

# Closing the Housing Gap

## Housing Affordability in Minnesota

December 2006



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Minnesota HOUSING Partnership



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Thriving communities require a range of housing opportunities. Minnesota is recognized as a national leader for its commitment to helping families with affordable ownership and rental housing, and has consistently maintained one of the highest homeownership rates in the country.

Nevertheless, housing has become too costly for growing numbers of low- and moderate-income Minnesotans. Some of the factors contributing to this decline in affordability include:

- Stagnating wages that have failed to keep up with rising housing costs.
- Increases in housing development costs, while federal and state funding for affordable housing has been scaled back.
- An overall loss of privately-owned affordable units as a result of market pressure, expiration of subsidized housing contracts, and condo conversions.

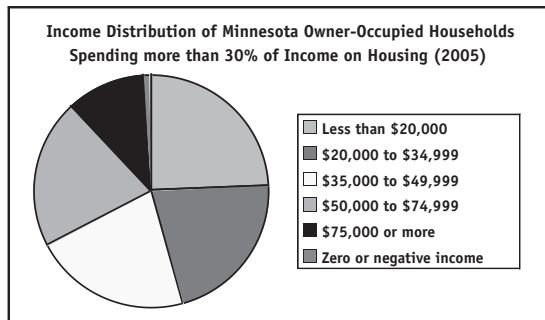
As housing affordability erodes, the number of Minnesotans burdened with excessive housing costs has grown dramatically, leaving thousands of households vulnerable to homelessness as they choose between housing and other basic needs.

While Minnesota is confronted with many housing challenges, they can be met with strong leadership and continued partnerships between the private and non-profit sectors, faith communities, philanthropic organizations, and all levels of government. Minnesota’s economy, when compared with other states, is strong on many fronts. Even in a time of constrained public spending, our relative prosperity allows us a unique opportunity to address the housing challenges we face.

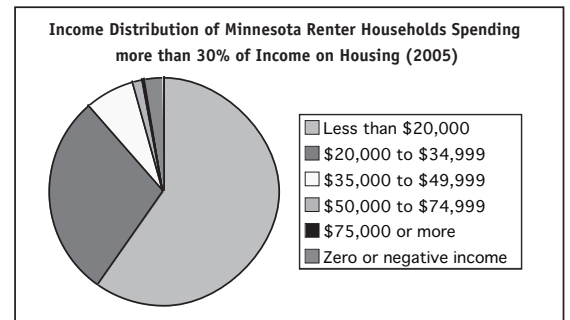
### What Does Affordability Mean?

In general, housing is considered affordable when it consumes no more than 30 percent of gross household income. When individuals and families spend more than 30 percent of their income on housing, they are considered “cost burdened,” and may not have enough money left over to weather financial setbacks or afford other basic needs, including food, medical insurance, and education.

than that earned by one-half of Minnesota households—in order to afford only basic necessities and spend no more than 30 percent of income on monthly rent.<sup>2</sup>



Source: American Community Survey (2005)



Source: American Community Survey (2005)

Some higher-income households do make a lifestyle choice to spend more money on housing. However, the vast majority of cost-burdened households have an annual income well below the state median. In 2005, more than two-thirds of cost-burdened owners and almost 100 percent of cost-burdened renters in Minnesota earned an annual income lower than the median household income of \$52,024.<sup>1</sup>

Based on research conducted by the Jobs Now Coalition, a four-person family with two working adults would need to earn at least \$53,500 each year—an amount slightly greater

### Why Does Housing Affordability Matter?

A full range of housing opportunities allows people at a range of income levels to hold steady jobs and pursue education. With safe, secure housing children can focus on school and play without worrying about when they will move again. Senior citizens and others with fixed incomes can live with dignity, without having to choose between housing and other necessities such as food and prescription medications. Workers who provide essential services, including firefighters, childcare workers, and medical assistants, can live in the communities they serve.



Having a supply of housing with prices matched to the income levels of local workers also contributes to Minnesota’s economic vitality, allowing employers to recruit and retain a quality workforce. Employees who do not have to endure long commute times are likely to have greater productivity and lower levels of absenteeism than those who cannot afford housing in close proximity to their place of employment.

