofit housing providers to meet homeownership needs in their communities.
- **Minnesota Urban and Rural Homesteading** awards grants to organizations and public agencies that acquire, rehabilitate, and sell single-family homes that are vacant, condemned, or blighted to at-risk first-time homebuyers.

Home Improvement and Rehabilitation

- **The Great Minnesota Fix-Up Fund** provides home improvement loans with below-market interest rates for low- and moderate-income homeowners.
- **Community Rehabilitation Fund** provides grants to cities for acquisition, rehabilitation, demolition, and new construction of single-family homes.

Rental Housing

- **Section 8 Project-Based Assistance** subsidizes the rent for low-income households that live in buildings with contracts with the Department of Housing and Urban Development. MHFA administers only about half of the HUD contracts.
- **Low and Moderate Income Rental Program** provides mortgages and rehabilitation funds for the acquisition and rehabilitation or new construction of rental housing for low- and moderate-income families.
- **Affordable Rental Investment Fund (ARIF)** provides low-interest first mortgages or deferred loans to help cover the costs of acquisition and rehabilitation or new construction of low-income rental housing.
- **ARIF Preservation** provides deferred loans with no or little interest to federally-assisted rental housing at risk of being converted to market rate.
- **Low Income Housing Tax Credits (LIHTC)** are MHFA's share of the tax credits allocated to Minnesota.
- **HOME Rental Rehabilitation** provides grants to rehabilitate privately-owned rental property in order to support affordable, decent, safe, and energy efficient housing for lower-income families.
- **Housing Trust Fund** provides deferred loans without interest for the development, construction, acquisition, preservation, or rehabilitation of low-income rental housing.
- **Rental Rehabilitation Loans** provide property improvement loans to rental property owners.

SOURCE: Program documents from the Minnesota Housing Finance Agency.

Table 2.8: Program Details for MHFA's Major Programs, 1999

Program	Type of Assistance	Amount of Statewide Assistance (in Millions)	Funding Source	Number of Housing Units Assisted	Median Annual Income of Assisted Households
Home Mortgage Programs					
Minnesota Mortgage Program	Low-interest loans	$90	MHFA bond proceeds	1,500	$25,812
Minnesota City Participation Program	Low-interest loans	25	MHFA bond proceeds	378	27,879
Community Activity Set-Aside	Low-interest loans	10	MHFA bond proceeds	129	29,000
Minnesota Urban and Rural Homesteading (MURL)	Grants	4	State appropriations and federal funds	37	N/A
Home Improvements and Rehabilitation Programs					
The Great Minnesota Fix-Up Fund	Low-interest loans	$21	MHFA bond proceeds and fund balances	2,143	$30,524
Community Rehabilitation Fund	Grants	7	State appropriations	141	N/A
Rental Housing					
Section 8 Project-Based Assistance	Rent Subsidies	$63	Federal funds	13,025	N/A
Low and Moderate Income Rental Program [a]	Loans and rehabilitation funding	18	MHFA bond proceeds and fund balances	808	$11,736[b]
Affordable Rental Investment Fund (ARIF)	Low-interest and deferred loans	6	State appropriations and fund balances	504	14,418
ARIF Preservation	Low- or no-interest deferred loans	5	State appropriations and federal funds	60	N/A
Low Income Housing Tax Credits (LIHTC)	Tax credits	4	Federal tax expenditures	662	N/A
HOME Rental Rehabilitation	Grants	3	Federal funds	304	11,016
Housing Trust Fund	No-interest deferred loans	2	State appropriations	481	9,112
Rental Rehabilitation Loans	Low-interest loans	2	Fund balances	478	20,000

NOTE: N/A means not available. Housing units that received funding from more than one MHFA program are identified once, under the program that provided the greatest portion of total assistance.

[a]Combination of the Low and Moderate Income Rental First Mortgage, New Construction Tax Credit Mortgage, and Bridge Loan programs.

[b]Excludes recipients of the New Construction Tax Credit Mortgage and Bridge Loan Programs. Data for these two programs are not available.

SOURCE: Minnesota Housing Finance Agency program documents.

materials and are located in communities willing to waive local restrictions that increase housing costs.[79] In Chapter 3, we provide some examples of these developments. Under the Economic Development and Housing Challenge Program, the Legislature appropriated $20 million for MHFA to provide grants and loans to housing projects with financial contributions from area employers, local governments, and private philanthropic organizations.[80]

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79 *Minn. Laws* (1999), ch. 223, art. 2, sec. 54. One half of the money went to MHFA, while the other half went to the Metropolitan Council.

80 *Minn. Laws* (1999), ch 223, art. 2, sec. 56.

Local and Philanthropic Sources of Financing

Local governments and philanthropic organizations also provide housing assistance.

Local governments and philanthropic organizations also provide financing for affordable housing projects. Table 2.9 briefly describes some major sources. Although we did not collect information about how much money each source provides, in our survey, we asked local housing organizations to indicate what sources of funds (federal, state, local, and private), they used in 1999 to develop, construct, or rehabilitate affordable housing. We did not ask about programs that subsidize rent or mortgage payments after the housing is built. Table 2.10 shows the percentage of local housing organizations that used each source. Community Development Block Grants, federal HOME funds, MHFA's Community Revitalization Fund, and tax increment financing appear to be the most widely used funding sources.

Table 2.9: Other Sources of Financing

Local Government Sources

- **Local bonds** that finance affordable housing come in two types. First, revenue bonds typically finance mortgages and are paid off with mortgage repayments. Second, general obligation bonds are paid off with local tax collections.
- **Tax increment financing** districts may be established by local governments. In these districts, local governments (1) "capture" the property tax revenue generated by a new development on top of what would have been collected without the project and (2) use the "captured" revenue to help finance the project.
- **Local tax levies** may be used to directly finance affordable housing.
- **Local housing trust funds** are local revenues dedicated exclusively to housing activities.
- **Metropolitan Council's Local Housing Incentives Account** is money provided through the Metropolitan Council's Livable Communities Act.

Non-Profit Sources

- **Family Housing Fund** is a nonprofit agency that operates in the seven-county Twin Cities metropolitan area and provides capital funding (grants and loans) to affordable housing projects. Contributions from the McKnight Foundation and corporate donations finance the fund.
- **Greater Minnesota Housing Fund** is also a nonprofit agency that provides capital funding but operates in outstate Minnesota. Contributions from the McKnight and Blandin Foundations finance the fund.

SOURCE: Office of the Legislative Auditor.

TAXES

Property taxes are an important revenue source for local governments. But, property taxes on rental housing have a significant effect on rents that property owners charge. According to the Department of Revenue and the Institute for

Funding from two federal grants, the HOME and Community Development Block Grant programs, have been the most widely used funding sources.

Table 2.10: Percentage of Local Housing Organizations that Used Various Funding Sources, 1999

Source	Percentage of Local Housing Organizations
Federal	
Community Development Block Grants/Small Cities Development Program	50%
Federal HOME funds	37
Low-income housing tax credits	19
Federal Home Loan Bank	14
State	
MHFA Community Revitalization Fund	34
MHFA Rental Rehabilitation Program	20
MHFA Housing Trust Fund	17
MHFA HOME Rental Rehabilitation Program	16
MHFA Affordable Rental Investment Fund	13
MHFA Low and Moderate Income Rental Program	5
MHFA Affordable Rental Investment Fund—Preservation	3
Other MHFA programs	29
Local	
Tax increment financing	23
Local tax levy	16
Local bonds	15
Metropolitan Council Local Housing Incentives Account	11
Local housing trust fund	9
Private, Nonprofit	
Greater Minnesota Housing Fund	20
Family Housing Fund	16
Other	38

NOTE: We asked local housing officials, "Which of the following financing tools did your organization use in 1999 to assist in the development, construction, or rehabilitation of affordable housing in Minnesota?" *N* = 149.

SOURCE: Office of the Legislative Auditor's survey of local housing officials, July and August 2000.

Real Estate Management, property taxes constitute about 14 percent of rent collections in Minnesota.[81] Thus, it is somewhat surprising that taxes were not a major concern of most survey respondents, as shown earlier in Tables 2.1 and 2.2.

When survey respondents did identify taxes as a factor that limits the production of affordable housing, they cited property taxes on rental housing the most often as an example. One developer wrote, "[Property taxes are] perhaps the most significant impediment to developing [multifamily] housing. [Minnesota's] property tax system imposes a heavy burden on multifamily housing, thus reducing debt that can be supported and negatively impacting financial feasibility." Another developer stated, "As a national developer we see [a] per unit [tax] that rates among the highest in the U.S. in Minnesota."

81 Minnesota Department of Revenue, *Analysis of Rent and Property Tax Data from Landlord Rental Property Tax Form LRP* (St. Paul, May 1994), 3; and Institute for Real Estate Management, *Income Expense Analysis: Conventional Apartments, 1999 Edition* (Chicago: Institute for Real Estate Management of the National Association of Realtors, 1999), 92-93.

A recent task force identified property taxes as a significant impediment to affordable housing.

In fact, an affordable rental housing task force, made up of local housing experts, recently identified property taxes on rental housing "as a very significant, perhaps the most significant, impediment to building needed apartments." According to the task force, developers of moderately-priced apartments cannot attract investors because property taxes are too high to make the project financially feasible. Consequently, virtually all apartments being built in Minnesota are either government subsidized housing or luxury apartments for which rent is sufficiently high to pay property taxes.[82] Indeed, as we showed at the end of Chapter 1, production of multifamily housing is currently relatively low.

The finding that most respondents did not cite property taxes as a significant impediment may be explained by two factors. First, although 105 developers and builders of multifamily housing completed our survey, it is likely that many of them only built owner-occupied housing, such as townhomes. The possibility that relatively few developers and builders of rental housing completed our survey may explain the low number of respondents identifying property taxes on rental property as a problem.

