WORKFORCE HOUSING:
THE KEY TO ONGOING REGIONAL PROSPERITY

A Study of Housing's Economic Impact on the Twin Cities

Executive Summary

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Maxfield Research Inc.

GVA Marquette Advisors
Real Estate Counselors

Introduction

Determining the economic impact of housing in any form is a difficult task. Housing affects, and is affected by, many other variables, most notably labor market and household characteristics, the transportation infrastructure and job densities and locations. Addressing housing's economic impact requires a researcher to make assumptions for a wide range of variables – housing obsolescence, housing vacancy, labor market conditions, production levels, and more – over different periods of time.

We chose to pursue this assignment – despite its difficulty – for a variety of reasons. First, as real estate researchers, we see the value of housing in virtually all of the studies that we complete. However, it is rare for us to be able to study in great detail housing's impact on the broader region. This task gave us a unique opportunity to gain firsthand experience into the broad-reaching importance of housing.

Second, we found very little research that estimates the economic return on housing investment. Such knowledge, we believe, would have strong and lasting value to the real estate community, the business community, developers, housing policy makers, neighborhood groups and government in general. Conducting research regarding housing's economic value establishes a starting point for further research and discussion, hopefully leading to effective solutions endorsed by all members of the community.

Finally, we completed this research because the time was right. So much of our world has changed recently and housing is one component that adds stability to our society. Housing affects everyone, regardless of income, occupation or lifestyle. Housing, therefore, should have a very high priority in the public policy arena. We hope that this study will allow us to contribute to the setting of priorities in our community.

Some points became clear to us in the process of doing this research: 1) there is strong unmet need for workforce housing in the Twin Cities, and the problem will only grow unless housing production increases significantly, 2) not addressing the need for workforce housing has significant, near-term consequences to the local economy, and 3) working to solve the workforce housing problem will stimulate significant economic benefits that far outweigh the costs, and last for decades.

We recognize that our research methods represent just one approach. However, we believe that the above conclusions would become clear to any researcher looking at this issue, using a logical, reasonable methodology.

Study Purpose

- This study examines the relationship between housing that is affordable to the typical worker in the Twin Cities (termed "workforce housing") and the ongoing vitality of the region. The lack of workforce housing has emerged as one of the most critical issues facing the Twin Cities.

- Those who hold workforce jobs represent the majority of all Twin Cities workers and are often the essential, frontline workers in the economy, holding such positions as light manufacturing worker, police officer, teacher, bus driver, nurse, retail salesperson and restaurant server. Understanding the housing needs for this segment of workers is therefore critical to the ongoing prosperity of the region.

- For the purposes of this study, workforce households are those who earn between $15,000 and $50,000 gross income annually. Workforce housing is either a rental unit with monthly rent between $375 and $1,250 or an owned unit priced below $125,000.

Scope of Research

- This study measures demand for workforce housing in the seven-county Twin Cities metro area, currently and over the next five years. We calculate the cost to produce all needed units, including the amount of subsidy investment that we believe would entice private developers to create affordable housing within the current development context.

- This study also estimates the economic impact of workforce housing and calculates the return on investment to the entire region if the full community can engage the private sector to tackle the issue of workforce housing development.

Origins of the Workforce Housing Crisis

- Strong commercial growth during the 1990s created over 254,000 new jobs in the Twin Cities, most of which pay workforce-level wages. Unfortunately, production of workforce housing dropped significantly during the same period.

- Housing construction continues to be suppressed by systemic problems including high land and construction costs, local opposition to multifamily development and a lack of suitable land for development, zoned such that workforce housing in a variety of forms can be produced.

Indicators of the Need for Workforce Housing

- The Twin Cities has among the tightest housing markets in the nation. According to the 2000 census,[1] the seven metro counties fell into the top one percent among all U.S. counties for lowest vacancy rate; all had an overall vacancy rate of 3% or less.

- Roughly 9,900 units are currently needed across the Twin Cities just to bring the market to a healthy vacancy level, including 6,800 new rental units and 3,100 new owner units.