## Dimensions of the Affordable Housing Challenge

As fundamental as housing is, it is not available and affordable to many Minnesotans. Produced in collaboration with the leading housing institutions in Minnesota, the BBC Research and Consulting report *The Next Decade of Housing in Minnesota* indicates that in 2000 there were nearly 300,000 cost-burdened, low-income households in the state. According to the report, by 2010 an additional 32,800 low-income households will need affordable housing; this projection will grow if there is any reduction in private market development or public and philanthropic funding of affordable housing.<sup>3</sup>

## Why is Housing Affordability Declining?

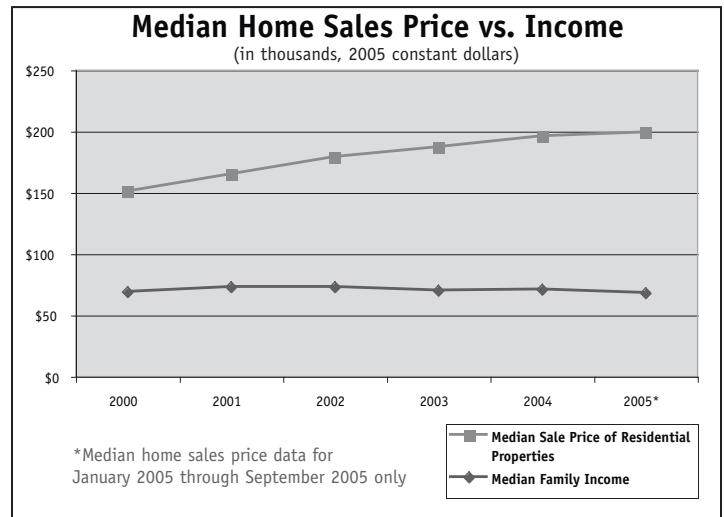
There is no single explanation for declines in housing affordability; rather, a variety of factors have converged to drive the cost of housing too high for many families. These include housing costs that have risen at a faster pace than wage levels; increases in development costs as the funds available for affordable housing have been cut; and the shrinking number of privately owned housing units affordable to low- and moderate-income families.

### Stagnating Wages Have Failed to Keep up with Growing Housing Costs

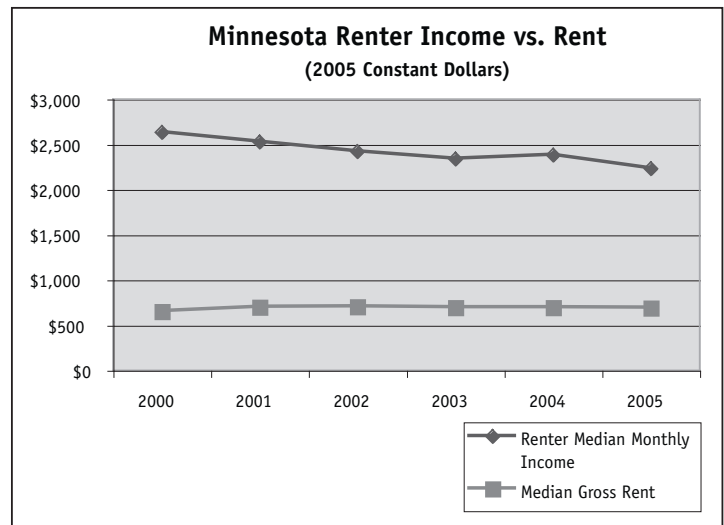
Since the late 1990s, home prices across the country have risen to record-breaking heights. Between 2000 and September 2005, the median home sales price in Minnesota grew by nearly 32 percent after adjustment for inflation. Even if home prices had stayed stable, however, homeownership would have remained unaffordable for a growing number of low- and middle-income households, as a result of falling wage levels. As housing prices increased, the median family income in Minnesota actually fell slightly.

Rental housing has also become less affordable. Between 2000 and 2005, the median rental household income fell by more than 15 percent after adjustment for inflation, while the median gross rent for an apartment in Minnesota increased by nearly 6 percent.

In 2000, a typical renter household in Minnesota earned \$27,852 annually and spent 25 percent of income on rent. By 2005, a typical renter household earned only \$26,755 annually and spent more than 30 percent of income on rent.