Second, developers, builders, and local housing organizations only pay property taxes while they own the property, typically while the housing is being developed and built. If we had surveyed owners of rental housing (the ones who pay property taxes), they may have cited taxes as a significant limitation more frequently. Indeed, a national survey of property owners cited property taxes as their number one concern.[83]

Nevertheless, it is evident that:

- **Minnesota has a relatively high tax rate on rental property.**

In 2000, the average effective tax rate on apartment buildings in Minnesota was 2.1 times greater than the rate on homesteads (owner-occupied housing). On average, owners of apartment buildings paid 2.85 percent of their properties' assessed market value in taxes, while owners of homesteads paid only 1.37 percent.[84] In addition, based on a $600,000 building, Minnesota had the third highest effective tax rate on apartments in the country in 1998. In contrast, the state had a typical tax rate for homesteads—its rank ranged from 18th to 26th depending on the value of the home.[85]

But in recent years:

- **The state has taken steps to lower taxes on rental property.**

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82 Affordable Rental Housing Task Force, *Affordable Rental Housing: Opening Doors for Private Development and Preserving Existent Housing Stock* (January 2000), 5-6.

83 Howard Savage, *Current Housing Report: What We Have Learned about Properties, Owners, and Tenants from the 1995 Property Owners and Managers Survey* H121/98-1 (Washington D.C.: United States Department of Commerce, Economics and Statistics Administration, October 1998), 1.

84 Office of the Legislative Auditor analysis of data from Minnesota House of Representatives Research Department, *House Research Issues & Information: Property Tax: Changes in Property Tax Burdens Since 1991* (St. Paul, 2000).

85 Minnesota Taxpayers Association, *50-State Property Tax Comparison Study: Payable Year 1998* (St. Paul: Minnesota Taxpayers Association, January 1999), iv.

Rental property's share of all property tax collections has declined.

The rate at which Minnesota taxes property is based on a combination of state and local policies—local property assessments, local tax rates, state class rates, and state tax credits. Table 2.11 provides details on calculating property taxes. Class rates are one of the state's main mechanisms for distributing property taxes among different types of property, and Table 2.12 shows the 1991 and 2000 class rates for standard residential properties. During this period, the state reduced the class rates on apartment buildings with four or more units by 33 percent and even more for buildings with less than four units. Because class rate reductions for rental properties were greater than other types of property, apartment buildings' share of all property tax collections declined from 8 to 6 percent, while the share for buildings with less than four units dropped from 7 to 3 percent.

Table 2.11: Calculating Property Taxes

Property Taxes Owed = (Assessed Value x State Class Rate x Local Tax Rate) - State Tax Credits

- The state sets the class rates, which ranged from 1.0 to 2.4 percent for standard residential properties in 2000.
- Local governments (a combination of cities, counties, school districts, and special taxing districts) set the local tax rate, which averaged 126.8 percent in the Twin Cities' metropolitan area and 138.5 percent in outstate Minnesota in 1999.
- The state also establishes tax credits. The broadest one is the education homestead tax credit, which lowers the tax on homesteads by 83 percent of general education's portion of the local tax levy. The maximum credit is $390 per homestead.

SOURCES: Minnesota Department of Revenue, *Minnesota Tax Handbook: A Profile of State and Local Taxes in Minnesota* (St. Paul, March 1999); and Citizen's League and Minnesota Taxpayers Association, *Minnesota Homestead Property Tax Review 1999* (St. Paul: Minnesota Taxpayers Association, October 1999).

In addition to the class rate reductions, the state created a new property class (4d) for lower-income rental housing that became effective in 1999. As shown in Table 2.12, the class rate on 4d properties is 1 percent of a property's assessed value, which is 17 to 58 percent lower than the rate on other rental property. For rental property to qualify for the lower tax rate, tenants' incomes cannot exceed 60 percent of the median family income, and rents cannot exceed 30 percent of the income limit.[86] For 2001, property owners have designated 82,063 rental units under the 4d class in Minnesota, which is 16 percent of all rental units in 1990 (the most recent available data). Of these 4d units, 58 percent are in compliance because they participate in other government programs (project-based Section 8, low-income housing tax credits, Rural Housing Service rental assistance, and MHFA Rental Assistance) with similar or more stringent income and rent requirements. The remaining 42 percent are market-rate units that property owners have pledged to the program.[87]

86 *Minn. Stat.* (2000) §273.126, subd. 2 and 3.

87 Minnesota Housing Finance Agency data on the class 4d program; and United States Bureau of the Census, *1990 Census of Population and Housing,* Summary Tape File 1, Matrices H1, H2, H5, P1 GEO, http://wwwfactfinder.census.gov/java_prod/dads.ui.homePage.HomePage; accessed December 20, 2000.

Table 2.12: Residential Property Tax Class Rates, 1991 and 2000

Class	Description	1991 Class Rates as a Percentage of a Property's Assessed Value	2000 Class Rates as a Percentage of a Property's Assessed Value
1a	Residential homestead (owner-occupied)		
	First Tier (applied to the first $68,000 of assessed value in 1991 and $76,000 in 2000)	1.00%	1.00%
	Second Tier (applied to the portion of assessed values between $68,000 and $110,000 in 1991 and greater than $76,000 in 2000)	2.00	1.65
	Third Tier (applied to the portion of assessed values greater than $110,000 in 1991)	3.00	N/A
4a	Rental property with four or more units	3.60	2.40
4b	Rental property with two or three units	3.00	1.65
4bb	Rental property with one unit		
	First Tier (applied to all values in 1991 and the first $76,000 in 2000)	3.00	1.20
	Second Tier (applied to the portion of assessed values greater than $76,000 in 2000)	N/A	1.65
4d	Qualifying low-income rental housing	N/A	1.00

NOTE: N/A means not applicable.

SOURCES: Minnesota Department of Revenue (DOR), *Addendum to the 1998 Edition of the Minnesota Tax Handbook* (St. Paul), 5; and DOR, *Property Taxes Levied in Minnesota: 1990 Assessments, Taxes Payable in 1991* (St. Paul, 1990), 4-7.

The 4d program is intended to encourage property owners to lower rents or build more affordable housing. However, we found that:

- **In the Twin Cities metropolitan area, rent limits for the 4d low-income housing program were actually higher than the average market-rate rents for efficiencies and one- and two-bedroom units for 2000.**

The "4d low-income program" provides tax breaks to property owners making a long-term commitment to affordable housing.

Table 2.13 shows the rent limits and average rents. Since much of the rental housing that meets the 4d rent limits does not take advantage of the lower property tax rates, it is unclear whether the new property class is stimulating much more affordable housing. Several program requirements may inhibit property owners from participating. First, tenants must meet the specified income limits. Second, property owners must commit to the income and rent limits for five years. Third, property owners must make a portion of the units available to Section 8 certificate and voucher holders. Finally, the units must be inspected every three years.[88] The program only provides tax benefits to those who are willing to make a long-term commitment to affordable housing.

88 Minnesota Housing Finance Agency, *2000 Application for Minnesota 4d Property Tax Classification* (St. Paul), 2.

Table 2.13: 4d Rent Limits and Average Rents in the Twin Cities Metropolitan Area, 2000

Number of Bedrooms	4d Rent Limits	Average Gross Rents
0	$ 690	$ 527
1	739	715
2	886	876
3	1,025	1,140

NOTE: Gross rents include rent payments and tenant paid utilities. To calculate average tenant utility payments, we obtained from Apartment Search the percentage of apartment buildings in which tenants pay each of the major utilities. We then applied these percentages to the Metro Housing and Redevelopment Authority's utility allowance.

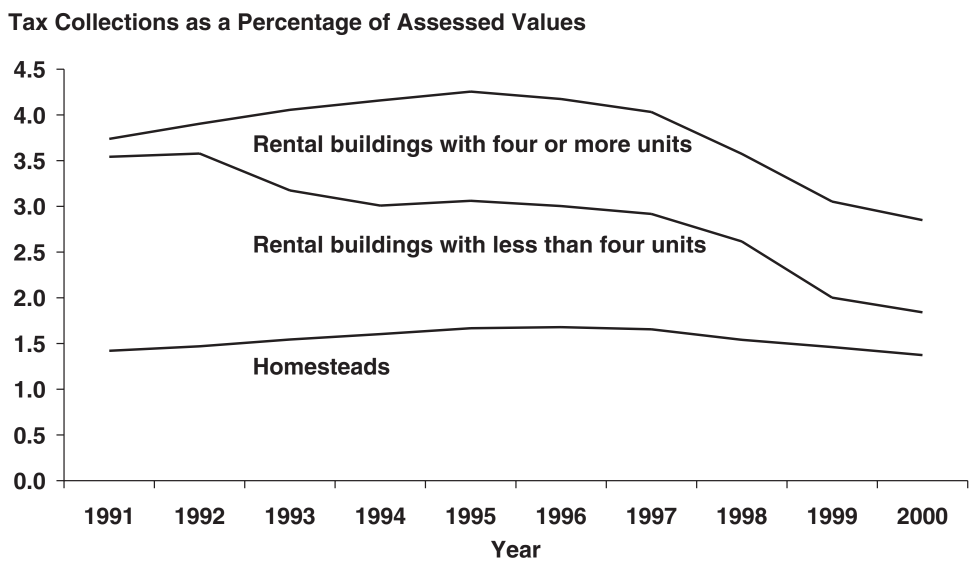
SOURCES: Minnesota Housing Finance Agency, *4d Rent Limits for 2000,* http://www.mhfa.State.mn.us/pages/4Dtax/rentlimit.htm; accessed on July 26, 2000; Apartment Search, *Profiles 2000 Quarterly Review,* (Edina, MN: Apartment Search, 2nd Quarter 2000); and Metro HRA, *Existing Housing Allowance for Tenants—Paid Utilities and Appliances* (St. Paul, July 2000).

We found that:

- **The reduction in class rates contributed to a significant decline in the effective tax rate on rental housing.**

As shown in Figure 2.7, the average effective tax rate (taxes paid divided by assessed market value) dropped from 3.74 percent in 1991 to 2.85 percent in 2000 for apartments with four or more units and from 3.54 to 1.84 percent for buildings

Figure 2.7: Effective Property Tax Rates in Minnesota



SOURCE: Office of the Legislative Auditor's analysis of data from Minnesota House of Representatives Research Department, *House Research Issues & Information: Property Tax, Changes in Property Tax Burdens Since 1991* (St. Paul, 2000).

with less than four units. In fact, even without adjusting for inflation, the total amount of taxes collected in Minnesota from rental properties declined although the aggregate market value of these properties increased. Tax collections from apartments declined 2 percent, while their aggregate market value increased 28 percent. Collections from buildings with less than four units declined 36 percent, while their aggregate market value increased 22 percent. In comparison, the effective tax rate on homesteads declined slightly, from 1.42 percent in 1991 to 1.37 percent 2000.[89]

Equalizing the tax rates on rental properties and homesteads has long been discussed in Minnesota. We estimated that:

- **Average rents would decrease by about 7 percent if the effective tax rate on rental income were cut in half to equal the homestead rate and *if* property owners passed all the savings on to renters through lower rents.**

As mentioned above, about 14 percent of rent collections go to pay property taxes. Consequently, if property taxes were cut in half and all the savings were passed on to renters, property taxes would account for only 7 percent of rent collections. This would constitute a 7 percent decline in rents. However, it is not entirely clear as to when and how much of a property tax reduction would be passed on to renters.

A Department of Revenue study assumed that in the long run property taxes savings are passed on to renters.

Since 1993, the Department of Revenue, in its biennial study on the incidence of taxes in Minnesota, has assumed that almost all changes in property taxes are passed on to renters in the long run.[90] The basic premise behind the department's assumption is that money moves to where it earns the highest rate of return. Consequently, it is assumed that if Minnesota lowers its tax on rental property, the following chain of events would occur:

1. Profits earned from rental properties would rise as tax expenses decline;
2. To take advantage of the higher rate of return, more people would invest in rental housing in Minnesota;
3. As the investment in rental housing increases, the supply would increase;
4. As the supply of rental housing and vacancies increase, property owners would compete to fill their units by reducing their rents;
5. As rents decline, profits would decline; and
6. Finally, the chain of events would stop once the decline in rents equals the decline in property taxes and the rate of return of investing in rental housing is back to its original level.

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89 Office of the Legislative Auditor analysis of data from Minnesota House of Representatives Research Department, *House Research Issues & Information: Property Tax, Changes in Property Tax Burdens Since 1991* (St. Paul, 2000).

90 Minnesota Department of Revenue (DOR), *1999 Minnesota Tax Incidence Study: Who Pays Minnesota's Household and Business Taxes* (St. Paul, March 1999), footnote 29 on page 48; and Paul Wilson (author of DOR report), interview by author, St. Paul, July 3, 2000.

In the short run, property owners have little incentive to pass tax savings on to renters.

However, in the short run, before the supply of rental housing increases, owners of rental housing have little incentive to pass any property tax savings on to renters, especially when the vacancy rate is well below 5 percent. Because there is such a high demand for rental housing, owners could keep all the savings from lower property taxes and still fill nearly all their units. In addition, factors that limit the production of rental housing, such as the supply of land, may prevent the market from fully adjusting to the lower property taxes by increasing supply.

In any case, we do not have any empirical evidence to show what is likely to happen if the state lowers taxes on rental property. In addition, lowering taxes on rental property would cause local governments to lose revenue. To make up for the loss, local governments would need either to increase the local property tax rate on all classes of property or to receive additional aid from the state. If local governments increased their local tax rate, homeowners and businesses would pay higher property taxes. If the state provided additional aid, it would have to raise taxes or take funding from other programs.

COMMUNITY OPPOSITION

We found that:

- **Community opposition to affordable housing—commonly known as "not in my backyard" (NIMBY)—appears to be a bigger limitation for multifamily than single-family housing.**

As shown earlier in Tables 2.1 and 2.2, a majority of developers of multifamily housing in our survey cited community reaction as a significant limitation to the production of new affordable housing. For example, a nonprofit housing agency commented in its survey, "Homeowners in every neighborhood object to 'those people' coming into their neighborhoods (minorities, low-income)." In addition, a developer wrote, "If there is a negative reaction from the community, it will deter developers from proposing a project or development."

People appear to support the concept of affordable housing in theory. In a recent survey, the Metropolitan Council found that 89 percent of residents in the Twin Cities area believe that all cities should have some affordable housing and that people should be able to find affordable housing near their workplace. In addition, 59 percent of residents said that low-income housing is not an important cause of neighborhood deterioration and crime when it is mixed with middle- and upper-income housing.[91] This acceptance of affordable housing is supported by a recent study by Maxfield Research (a market research firm) that examined the effect that housing financed with low-income housing tax credits had on surrounding property values in the Twin Cities area. It found that:

91 Metropolitan Council, *Report to the Minnesota Legislature on Affordable and Life-Cycle Housing* (St. Paul, December 1999), 30-31.

> The homes that were sold in the subject areas around 12 tax-credit developments…, in general, displayed *similar or stronger market performance in the period after the tax credit properties were built*, as well as *similar or stronger performance to comparable homes sales from a control group* (emphasis in original).[92]

Nevertheless, there is often vocal opposition to affordable housing. According to the developers and representatives of local housing organizations that we interviewed, people often associate affordable multifamily housing with negative stereotypes of public housing—large, unattractive buildings riddled with crime and drugs. They fear that their neighborhoods and property values will decline. In addition, some people do not like any growth or change in their neighborhoods, regardless of whether it is affordable housing or a high-end development.

Profit-minded developers are often unwilling to devote resources to fighting community opposition.

In some cases, it takes years of meeting with city and community officials to build acceptance and support for a project. For example, CommonBond Communities (a nonprofit developer) recently built 19 affordable rental townhomes in Maple Grove. It took the developer three and one-half years to complete the project. It spent the first two years getting the city council's approval and breaking down the NIMBY attitude of the residents. CommonBond obtained the acceptance of city officials by showing them some low-income housing that it built in Edina, which counteracted negative stereotypes of affordable housing. CommonBond then worked with churches, businesses, immediate neighbors, civic leaders, and organizations to build community support. Even with all the groundwork to build community support, the final public hearing about the project before the city council was overflowing and rancorous. It is unclear if developers are only confronting a vocal minority or if people's attitudes change when affordable housing is actually in their neighborhoods. In any event, profit-minded developers are often unwilling to devote resources to such an effort.[93]

CONCLUSION

Developers, builders, and local housing organizations cite many factors that potentially limit the production of affordable housing. As we note in this chapter, governments created many of these potential impediments to achieve other valid policy objectives. For example, zoning ordinances allow local governments to develop their communities based on local priorities. The Metropolitan Council uses the MUSA to encourage compact, orderly development in the seven-county Twin Cities area. Municipalities use property taxes and development and construction fees to pay for local services. Finally, the building code ensures that housing is safe and well constructed. If policy makers at all levels decide to address any of these potential impediments, they must balance these objectives with the goal of reducing housing costs.

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92 Maxfield Research, *A Study of the Relationship Between Affordable Family Rental Housing and Home Values in the Twin Cities: Summary of Finding* (Minneapolis: Family Housing Fund, September 2000), 2.

93 Joe Errigo (CommonBond Communities), telephone interview by author, October 5, 2000.

3 Strategies for Producing Affordable Housing

SUMMARY

Despite various factors that potentially limit the production of affordable housing, many of the organizations that we surveyed helped produce affordable housing. For these organizations, government intervention—particularly in the form of financial assistance—is a crucial part of building affordable housing. Apart from obtaining government subsidies, however, there is no universal strategy to building affordable housing. On a case-by-case basis, project developers and local officials take advantage of various types of regulatory relief, such as zoning modifications and fee waivers. Some other states have taken a more prescriptive approach by requiring the development of affordable housing or mandating local government to provide regulatory relief. In the mid 1990s, Minnesota rejected these types of policies in favor of an incentive-based, voluntary program for the seven-county Twin Cities area under the Livable Communities Act of 1995. So far, the program has been only marginally successful in producing affordable housing.

As discussed in Chapters 1 and 2, housing costs have escalated in recent years, and several factors limit the production of affordable housing. However, despite these trends some affordable housing is being produced. In this chapter, we highlight examples of the strategies currently being used to produce affordable housing in Minnesota and elsewhere. This chapter addresses the following questions:

- **What strategies have developers, builders, local housing organizations, and cities in Minnesota used to overcome factors that might limit the production of affordable housing?**

- **What strategies have other states used to overcome these factors and encourage the production of affordable housing?**

- **How effective has the Livable Communities Act been in producing affordable housing in the Twin Cities metropolitan region?**

To answer these questions we surveyed and interviewed developers, builders, and local housing organizations. We also reviewed national literature on affordable housing activities. Finally, we reviewed statutes and reports related to the Livable Communities Act and interviewed Metropolitan Council and municipal government staff.

DEVELOPERS, BUILDERS, AND LOCAL HOUSING ORGANIZATIONS

Less than half of the developers and builders we surveyed produced affordable housing in 1999.

In our survey, we asked developers, builders, and local housing organizations if they had produced any affordable housing during 1999.[1] Forty-seven percent of the developers, 31 percent of the developers/builders, 27 percent of the builders, and 91 percent of the local housing organizations said they had produced affordable housing. We asked these companies and organizations, "What resources or strategies helped make it possible for your organization to produce affordable housing?" We found that:

- **According to survey respondents, government intervention—most often in the form of financial assistance—is crucial to producing affordable housing in Minnesota.**

Table 3.1 lists the resources and strategies reported by the organizations responding to our survey. Similar to their responses to other survey questions, their strategies were related to the role that they played. For example, local housing organizations, whose job it is to find the resources to meet the housing needs in their area, were most likely to report that government financial assistance is important. Builders, on the other hand, emphasized cost-saving measures, such as building on less expensive lots or building smaller or simpler units.