Source: Minnesota Revenue Department, *Sales Ratio Study (2000-2005)*; National Low Income Housing Coalition, *Out of Reach (2000-2005)*



Source: American Community Survey (2000-2005)

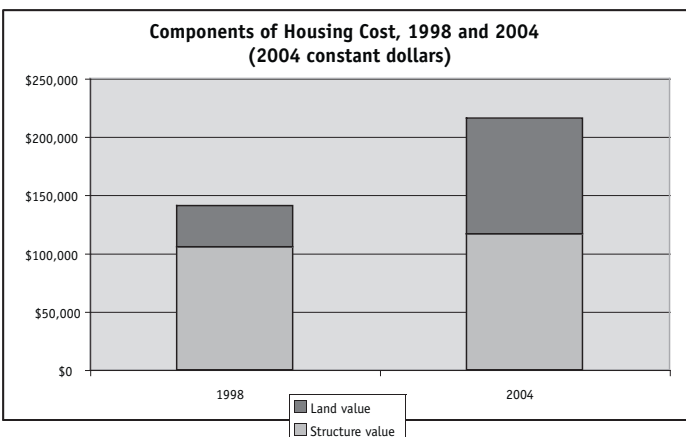
According to *The Next Decade of Housing in Minnesota*, low-income households will comprise more than one-half of the new households in the state between 2000 and 2010. With earnings failing to keep up with the escalating cost of renting or owning a home, housing affordability will be increasingly difficult to achieve, particularly for these new Minnesotans.

### Development Costs are Increasing as Federal and State Funds for Affordable Housing are Scaled Back

Housing affordability is also being compromised as a result of continued growth in development costs. While construction wages have actually fallen slightly in the past year,

building materials and land costs have continued to climb.<sup>5</sup> Land cost, in particular, plays an increasingly essential role in determining housing affordability, making up a growing percentage of overall home value over the past 20 years. According to a recent study, land costs accounted for 46 percent of home value in the Twin Cities metropolitan area in 2004, a significant increase from 1984, when land's share of home value was only 12 percent.<sup>6</sup>

With land costs both rising and accounting for a growing share of home value, housing affordability has declined.<sup>7</sup> For example, in 1998, a median-priced home in the Twin Cities cost \$121,500, with 25 percent of this cost, \$30,375, attributable to land.<sup>8</sup> In 2004 a typical home in the region cost \$216,050, and land costs accounted for 46 percent of this total, or \$99,383.<sup>9</sup> This means that while the median home sales price increased by more than 50 percent between 1998 and 2004 after adjustment for inflation, the cost of land alone nearly tripled, increasing by more than 180 percent.



Source: Minnesota Revenue Department, *Sales Ratio Study (1998 and 2004)*; Morris A. Davis and Michael G. Palumbo, *The Price of Residential Land in Large U.S. Cities*, Federal Reserve Board Finance and Economics Discussion Series Working Paper 2006-25 (May 2006)

At the same time, federal and state funding for affordable housing have failed to keep pace. Since 2001 federal expenditures targeted for low-income housing assistance have remained relatively flat, despite an aging public housing stock, rising market rents, and demonstrated growth in affordable housing need. Public housing programs have been subject to continual reductions in resources, with housing authorities receiving a shrinking fraction of the funding needed to maintain well-run properties. Moreover, since 2002, Congress has failed to appropriate any funds for incremental vouchers through the Section 8 program, in which the federal government pays the difference between 30 percent of a renter's income and the rent charged for a privately-owned apartment.

As the federal commitment to affordable housing has weakened, more and more housing policy responsibilities have been delegated to the state and local levels.<sup>10</sup> However, as housing affordability has declined, base funding appropriations to Minnesota's housing finance agency have eroded from \$80 million in the 2000-2001 biennium to approximately \$70 million in the 2006-2007 biennium. This shrinking commitment means less money for programs that help keep Minnesotans affordably housed.