As discussed in Chapter 2, many levels of government, as well as philanthropic sources, provide financial assistance for affordable housing. The Minnesota Housing Finance Agency (MHFA) provides most of the state's financial assistance. Many of the surveys we received and interviews we conducted emphasized the importance of MHFA funding, and many of the people involved with providing affordable housing applauded the increase in MHFA funding over the last biennium.

EXAMPLES FROM MINNESOTA

Through telephone interviews with 76 developers, builders, and local housing officials, we identified examples of both single-family and multifamily affordable housing developments throughout the state. In the following sections, we briefly describe eight of these projects. Overall, we found that:

- **With the exception of obtaining government subsidies, there is no universal strategy to building affordable housing. On a case-by-case basis, project developers and local government officials took advantage of the available resources and strategies.**

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1 In our survey we defined "affordable housing" as a unit selling for less than $131,000 or renting for less than $683 (two bedroom) in metropolitan areas (Minneapolis/St. Paul, Duluth, Fargo/Moorhead, Grand Forks, La Crosse, Rochester, or St. Cloud); or selling for less than $90,000 or renting for less than $468 (two bedroom) in non-metropolitan areas (for greater detail see the questionnaire on our website at http://www.auditor.leg.state.mn.us/ ped/2001/pe0103.htm).

Obtaining government financing is an important strategy for building affordable housing.

Table 3.1: Resources and Strategies Used by Developers, Builders, and Local Housing Organizations

	Developers (N = 26)	Developers/ Builders (N = 25†)	Builders (N = 28†)	Local Housing Organizations (N = 120†)
Government Assistance				
Government financing	****	**	**	****
Helpful zoning	*	*	*	*
Fee reduction / waivers	*	*	*	*
Donated or low-cost land from local government	—	—	—	*
Local government advocacy	*	*	*	*
Cost-Saving Measures				
Building on cheaper lots	*	**	**	*
Building smaller/simpler units	*	**	**	*
Other cost savings	—	*	*	*
Private Sector Financial Assistance	*	*	*	*

NOTE: Rankings only include respondents who produced at least one unit of affordable housing in 1999.

**** 75 to 100 percent of respondents mentioned the strategy.
*** 50 to 74 percent of respondents mentioned the strategy.
** 25 to 49 percent of respondents mentioned the strategy.
* 1 to 24 percent of respondents mentioned the strategy.
— No responses.

†An additional 6 developers/builders, 11 builders, and 16 local housing agencies produced affordable housing in 1999, but did not answer the question regarding strategies.

SOURCE: Office of the Legislative Auditor's survey of developers, builders, and local housing organizations, July and August, 2000.

In most of our examples, financial assistance was combined with relief from government regulation, including zoning modifications and fee waivers. In a few cases, the savings from regulatory relief were substantial, but in most cases, the savings were less than $3,000 per unit. Although the savings from regulatory relief may be limited, they facilitate the development of affordable housing and stretch the limited financial resources that government devotes to affordable housing.

Chaska

In 1992, the Carver County Housing and Redevelopment Authority (HRA) began looking for office space. After being frequently stalled by high costs, the director went to the city of Chaska to inquire about potential properties on which to construct an office building. The city was in the process of acquiring properties for redevelopment and offered the HRA an old brick yard on which to construct a mixed-use building. The HRA bought the site for $150,000 with a deferred loan from city after the city spent more than $425,000 acquiring and cleaning up the contaminated site.

Chaska's brickyard development.

The building will have a mix of office, retail, and apartment space. Renovations have begun, and the HRA expects the project to be completed in early 2001. When completed, the HRA's offices will be located on the first floor, along with 2,200 square feet of retail space. Thirty-two apartments will occupy the upper floors and rent for $510 to $700 per month.

In some cases, relief from government regulations substantially lowers housing costs.

The HRA collaborated with the city to reduce the project's costs by $1.7 million ($54,000 per apartment) through zoning variances and fee reductions. For example, the city granted a zoning variance that allowed housing above commercial space and increased the allowable density three-fold to 64 units per acre, which reduced costs by $29,000 per unit. The city also granted a variance that reduced the required number of garage spaces per unit from two to one. This reduced land acquisition, demolition, soil correction, and construction costs by an average of $24,000 per unit. Finally, the city agreed to defer $40,000 in local fees, which reduced costs by $1,250 per unit.

These reductions decreased the project's total costs to $4.2 million, with the housing component accounting for $3.6 million. Chaska provided the primary funding for the housing component through $2.7 million in general obligation bond proceeds. The project is also receiving funding from other sources, including $450,000 from the Metropolitan Council's Inclusionary Housing Account.[2]

2 Julie Frick, (Carver County Housing and Redevelopment Authority), telephone interview by author, November 1 and December 20 and 28, 2000; Ryan Meisner (Frana and Sons, Incorporated), telephone interview by author, November 1 and December 8, 2000; Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Item 1999-18), December 10, 1999; and Carver County HRA, unpublished table titled "Development Budget," February 11, 2000.

Mankato

Some argue that businesses are reluctant to move into an area or expand if the area lacks affordable housing for their employees. The city of Mankato has adopted an innovative approach to address this issue. Under a demonstration project, the city is negotiating with businesses that receive the city's economic development subsidies to use 5 percent of the subsidy for affordable housing. For example, three businesses recently agreed to subsidize the sale of 15 homes that will sell for $120,000 to $130,000. Altogether the businesses are contributing $15,000, which will be combined with $45,000 from MHFA to provide each homebuyer $4,000 for down-payment assistance. To make these homes affordable, MHFA is subsidizing each homeowner's mortgage payments by an average of $18,000 in loans that do not require payments until ten years after the purchase and $67,000 from low-interest, 30-year mortgages.

The city helped reduce the selling price of the homes by waiving its sewer and water access charges—$2,000 for each home. In addition, the Minnesota Department of Trade and Economic Development provided $220,000 to help install the infrastructure for the 15 homes, which are in a low-lying area and require a sanitary sewer lift station.[3]

Plymouth

In a development called the Reserve, the city of Plymouth and its HRA are working with Rottlund Homes to make 25 townhomes of the 627 owner-occupied units affordable to lower-income households at prices of $120,000 to $134,000. The city reduced:

- Driveway construction and utility installation costs by $478 per home by decreasing the distance the homes are set back from the lot boundary by 11 feet, and

- Road construction costs by $720 per home by decreasing the road widths.

In other cases, regulatory relief makes little difference.

The regulatory relief provided by these efforts is minimal—less than 1 percent of the homes' cost. Nevertheless, the selling price still meets our definition of affordability for metropolitan areas ($140,000). As mentioned in Chapter 1, townhomes account for most of the new affordable housing for sale in the Twin Cities area. Although these homes are already affordable to some lower-income households, qualifying homebuyers will receive an average of $15,000 in additional financial assistance from various sources, including MHFA, the Metropolitan Council, the city, and others.[4]

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3 Dan Jordet (city of Mankato), telephone interview by author, October 30 and 31, 2000; Sue Matzke (Petrie Development), telephone interview by author, October 30 and 31, 2000; and Petrie Development, unpublished table titled "Source and Use of Funds," undated.

4 Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Committee Agenda Item SW 2000-476), October 2, 2000; Rebecca Stoen (city of Plymouth), letter to Reed Erickson of the Minnesota Housing Finance Agency, August 14, 2000; and Rebecca Stoen, unpublished description of funding sources, undated.

St. Paul

CommonBond's Cathedral Hill apartments.

CommonBond Communities, a nonprofit provider of affordable housing and support services, recently purchased and rehabilitated a complex of seven deteriorating apartment buildings near the St. Paul Cathedral. Before CommonBond's intervention, the buildings were 50 percent vacant and in danger of converting from affordable units under the federal government's Section 8 program to market-rate housing. Many of the nearby buildings had recently converted to upscale apartments and condominiums, and CommonBond pursued the project in part to demonstrate how to successfully maintain and operate low-income housing in such a neighborhood.

Some projects receive no regulatory relief.

CommonBond rehabilitated the buildings, which remain in the Section 8 program, at a cost of $133,000 per unit. To serve large families, CommonBond increased the average living space per unit and reduced the number of units from 93 to 60. In addition, it added an "advantage center" that provides tenants with services, such as job training, English-as-a-Second Language classes, and children's activities. While CommonBond did not use any specific strategies to reduce its costs, it received government financing. Low-income housing and historic preservation tax credits subsidized 57 percent of the total costs and MHFA mortgages financed 20 percent.[5]

Farmington

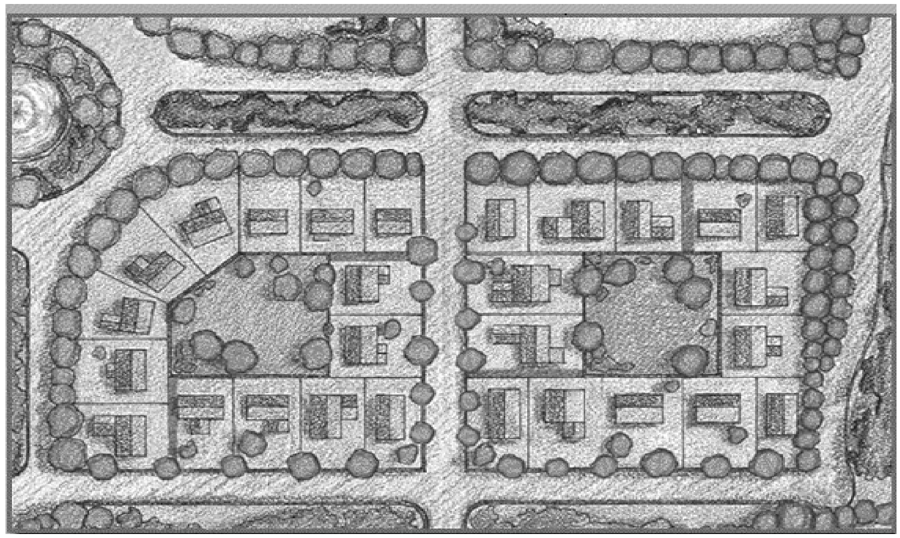
The city of Farmington recognized the need for housing, especially affordable housing, in the early 1990s. At that time, a task force of local officials worked with a developer and the Center of the Urban American Landscape on a plan for a subdivision, called East Farmington, that would accommodate projected population growth while maintaining the small town image and character of Farmington.

East Farmington is a 180-acre development of 374 single-family homes and 16 multifamily units. Now in its seventh and final phase of development, single-family homes are currently selling for $120,000 to $150,000. Three factors account for the relatively low prices. The developer was able to:

- Plat smaller lots – 6,000 to 8,000 square feet;

5 CommonBond Communities, unpublished project description and budget information, undated; and Joe Errigo (CommonBond Communities), interview by authors at the Cathedral Hill Apartments, St. Paul, June 22, 2000.

Figure 3.1: East Farmington Lot Layout



SOURCE: Metropolitan Council, unpublished document. Drawing by Derek Young, Landscape Architecture, for Sienna Corporation.

- Purchase the undeveloped land, which had major drainage problems, for only $8,000 to $10,000 an acre; and
- Obtain tax-increment financing to pay for soil correction and a new waterway that corrects a citywide storm water drainage problem.

East Farmington has a unique design of shared open space and varying housing styles. As shown in Figure 3.1, small parks are situated in the center of each city block with the backyards of 14 to 16 homes adjoining each park. In addition, besides redistributing ground water to the Vermillion River, the new waterway provides park space, wildlife habitation, storm water filtration, and flood control.[6]

Albert Lea

In 1998, the city of Albert Lea initiated a request for proposals for affordable rental housing to meet the city's economic development and workforce needs. Construction of 24 rental townhomes in Pickerel Park will be completed in 2001. Twelve two-bedroom units will rent for $347 a month, and 12 three-bedroom units will rent for $455. The city reduced the project's costs by waiving $34,000 in park dedication, sewer, and water fees and provided $107,000 in tax increment financing for street and utility extensions. The remaining $2.2 million in costs

6 David Olson (city of Farmington), telephone interview by author, October 27, 2000; Rod Hardy (Sienna Corporation), telephone interview by author, October 31 and December 20, 2000; and Sienna Corporation, unpublished project documents, undated.

were financed primarily with $1.3 million from low-income housing tax credits and $500,000 from the Community Development Block Grant program.[7]

Minneapolis

Humboldt Greenway is a redevelopment project in North Minneapolis designed to revitalize an area with deteriorating houses and home values. Aimed at attracting mixed-income homebuyers, the project will be completed in three phases. In Phase I of the project, Hennepin County and the Minneapolis Community Development Agency will develop 36 townhomes and 58 single-family homes. The total cost for each of these units will average over $255,000. The costs would have been even higher if the city had not reduced lot widths from the standard 50 to 55 feet to 42.5 feet, which reduced costs by $25,000 per lot.

The county and city further reduced the average unit cost from $255,000 to $168,000 by selling the site to the developer for $8.2 million less than it cost Hennepin County to acquire and clear the land, which had existing homes. Finally, the city hopes to reduce homebuyer costs for 40 of the 94 homes to about $149,000 by receiving $750,000 ($19,000 per unit) in assistance from MHFA's Community Revitalization Fund and the Metropolitan Council's Inclusionary Housing Account.[8] A $149,000 house is affordable for a household earning 80 percent of the Twin Cities metropolitan area median family income with a 10 percent down payment and a mortgage interest rate just over 7 percent.

Rothsay

Inmate labor is an innovative strategy that has been used to build affordable housing.

The state's Institution/Community Work Crew Affordable Homes Program reduces construction costs by providing inmate labor to housing projects in outstate Minnesota. Under this program, the Department of Corrections recently helped build a three-bedroom rambler with an attached garage in Rothsay, Minnesota. This home with 1,050 square feet of finished space sold for only $65,000. Besides prison labor, a land donation from the city and discounts on building materials led to the low price.

Since the inmate labor program's creation in 1998, 27 new homes have been built, 18 are in final construction, 19 homes have been rehabilitated, and another 60 houses have been repaired. On average, 25 minimum-security inmates participate in the program and earn up to $1.50 an hour. According to the program director, builders would typically pay $10 to $12 an hour for similar labor. However, inmate labor does not account for all labor costs. Technical work such as plumbing, heating, electrical, and excavation is subcontracted at market rates. The Associated General Contractors of Minnesota sponsors classroom training in

7 Newbury Development Company, unpublished project documents, undated; and Denise Derscheid (Newbury Development Company), telephone interview by author, October 5 and November 1, 2000.

8 Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Committee Agenda Item SW 2000-476), October 2, 2000; Cynthia Lee (Minneapolis Community Development Agency – MCDA), letter to Reed Erickson (Minnesota Housing Finance Agency), July 27,2000; Cynthia Lee, telephone interview by author, November 8 and January 3, 2000; and MCDA, unpublished project description and budget documents, undated.

construction skills to the inmates; and local nonprofit agencies, housing and redevelopment authorities, and community action councils develop the projects and sell the homes to households with annual incomes of $10,000 to $41,000.[9]

STRATEGIES USED IN OTHER STATES

As the above examples illustrate, developers and builders often work with local agencies on a case-by-case basis to reduce housing costs through regulatory relief. Several other states have taken more prescriptive approaches by adopting policies that require the development of affordable housing or mandating zoning modifications and other types of regulatory relief for developments that include affordable housing. In 1992, the United States Office of Housing and Urban Development issued *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead*, which provides profiles of these policies.[10] Below, we summarize some of the strategies that the Minnesota Legislature could consider. In the section following these examples, we discuss the Livable Communities Act—Minnesota's current alternative to these more prescriptive strategies.

Montgomery County, Maryland

In Montgomery County, large developments must include affordable housing.

Montgomery County's inclusionary zoning program is often cited as an innovative strategy for increasing the production of affordable housing. Under the program, between 12.5 and 15 percent all units in a residential development of 50 or more units must be affordable for lower-income households. To partially offset the cost of providing lower-income housing, the county increases the development's density 22 percent above the otherwise maximum allowable density.

Nearly 250 units of affordable housing were constructed in 2000 under this program, bringing the total number of units to approximately 11,000 since 1974. A recent example of the program is the Hurley Ridge single-family housing development in Germantown. Without the inclusionary zoning program, the development would have included 110 market-rate single family homes. Instead, the development includes 113 market rate homes and 20 moderately-priced homes. Six of the moderately priced homes will be purchased by the county's housing authority and rented to low-income households.[11]

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9 Ronald Solheid (Minnesota Department of Corrections), interview by author at the Office of the Legislative Auditor, St. Paul, November 17, 2000.

10 United States Department of Housing and Urban Development (HUD), *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead* (Washington DC: HUD, December 1992).

11 Eric Larsen (Director, Moderately Priced Dwelling Unit Program, Montgomery County, Maryland), telephone interview by author, November 14 and 15, 2000; Russ Adams (Alliance for Metro Stability), interview by authors at the Alliance for Metro Stability, Minneapolis, November 7, 2000; and Russ Adams, "Inclusionary Housing: How the Model has Worked in Other States," *Common Ground* (Winter 1999), 7.

California

In California, local governments must provide regulatory relief to developments with affordable housing.

California has a policy similar to Montgomery County, Maryland, but housing developers are not required to participate. Under California law, local governments must increase a development's density by at least 25 percent above the otherwise maximum allowable density if the developer chooses to make at least:

- 20 percent of a development's units affordable for households with incomes below 80 percent of the median family income; or
- 10 percent of the units affordable for households with incomes below 50 percent of the median family income.

Developers can also take advantage of the increased density provision if they construct senior housing. Besides the increased density, cities must provide additional incentives, including reduced development or zoning standards, other regulatory savings, or financial assistance. According to the California Local Governments Commission, 45 cities and 7 counties have gone one step farther and have required developers to provide affordable housing. The percentage requirement for affordable housing in these communities ranges from 5 percent in Coronado, California to 35 percent in Davis, California.[12]

Massachusetts

The state of Massachusetts can override local zoning restrictions.

The state of Massachusetts has adopted a set of procedures that effectively allows the state to over-ride local zoning restrictions for certain affordable housing developments. In 1969, Massachusetts passed legislation setting the goal that 10 percent of each municipality's housing stock should be subsidized for low-income households. To achieve the goal, the state enacted a process through which developers can get waivers from local regulations that limit the construction of subsidized housing. Public agencies and developers who want to build federal- or state-subsidized housing can apply for a comprehensive permit from their local zoning boards—"one-stop shopping" for all local approvals, including zoning modifications and permits. In developing a comprehensive permit, the zoning board works with the other local entities normally involved in the permitting process (including the city council) to balance the community's need for affordable housing with other planning and environmental concerns.

If a municipality's local zoning board denies a comprehensive permit or grants it with conditions that make the project financially infeasible and less than 10 percent of the municipality's housing stock is subsidized, the developer can appeal the decision to the state's Housing Appeals Committee (HAC). The HAC has the authority to issue its own comprehensive permit and preempt local regulations, including zoning restrictions. During the appeals process, the burden falls on the municipality to prove that there are valid health, safety, environmental, design, open space, or other concerns that outweigh the need for subsidized

12 Robert Maus, (California Department of Housing and Community Development), telephone interview by author, November 28, 2000. The California law is government code section 65915.

housing. In the end, a municipality can either accommodate subsidized housing (for example, by allowing higher densities) or argue its case before the HAC.