### ***The Availability of Privately-Owned Affordable Units is Declining***

In both 2000 and 2005, the average renter household in Minnesota could afford a gross monthly rent of about \$700. Between 2000 and 2005, however, the number of apartments with a gross monthly rent at or below \$700 fell by 67,651—more than a 22 percent drop. This decline in affordability occurred even as the overall number of rental units in Minnesota increased by 6.5 percent.<sup>11</sup>

During this same time period, the number of owner-occupied housing units valued at or below \$150,000 fell from 997,102 to 473,045, a decline of over 50 percent. These units accounted for 68 percent of all owner-occupied homes in 2000, but only 31 percent in 2005.<sup>12</sup> The loss of lower-cost homes was particularly acute in the Twin Cities, where the number of homes sold for under \$150,000 fell from 21,708 in 2000 to 4,701 in 2005—a decrease of more than 78 percent.<sup>13</sup> Again, this decline in lower-cost units occurred as the overall number of owner-occupied housing units in Minnesota increased by 4.6 percent.<sup>14</sup>

Other factors, including the expiration of federal subsidy contracts tied to affordable housing units and the conversion of rental units to condos, further compromise the availability of housing affordable to low-income households in Minnesota. Between 1995 and 2005 Minnesota lost more than 2,000 units receiving project-based assistance or mortgage subsidies.<sup>15</sup> While state programs offer incentives for owners of property with expiring federal assistance contracts to continue serving lower-income households, there is no statutory requirement for owners to preserve affordability as mortgages mature.<sup>16</sup> Additionally, in recent years thousands of affordable rental units have been converted to condos. In Minneapolis alone, over 3,000 rental units have been lost to conversion since 2000. Estimates indicate that more than half of these units had been affordable to low-income households.<sup>17</sup>

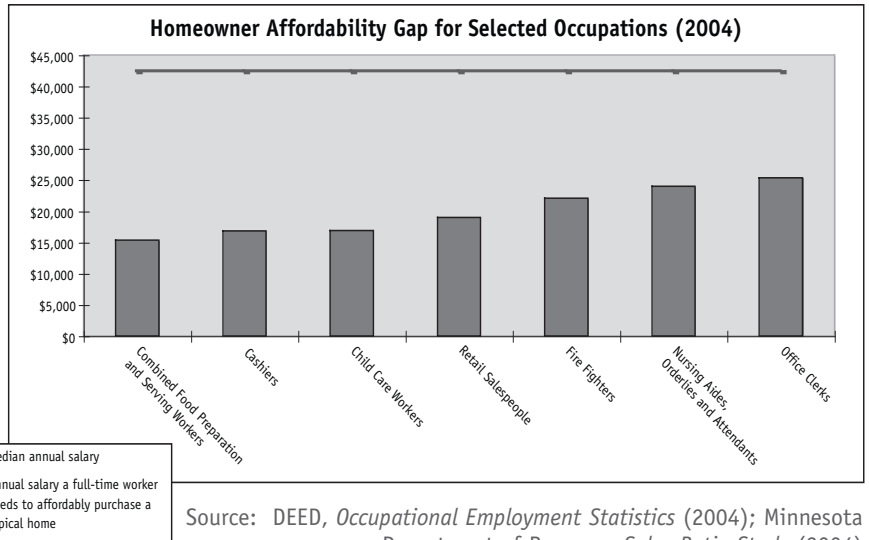
### **What Does This Mean for Minnesotans?**

As housing costs grow and income levels fall, Minnesotans are devoting a growing portion of their income to housing.



Between 2000 and 2005, Minnesota had the fastest growth in renter and owner households spending more than half of their income on housing of all states in the nation.

Minnesotans spending a disproportionate share of income on housing are forced to divert resources from other basic needs, and may find themselves at risk of homelessness. This problem is not limited to one sector of the population. As housing prices climb, affordability is a problem for a growing number of families. More and more, individuals employed in essential occupations that help communities thrive are unable to afford the cost of renting or owning a home.



Top 10 States with the Fastest Growth in Severely Cost-Burdened Households			
	Percentage of Households Spending More Than Half of Their Income on Housing		Percent Change 2000-2005
	2000	2005	
Minnesota	6.59	11.89	80.37
New Hampshire	8.61	13.41	55.79
New Jersey	12.34	18.18	47.39
Michigan	9.93	14.52	46.27
Idaho	8.06	11.75	45.79
Wisconsin	8.93	12.69	42.19
Alaska	9.75	13.73	40.81
Texas	10.45	14.66	40.35
Rhode Island	11.73	16.33	39.21
Illinois	11.45	15.79	37.89

Units that were "Not computed" have been excluded from household totals  
Source: American Community Survey, 2000-2005

### Strategies to Close the Housing Affordability Gap

The housing affordability gap could be substantially narrowed by simply increasing earnings for workers with low and moderate incomes. Unfortunately, in the past five years

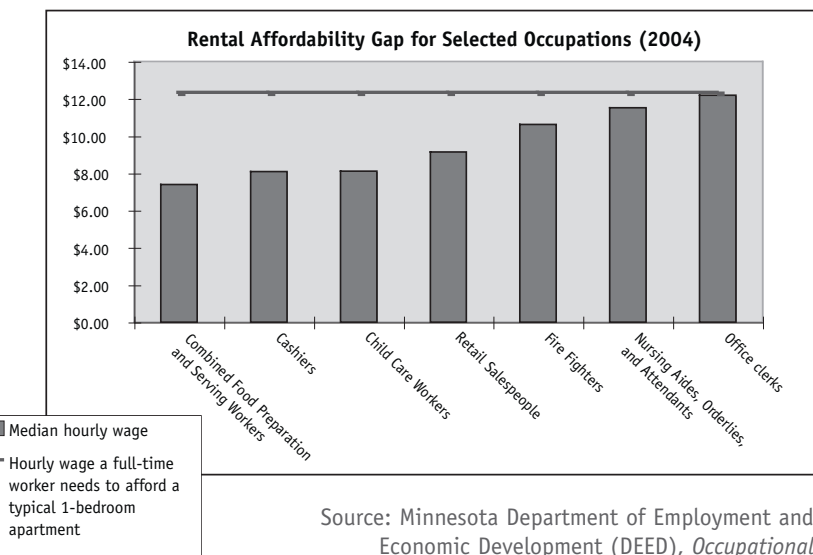
The salary needed to afford a median-priced home was calculated using the National Association of REALTORS® methodology for calculating the Housing Affordability Index. This methodology assumes a 20 percent down payment on a 30-year, fixed rate mortgage at the prevailing interest rate.

income levels have fallen slightly, while the cost of homeownership has skyrocketed and rent levels have increased slightly after climbing steadily through the 1990s. In response to these trends, steps must be taken to supplement incomes to bring them in line with housing costs, create new affordable units, and preserve those that already exist.

Housing affordability can be achieved in two ways, either by lowering the cost of housing or enhancing the purchasing power of low and moderate income households.

#### Lower the Cost of Developing and Maintaining Housing

Reductions in the cost of housing for the home buyer or renter can be brought about through a variety of mechanisms, including the use of government subsidies and financial incentives; modification of land use regulations and the use of innovative construction techniques at the local level; and efforts by faith-based organizations and the non-profit and private sectors to ensure the availability of housing that is affordable to households at all income levels.



A number of existing government programs, supplemented with private foundation contributions, lower the cost of housing and provide the avenues through which affordability is most commonly achieved. Some of these programs, such as the state of Minnesota's Challenge Fund, subsidize development costs, enabling developers to pass along those savings by selling or renting units to low-income households at prices they can afford. Other programs, including the federal Low Income Housing Tax



Credit, promote rental housing affordability by providing financial incentives to developers who incorporate affordable units into their projects.

Steps can also be taken to lower housing costs by reducing property tax rates and insurance costs for housing affordable to low-income residents. For example, in Minnesota affordable multifamily rental housing can be taxed under the “4d” property classification, which entitles owners to a lower property tax rate than applies to market-rate apartments. Non-profit organizations and other groups have also started cooperative insurance programs; both initiatives allow owners to operate their properties with reduced expenses, making housing affordability easier to achieve.

#### ***Strategies to Lower the Cost of Housing Include:***

- **Using government subsidies and financial incentives to lower development costs**
- **Lowering operating costs through reduced property tax rates and innovative insurance programs**
- **Re-assessing land use regulations to allow development of affordable units**
- **Adopting streamlined and innovative building techniques to cut the cost of development**
- **Implementing "inclusionary zoning" policies to encourage development of affordable units**
- **Locating employment centers in areas committed to housing affordability**
- **Using volunteer labor to reduce development costs**

In addition, efforts can be made at the local level to ease the regulatory barriers that often serve important public purposes but raise the cost of producing housing. Re-assessment of land use regulations that require large minimum lot sizes and costly materials could help promote housing affordability in many communities. Moreover, streamlined building techniques can further cut costs. The use of factory-built homes or components and adoption of building methods that emphasize production efficiency and elimination of waste can result in a significant reduction in development costs.<sup>19</sup>

Local housing ordinances can address the development of mixed-income housing more explicitly by requiring that a specified share of units in all new market-rate housing developments be “set aside” as affordable to low- or middle-income households. Developers who comply with program requirements, sometimes called “inclusionary housing” requirements, receive special benefits to off-set the loss of revenue associated with the sale or rental of affordable units. These benefits can include density bonuses,

streamlined permitting processes, and increased flexibility with regard to design standards.