Because of the decentralized nature of the process, it is difficult to determine how many affordable housing proposals developers have presented to local zoning boards since the program began. The Chair of the HAC estimates about 1,000 proposals have been presented. Of the more than 300 appeals that developers have brought to the state, the HAC has written over 100 substantive decisions, and about one-third of the decisions approving a housing development have been appealed in the courts. To date, no comprehensive permit issued by the HAC has been over overturned in court. However, only 23 of Massachusetts' 351 municipalities have achieved the 10 percent threshold for subsidized housing—the majority of which are cities rather than suburban or rural communities.[13]

New Jersey

New Jersey courts have required municipalities to provide affordable housing.

In a series of decisions involving the township of Mount Laurel (1975, 1983, and 1986), the New Jersey Supreme Court ruled that, under the general welfare provision in the state's constitution, municipalities cannot exclude housing for low- and moderate-income households. In addition, the court ruled that localities must provide their fair share of affordable housing and authorized specific judicial remedies to ensure that municipalities meet these obligations.

In 1985, the New Jersey Legislature established an alternative to court action by creating the Council on Affordable Housing (COAH), which defines regional needs for affordable housing, develops guidelines for municipalities to meet their fair share requirements, and reviews local housing plans. If a municipality elects the COAH process and has its housing plan certified, it has a level of protection from judicial remedies. The COAH process provides municipalities with a range of options to meet their affordable housing needs, such as (1) granting increases in density to developers in exchange for building affordable housing, (2) collecting development fees on residential and nonresidential projects to subsidize affordable housing, and (3) transferring a portion of their affordable housing obligation to another municipality.[14]

MINNESOTA'S LIVABLE COMMUNITIES ACT

The 1995 Livable Communities Act (LCA) is one of Minnesota's recent attempts to encourage the production of affordable housing in the Twin Cities seven-county area.[15] The LCA is a voluntary, incentive-based program administered by the

13 Werner Lohe, "The Massachusetts Comprehensive Permit Law: Collaboration Between Affordable Housing Advocates and Environmentalists," *Land Use & Zoning Digest* (May 2000), 3-9; and HUD, *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead,* 15-18.

14 Sinda Mitchell, *COAH Handbook, 2000-2001* (Trenton, NJ: Council on Affordable Housing), 3; and HUD, *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead*, and 23-25.

15 *Minn. Stat.* (2000) §§473.25-473.255.

Metropolitan Council. The LCA is not strictly an affordable housing program, but rather a community development program that emphasizes affordable housing. We examined the program's affordable housing components, and found that:

- **The Livable Communities Act has been only marginally successful in producing affordable housing in the Twin Cities metropolitan area.**

Minnesota's Livable Communities Act is a voluntary, incentive-based program.

The LCA is relatively weak by design. During each of the two legislative sessions prior to its 1995 passage, the Legislature adopted a more stringent housing bill. The Comprehensive Choice Housing Bill would have required the Metropolitan Council to declare annually whether each municipality in the metropolitan area provided a pre-determined "fair share" of affordable housing. Municipalities that failed to do so could have satisfied the requirements of the act by complying with the Metropolitan Council's directions to (1) eliminate barriers to affordable housing, (2) allow proposed affordable housing developments in the community, and (3) preserve the affordability of existing housing into the future.[16] Municipalities unwilling to meet the requirements would have faced serious penalties, including a loss of state revenue-sharing payments and the ability to use tax increment financing. Although the penalties were removed from the final version of the bill in both 1993 and 1994, Governor Carlson still vetoed the bill in both years.[17] In the end, the Livable Communities Act replaced requirements and penalties of the earlier bill with voluntary participation and incentives.

As shown in Figure 3.2, 104 of 186 metropolitan municipalities currently participate in the program, including Minneapolis, St. Paul, and nearly every major suburb. Municipalities that elect to participate in the LCA must negotiate housing goals with the Metropolitan Council.[18] The goals address (1) affordable housing, (2) the mix of rental versus owner-occupied housing, and (3) housing density. In reviewing the goal-setting process, we found that:

- **The Metropolitan Council bases each municipality's affordable housing goals on its location and level of development, *not* on projected needs for affordable housing.**

Each municipality's affordable housing goals are based on "benchmarks" that the Council developed by determining the average proportion of affordable housing in municipalities within similar geographic locations and at similar stages of growth and development. If the proportion of affordable housing in a municipality is below the benchmark, the Council attempts to negotiate goals that would increase the proportion of affordable housing. Some municipalities already meet or exceed the benchmark range, including Minneapolis, St. Paul, and several older suburbs. These municipalities typically have goals of "maintaining within the benchmark"—which does not include producing additional affordable housing. Thus, the LCA goals-setting process encourages increased production of

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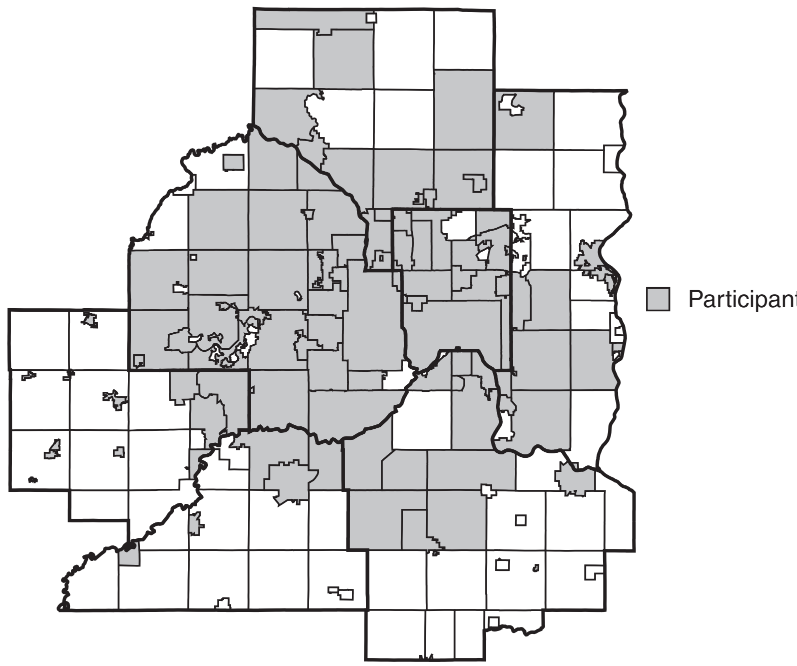
16 Myron Orfield, *Metropolitics* (Washington D.C.: Brookings Institution Press, 1997), 114-15 and 131-33. Also see, *Comprehensive Choice Housing Act of 1993*, 77th Session (House File 671), and *Comprehensive Choice Housing Act of 1994*, 78th Session (House File 2171).

17 Orfield, *Metropolitics*, 121 and 131.

18 Technically, communities elect to participate in the Local Housing Incentive Accounts program, which enables them to compete for LCA funding (*Minn. Stat.* (2000) §473.254).

Figure 3.2: Participants in the Livable Communities Act, 2000



SOURCE: Metropolitan Council.

Few municipalities produce affordable housing consistent with their Livable Communities Act goals.

affordable housing in the developing suburbs, but is *not* linked to the region's affordable housing needs.

The Metropolitan Council estimates that if each municipality met its affordable housing goals, 77,200 new affordable units would be added to the region between 1995 and 2010, including 12,600 rental and 64,600 owner-occupied units.[19] But few municipalities have produced affordable housing at a rate consistent with their LCA goals. Based on affordable housing production rates between 1996 and 1998, the Council estimates that the region will produce only 84 percent of the anticipated units by 2010. However, the Council acknowledges that this estimate is probably too high because land costs were not explicitly factored into the home values reported in 1996 and 1997.[20] Table 3.2 shows the Twin Cities metropolitan area municipalities that produced the most housing in 1998 and the percentage of affordable units produced by each.[21] The 1998 data included land costs.

19 John Kari and Guy Peterson (Metropolitan Council, Livable Communities and Housing Division), memorandum to Housing and Land Use Advisory Committee, July 26, 2000.

20 Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, (St. Paul, December 1999), 14.

21 According to data from the Council's LCA survey, 55 percent of the affordable units built in 1998 were either duplexes, townhomes, or quads (Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, Appendix 4 and 16).

Table 3.2: Twin Cities Area Communities Producing the Most Housing, 1998

	Total Units Produced	Affordable Units	Affordable Units as Percentage of Total Production
Woodbury	1,854	707	38%
Lakeville	680	97	14
Shakopee	643	388	60
Blaine	587	252	43
Savage	511	64	13
Maple Grove	450	67	15
Chanhassen	425	144	34
Inver Grove Heights	398	130	33
Brooklyn Park	378	23	6
Coon Rapids	308	274	89
Eden Prairie	308	79	26
Minneapolis	301	98	33
Farmington	300	173	58
Apple Valley	295	44	15
Plymouth	288	71	25
Eagan	273	102	37
Champlin	233	56	24
Minnetonka	230	6	3
Lino Lakes	220	29	13
Cottage Grove	218	91	42
Prior Lake	214	28	13
Burnsville	213	160	75
Waconia	197	97	49
Chaska	195	43	22
Rosemount	190	65	34

NOTE: Communities that did not report housing production or affordability information to the Metropolitan Council are excluded from the table (including Bloomington).

SOURCE: Office of the Legislative Auditor's analysis of data from Metropolitan Council, *Report to the Minnesota Legislature on Affordable and Life-Cycle Housing* (St. Paul, December, 1999), Appendix 4 and 16.

We think there are shortcomings with the system of benchmarks and goals that the Metropolitan Council has implemented. For example:

- **While the Council collects data on each municipality's housing supply, reflecting the addition of new units and the loss of affordable units through market inflation, it does not use these data in administering the LCA program.**

For example, in 1995 the Council estimated that 69 percent of the single-family homes in Burnsville were affordable. By 1997 the proportion had fallen to 46 percent, according to the Department of Revenue data published by the Council.[22] Despite this change, the Council has not changed the affordable housing profile of Burnsville, or other municipalities, that the Council uses for administering the

22 *Ibid.*, Appendix 9.

LCA. Metropolitan Council staff indicated to us that the Council is likely to revise the LCA's benchmarking and goal-setting system after the 2000 census data are released.

Besides negotiating goals with the Metropolitan Council, participating municipalities must also show that they have spent a statutorily-defined amount of money on affordable housing each year.[23] Municipalities can satisfy the requirement by allocating funds over which they have discretion to affordable housing, including facilitating federal funding of local projects and supporting their local housing and redevelopment agency. According to the Metropolitan Council:

- **In practice, nearly every municipality has easily met the Livable Communities Act's spending requirement for affordable housing.**[24]

The LCA spending requirement is a complex formula that requires municipalities that have experienced an increase in the number of very expensive homes, either through new housing or market appreciation, to spend more on affordable housing. In practice, most participating municipalities are required to spend less than $10,000 annually, and many have requirements below $2,000. In 1998, Eden Prairie had the highest requirement ($111,068), followed by St. Paul ($76,776), Minneapolis ($51,585), and Apple Valley ($38,022).

The Metropolitan Council cannot reject inadequate housing action plans.

Beyond the actual requirements, the LCA sets forth additional expectations for participating municipalities. For example, every municipality that participates in the LCA is expected to "identify to the Council the actions it plans to take to meet the established housing goals."[25] But, the Metropolitan Council is not empowered to reject inadequate housing action plans, and the action plans are not legally binding documents. Similarly, the LCA requires the Metropolitan Council to prepare annually a "comprehensive report card on affordable and life-cycle housing in each municipality,"[26] but municipalities are not mandated to provide the Metropolitan Council with the information necessary to produce an accurate and comprehensive report. While many municipalities have undertaken serious housing action plans and have completed the annual Livable Communities Act survey, the Metropolitan Council's lack of statutory authority in these areas hinders its ability to monitor each municipality's progress toward the negotiated housing goals.

As an incentive for participation, municipalities can compete for grants from the Livable Communities Fund, which is made up of the four accounts shown in Table 3.3. Compared with many of the programs administered by the Minnesota Housing Finance Agency (MHFA), the accounts in the Livable Communities Fund

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23 The "affordable and life-cycle housing opportunities amount" (ALHOA), is defined in *Minn. Stat.* (2000) §473.254, subd. 4.

24 Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, Appendix 13. Council staff indicated that North Oaks is the only community ever required to contribute the amount toward a housing fund at the year's end because of failing to expend the amount during the year. North Oaks no longer participates in the LCA.

25 *Minn. Stat.* (2000) §473.254, subd. 2.

26 *Minn. Stat.* (2000) §473.254, subd. 10. "Life-cycle housing" refers to housing appropriate for each stage of life (e.g., rental housing for young adults and supported living for seniors).

Table 3.3: Accounts in the Livable Communities Act Fund

Tax Base Revitalization Account (TBRA)
This account funds "the cleanup of polluted land in the metropolitan area."[1] The TBRA is the largest account in the fund, accounting for approximately half of the fund's grants ($5.4 million to $8 million annually). This account is administered in coordination with the Department of Trade and Economic Development's Contaminated Site Cleanup Program,[2] and Minnesota Pollution Control Agency staff reviews applications for TBRA funding.

Livable Communities Demonstration Account (LCDA)
These grants fund "smart growth" initiatives, including projects that (1) interrelate development and transit, (2) interrelate affordable housing and job growth, (3) promote compact development, (4) involve mixed income development, or (5) "encourage public infrastructure investments which connect urban neighborhoods and suburban communities."[3] The LCDA is the second largest account in the fund, granting $4.0 million to $5.8 million annually. A 17-member Livable Communities Advisory Committee reviews applications for LCDA funding.

Local Housing Incentives Account (LHIA)
This account funds both affordable and life-cycle housing projects.[4] The LHIA is the smallest of the three original accounts, providing grants totaling $625,000 to $1,935,000 annually. Communities are required to match the grants from this account dollar for dollar. The Metropolitan Council administers this account through the Metropolitan Housing Implementation Group's "super RFP" process, which enables applicants to simultaneously apply for funding from the Minnesota Housing Finance Agency, the Metropolitan Council, and philanthropic organizations. Nearly all of the grants provided through this account are small, $200,000 or less, and make up only a fraction of project costs (most projects are in the $3-$5 million range).

Inclusionary Housing Account (IHA)

This is the newest account in the fund, established in 1999, and the only account funded by a legislative appropriation, rather than the Metropolitan Council's tax capacity. Grants from this account target projects that "(1) use innovative building techniques or materials to lower construction costs while maintaining high quality construction and livability; (2) are located in communities that have demonstrated a willingness to waive local restrictions which otherwise would increase costs of construction; and (3) include units affordable to households with incomes at or below 80 percent of area median income."[5] The Legislature provided a one-time appropriation of $4.0 million for the 2000-01 biennium and the Metropolitan Council has since committed all the funding by assisting 11 projects. Like the LHIA, the Council administers the IHA through the super RFP process in conjunction with the Minnesota Housing Finance Agency and others.[6]

[1] *Minn. Stat.* (2000) §473.252, subd. 3.

[2] LCA participation is also required for Twin Cities metro area communities interested in receiving funds from DTED's $6.2 million annual Contaminated Site Cleanup Program. Thus, between two programs, LCA participation enables communities to compete for $11 million. In recent years virtually all of the TBRA funds have gone to fully-developed communities, primarily Minneapolis and St. Paul.

[3] *Minn. Stat.* (2000) §473.25.

[4] *Minn. Stat.* (2000) §473.254, subd. 5.

[5] *Minn. Stat.* (2000) §473.255, subd. 2.

[6] The Minnesota Housing Finance Agency was also awarded $4.0 million for the *non*metropolitan innovative and inclusionary housing program (under *Minn. Stat.* (2000) §462A.2093; *Minn. Laws* (1999) ch. 223, art. 2, sec. 54).

Participating communities can compete for limited funding for affordable housing.

provide relatively little funding. In addition, the two accounts specifically designated for affordable housing—the Local Housing Incentives Account (LHIA) and the Inclusionary Housing Account (IHA)—are the smallest accounts in the fund.[27] Furthermore, the Legislature only provided the IHA with a one-time appropriation for the 2000-01 biennium. Metropolitan Council staff indicated that they annually receive several more proposals for affordable housing projects than they are able to fund.

As another incentive for LCA participation, the Metropolitan Council must "give consideration to a municipality's participation" when making discretionary funding decisions.[28] According to staff, the Metropolitan Council did not link LCA participation with discretionary spending decisions before 1999. However, the current council is more interested in doing so. For example, the Metropolitan Council recently incorporated LCA participation into the criteria for two sets of grants administered by the Environmental Services Division—the Metro Environment Partnership program, and a program related to storm water run-off. In 2000, Mahtomedi's application for a grant from the latter program was not fully funded because the city did not participate in the LCA at the time.

In reviewing the LCA statute and discussing the program with Metropolitan Council staff and others, we found that:

- **The Livable Communities Act rewards participation, not performance; a municipality does not need to increase its supply of affordable housing to receive benefits from the program.**

There are three possible explanations for this. First, the statute explicitly mentions that discretionary funding decisions can be linked with "participation," without explicitly indicating whether participation includes actually making progress toward the act's goals.[29] At the same time, the Metropolitan Council's *Regional Blueprint* states that the Council will "give priority for regional infrastructure investments or expenditure of public dollars to municipalities that have implemented plans to provide their share of the regions low- and moderate-income … housing opportunities."[30] The policy goes on to state that, "six months after establishing criteria for reviewing housing elements of comprehensive plans, [the council shall] take into account the progress made by cities toward life-cycle and affordable housing goals when making discretionary housing decisions."[31]

Second, Council staff told us that linking funding to a municipality's success in producing affordable housing could be counterproductive because performance-based evaluations may discourage municipalities from participating in the program, especially those that are not inclined to consider affordable housing. Additionally, denying municipalities the opportunity to compete for

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27 As noted in Table 3.3, affordable housing is also one of many goals set for the Livable Communities Demonstration Account (LCDA) in statute. Council staff indicated that most projects that have recieved LCDA grants include an affordable housing component.

28 *Minn. Stat.* (2000) § 473.254, subd. 1 (b).

29 *Ibid.*

30 Metropolitan Council, *Regional Blueprint* (St. Paul, 1996), 57.

31 *Ibid.*

affordable housing funds only adds to the difficulties that municipalities have in producing affordable housing.

Third, maintaining an adequate supply of affordable housing is very difficult. As we noted in Chapters 1 and 2, housing prices are rising rapidly in the current market, and the production of affordable housing typically requires financial assistance. A 1997 report by a task force studying the LCA found that there were not enough subsidies available to enable municipalities to meet the affordable housing goals negotiated by LCA participants.[32]

Despite the arguments against linking funding decisions to the production of affordable housing, the LCA directs the Metropolitan Council to create "incentives for developing municipalities to include a full range of housing opportunities."[33] The Council has recently taken steps in this direction by developing a proposal to include affordable housing considerations in the criteria it uses to award community development, environmental protection and clean up, and transportation funding.[34] Under the proposal, a maximum of 100 points out of the Council's 1,400 point system for rating funding requests will be linked to a municipality's (or sub-region's) supply of affordable housing.[35] An additional 250 points will be linked to "smart growth" initiatives, which the Council contends will also bring down housing costs.

The Livable Communities Act has led some municipalities to focus more attention on affordable housing.