The private and nonprofit sectors can also play a role in expanding housing affordability. Employers can choose to locate their facilities in communities that have made a commitment to housing affordability. By establishing employment centers in areas where their workers can afford to live, these companies benefit from reduced turnover while employees enjoy reduced commute times and increased financial stability. Many faith-based organizations are also engaged in efforts to expand the supply of affordable housing, with strategies ranging from the use of volunteer labor to create new homeowner units, to action to preserve local rental stock.

Public subsidies have been the mainstay of supply-oriented strategies; however, as available government funding has constricted it is important to focus on other ways to expand the supply of housing and help lower-income households better compete in the housing market.

#### ***Enhance the Purchasing Power of Low- and Middle-Income Households***

To complement efforts to reduce the cost of housing, the state and federal government, private foundations, and private sector employers can all take steps to enhance the resources available to lower-income households.

#### ***Strategies to Enhance the Purchasing Power of Lower Income Households Include:***

- **Using government assistance programs to subsidize the cost of buying or renting a home**
- **Offering financial counseling and courses to improve money management**
- **Applying funding available from non-profit organizations to costs associated with home-buying**
- **Implementing employer assisted housing programs**

A number of programs intended to help low- and middle-income households pay for market-rate housing already exist. Programs such as Minnesota Housing’s Entry Cost Homeownership Opportunity (ECHO) assistance help individuals and families pay for the costs associated with buying a home through down-payment and closing-cost assistance loans. Other programs provide ongoing assistance; for example households participating in the Section 8 voucher program receive a rent subsidy they can apply towards the monthly rent of market-rate units.

Nonprofit organizations, often in partnership with private foundations, offer an array of services and financial assistance programs to help households move into affordable homeownership. In some cases, nonprofits offer financial counseling and budgeting courses to help prospective homeowners prepare for home-buying and better manage their money. Other programs supported by foundations provide down-payment assistance or loans and grants to cover closing costs. By supplementing the funds available to lower-income households from public sources, private foundations expand available housing opportunities and help families remain stably housed.

Recognizing the relationship between housing affordability and economic vitality, a few private companies offer rental and ownership support for employees. Through these arrangements, sometimes called “employer assisted

housing,” employers assist their workers in overcoming housing affordability challenges. Specific assistance can vary, and may include grants, forgivable loans, and interest rate reductions.<sup>20</sup> All of these programs enhance employees’ buying power, and employers benefit from greater retention rates and workforce productivity, and a positive community image.

While no single solution will satisfy the many housing challenges Minnesota faces, progress will be achieved through continued leadership and partnership between all levels of government, the private and non-profit sectors, and philanthropic organizations. The strength of Minnesota’s communities and the success and well-being of Minnesota’s families depend upon the availability of a range of housing choices and opportunities.

***The purpose of this booklet is to provide an overview of housing affordability in Minnesota. For further information on homelessness and building strong communities, please see the other booklets in this series: Homelessness in Minnesota and Better Communities in Minnesota. Both are available at [www.mhponline.org](http://www.mhponline.org).***

#### ENDNOTES

- 1 American Community Survey (2005)
- 2 Number derived from Jobs Now Coalition, *The Cost of Living in Minnesota* 2004 (April 2006), p. 6.
- 3 BBC Research & Consulting, *The Next Decade of Housing in Minnesota* (2003), p. III-3. The Family Housing Fund, Minnesota Housing Finance Agency, and Greater Minnesota Housing Fund commissioned this study.
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- 11 American Community Survey (2000, 2005)
- 12 American Community Survey (2000, 2005)
- 13 Homes sales prices provided by the Saint Paul Area Association of REALTORS, based on closed existing home sales as reported by the Regional Multiple Listing Service. Figures are not adjusted for inflation.
- 14 American Community Survey (2000,2005)
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