Despite the criticism and shortcomings noted above, the Livable Communities Act has caused municipalities in the Twin Cities metropolitan area to focus some additional attention on providing affordable housing. Metropolitan Council staff said that this is one of the LCA's main benefits. Although many municipal officials that we interviewed said that their communities were attempting to address affordable housing needs prior to the LCA, many also indicated that the LCA had caused their communities to focus additional attention on affordable housing. Some specifically mentioned developing housing action plans, while others noted applying for LCA funding. Officials from municipalities that received LCA funding generally indicated that this funding was a small but crucial part of financing projects in their community. We also found limited evidence that community officials sometimes use LCA requirements to build community support for providing additional housing opportunities.[36]

While outstate Minnesota lacks an equivalent to a Livable Communities Act to encourage affordable housing, the Legislature also created the Economic Vitality and Housing Initiative (EVHI) in 1995. The EVHI was established to counteract

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32 The Livable Communities Housing Task Force, *Promises Deferred: Analysis of the Affordable Housing Provisions of the Livable Communities Act* (St. Paul: The Livable Communities Task Force, 1997), 13-17.

33 *Minn. Stat.* (2000) §473.25.

34 Ted Mondale, Metropolitan Council Chair, and Matthew Ramadan, Livable Communities Committee Chair, to Local Official or Interested Person, November 15, 2000, letter. The Council currently plans to hold public hearings in February and adopt the new policy in March, 2001.

35 John Kari, Guy Peterson, and Bill Dermody (Metropolitan Council), memorandum to the Livable Communities Committee, August 25, 2000.

36 For example: Heather Johnson, "Lakeside Townhomes Foes get no Satisfaction," *St. Paul Pioneer Press*, November 5, 1999, 2B; Nancy Ngo, "Owned vs. Rented Units Debated," *St. Paul Pioneer Press*, February 19, 2000, 1B; Mike Kaszuba, "Maple Grove Nails a Winning Strategy," *Minneapolis Star Tribune*, November 18, 1999, 1B.

Outstate Minnesota lacks an equivalent to the Livable Communities Act.

potential reluctance from businesses to locate or expand in areas that do not have enough affordable housing for their employees. The 1995 EVHI legislation stated:

> The Minnesota Housing Financing Agency may establish an economic vitality and housing initiative to provide funds for affordable housing projects in connection with local communities' economic development and redevelopment efforts. The purpose of the economic vitality and housing initiative is to provide resources for affordable housing in communities throughout the state necessary to ensure the expansion and preservation of the economic base and employment opportunities.[37]

The MHFA funds the initiative, primarily through its Affordable Rental Investment Fund, Community Rehabilitation Fund, and Capacity Building Grant. The first two programs are described in Tables 2.7 and 2.8, while the last program is a flexible pool of funds for increasing a region's capacity to maintain or create affordable housing.

In addition, the EVHI created six regions in outstate Minnesota. Housing, economic development, and related organizations in each region have created regional advisory groups to work with MHFA staff. These advisory groups:

- Develop investment guidelines that (1) outline the type of development that the region needs, (2) set priorities for regional investment, and (3) identify areas experiencing significant economic growth;
- Inform MHFA staff about regional trends, economic activity, and housing needs;
- Decide how the regional Capacity Building Grant should be spent; and
- Provide a forum for better housing resource coordination and information sharing.

MHFA staff meets with each regional advisory group quarterly and uses the advisory groups' investment guidelines in making its funding decisions.[38]

CONCLUSION

In Minnesota, most affordable housing is produced through local efforts in response to local needs. Housing developers and city officials put together housing projects on a case-by-case basis by combining funding from several sources with zoning variances and fee waivers. While some other states have chosen more systematic approaches, by requiring the production of affordable housing, Minnesota's Livable Communities Act is a voluntary, incentive-based approach to providing affordable housing that has been only marginally successful in producing more affordable housing.

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37 *Minn. Laws* (1995), ch. 255, art 2, sec. 16.

38 Minnesota Housing Finance Agency, *Economic Vitality and Housing Initiative*, http://www.mhfa.state.mn.us/images/EVHIhist.htm; accessed February 14, 2000.

Survey of Developers, Builders, and Local Housing Organizations

APPENDIX A

In July 2000, we sent a questionnaire on housing topics to 1,106 developers, builders, and local housing organizations. We surveyed these organizations to document what the people most directly involved with producing housing think are the most important factors limiting the production of affordable housing in Minnesota. We asked respondents to rate a series of factors that potentially limit the production of affordable housing. We developed the list of factors through a review of the housing literature and interviews with people active in Minnesota's housing industry. The list included: (1) financing issues, (2) local zoning or subdivision ordinances or development standards, (3) land-use policies other than local zoning or subdivision ordinances, (4) standards from the state building or fire code, (5) development or construction fees, (6) taxes, (7) other government policies or programs, (8) reaction from the community, and (9) cost of labor, materials, or land. We purposefully used broad categories, rather than specific policies, to avoid leading respondents to certain responses. In addition we encouraged respondents to provide their own specific examples. We also sought to identify factors not included in our list by asking respondents who were not producing affordable housing "why not?" and by providing space for respondents to suggest other factors. Finally, we sought to identify the key resources and strategies used by companies and organizations that have recently produced affordable housing.[1]

We identified builders primarily through a membership list provided by the Builders Association of Minnesota. We randomly sampled 600 of the 1,300 companies and individuals listed as "builders." We attempted to survey all known and active developers in Minnesota by developing a list of 229 developers with assistance from the Minnesota Housing Finance Agency (MHFA), the Builders Association of Minnesota, the Minnesota Multi Housing Association, and through interviews. Some of the developers that we identified were also in the Builders Association's list of builders. As shown in Table A.1, we sent questionnaires to 783 developers and builders and received responses from 382 (49 percent).

We also attempted to survey all local housing organizations producing housing; including local governments, housing and redevelopment authorities, and nonprofits. We surveyed all members of the Minnesota Chapter of the National Association of Housing and Redevelopment Officials, the Minnesota Association of Local Housing Finance Agencies, and the Community Action Association, as well as additional governmental and nonprofit organizations who applied to MHFA for funding from the fall of 1998 through the spring of 2000. In all, we sent 323 questionnaires to local housing organizations and received responses from 231 (72 percent).

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1 The complete questionnaire can be found on our website at http://www.auditor.leg.state.mn.us/ped/2001/pe0103.htm.

Table A.1: Number of Questionnaires Sent, Returned, and Analyzed

	Sent	Returned	Response Rate	Analyzed (Produced at Least One Unit in 1999)
Developers and Builders	783	382	49%	290
Local Housing Organizations	323	231	72	149
TOTAL	1,106	613	55	439

SOURCE: Office of the Legislative Auditor.

We restricted our analysis to those organizations who produced housing in 1999. Thus, we analyzed the responses of a sub-sample of 439 respondents, including 50 developers, 143 builders, 97 companies that develop and build, and 149 local housing organizations. We restricted the analysis further when examining the results of certain questions. For example, when analyzing factors that limit the production of affordable multifamily housing, we only examined responses from those who had produced multifamily housing.

Our survey should not be interpreted as generalizable to the actual population of developers, builders, and local housing organizations in Minnesota, but rather as representative of those who responded to our survey, which we attempted to make as representative as possible. Due to uncertainty over the actual size of the populations we surveyed, we cannot provide any standard errors around our results or estimate the precision of the results. In order to avoid misrepresenting our results as precise or representative, we generally avoided using numbers or percentages when reporting results in the body of this report.

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January 18, 2001

James Nobles
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Dear Mr. Nobles:

Thank you for the opportunity to comment on the findings and conclusions in your January 2001 report, *Affordable Housing*. The Metropolitan Council appreciates the hard work and breadth of research necessary to produce this report. The Council's staff has found staff of the legislative Auditor to be highly professional and this report to be thorough and informative.

We do, however, respectfully disagree with the finding in the report that the "Livable Communities Act has been only marginally successful in producing affordable housing in the Twin Cities." The Livable Communities Act (LCA) has been very successful in encouraging local government to address affordable and life-cycle housing issues. The LCA is not housing production legislation.

Drafted at a time of great divisiveness over whether affordable housing efforts by local government should be mandated or encouraged through incentives, the LCA of 1995 represents an innovative piece of community development legislation that offers a modest amount of funds to assist pollution cleanup efforts, examples of good planning and development practices, and affordable housing.

As a requirement to be able to compete for these funds, local governments must enlist in the LCA housing incentives program and negotiate affordable and life-cycle housing goals with the Council.

Communities have done this. In 2001, 103 communities, including all but a handful of sewered cities, are participants in the LCA. They have negotiated goals to add over 12,000 affordable rental units and over 64,000 affordable ownership units by 2010. Certainly, the $1.5 million available annually in the LCA for affordable housing makes it clear the LCA is not a housing production tool.

LCA implementation has been about raising communities' awareness and commitment regarding affordable and life-cycle housing, and, with limited funds, getting cities to collaborate on new smart development initiatives, and the economic revitalization and reuse of land. In this regard, the Metropolitan Council believes the LCA has been very successful. The production of affordable housing is not proceeding at a pace to accomplish the LCA goals because, as the report so aptly details, there are a myriad of economic and social factors at work against affordable housing production and preservation.

These impediments not withstanding, the Council continues its efforts to promote, assist and produce affordable housing. Through implementation of its Smart Growth development policy that encourages housing diversification and linkage to employment opportunities, through its efforts to convene and coalesce local government around affordable housing issues in the Mayors Regional Housing Task Force, and through its Family Affordable Housing Program to develop Hollman public housing opportunities in the suburbs, the Council is advancing the cause of affordable and life-cycle housing.

Regarding the report's discussion about the Metropolitan Urban Service Area, it fails to mention that the Metropolitan Council is currently working with the Builders Association of the Twin Cities (BATC) and local governments to further our understanding of land availability. The Council and BATC are undertaking a collaborative, in-depth analysis to gain a full understanding of the amount of land available for development in five high-growth communities. All parties agree that the region will be served with an accurate assessment of available land.

Again, thank you for the report and the opportunity to comment. We believe the report offers a thorough explanation of why, despite the best efforts of all of the players in the affordable housing arena, greater measures will be necessary realize any significant progress in addressing this important issue.

Sincerely,

/s/ Jay R. Lindgren

Jay R. Lindgren
Regional Administrator