[1] *Vacancy signs are rare in the Twin Cities*, Demographics Daily, June 1, 2001 (http://bizjournals.bcentral.com/journals/demographics/doc/2001/06/01/1.html). This article based its findings on a review of 2000 U.S. Census housing occupancy figures for all counties in the country.

- There are about 10,000 housing units metro-wide that are vulnerable to demolition. In reality, many of these units are occupied with working households, further justifying the need for immediate housing construction.

- The Twin Cities metro area has over 64,000 unfilled jobs, 3.1 % unemployment, and the highest overall labor participation rate in the country. These facts suggest that virtually all Twin Cities residents who wish to work have jobs, and that employers with job openings will likely need to attract workers from outside of the metro area. This will require new housing.

- Housing production in the counties surrounding the Twin Cities will do little to help meet workforce housing needs in the metro area as these areas offer very little new rental housing at any price level, and new owner housing typically starts at prices above workforce affordability.

Estimates of Demand for Workforce Housing

- Currently, 88% of the unfilled jobs in the Twin Cities (roughly 57,000 jobs) pay $18.00 per hour ($37,000 per year) or less. We estimate that 5,000 new households would move to the Twin Cities to fill some of these jobs if new housing were available. We term this pent-up demand.

- Job growth will create the need for 26,800 new workforce units over the next five years, not including the 5,000 units mentioned above. After subtracting out expected construction of 10,000 units, we estimate that there will be a shortfall of 16,800 workforce housing units in the Twin Cities over the next five years. This number could change given the growing level of uncertainty in the economy. However, over the next five years, some level of new job creation is highly likely in the Twin Cities, leading to the need for more housing.

- In total, we believe that the full community needs to commit to the construction of 31,700 new workforce units in the region over the next five years, including 25,400 rental units and 6,300 owner units. This would satisfy pent-up demand, meet new housing demand over the next five years and create a healthy vacancy rate among new workforce units, which is crucial to allow households adequate housing choices from which to select.

Subsidy Required to Develop New Units

- The existing cost structure for housing makes the development of workforce housing financially unfeasible for the private sector. A private developer would likely lose about $31,000 per unit trying to develop average-size, new owner workforce units and about $43,000 per unit trying to develop typical workforce rental units.

- We estimate a need for about $1.5 billion in gap financing to develop the 31,700 workforce housing units that we believe are needed in the Twin Cities over the next five years. This translates to an average of $48,750 per rental unit and $41,500 per owner unit. We make no assumptions about who provides the gap financing, however we believe that it will likely need to come from a variety of private and public sources.

- The $1.5 billion subsidy outlined above is based on the current context for development in the Twin Cities, in terms of development costs, typical development patterns, consumer expectations and existing housing and zoning regulations. Development-friendly changes in any of these variables, such as increased allowable densities or the market's acceptance of smaller units, could substantially reduce the needed subsidy.

Economic Impact of Workforce Housing

- The Twin Cities loses out on roughly $128 million in annual consumer spending because it does not provide workforce housing to meet pent-up demand. The lack of workforce housing also causes Twin Cities businesses to lose out on an estimated $137 million in income annually because prospective workers cannot find housing.

- In total, the Twin Cities forgoes an estimated $265 million in combined consumer spending and business income per year because there is a current shortfall of workforce housing.

- If the Twin Cities completed workforce housing construction equal to the need over the next five years, substantial economic benefits would accrue. The construction task alone adds an estimated $1.6 billion to the local economy, in the form of increased construction wages and development fees and assessments paid to local governments.

- Once the new workforce units that we believe are needed become occupied with new households, the Twin Cities can expect to capture $523 million in new, annual consumer spending and about $564 million in annual income gains to local businesses.

- The net benefit for producing all needed units would approach $3 billion during the five-year construction period. Roughly $1.1 billion in consumer spending and increased business income would recur on an annual basis in the Twin Cities economy, once new units become occupied.

Return on Investment

- Investment in just a portion of the capital required to produce the workforce units needed over the next five years would stimulate a substantial long-term economic gain for the Twin Cities. We estimate that $1.5 billion in subsidy for new workforce housing would generate a net gain of $12.2 billion to the regional economy over the next fifteen years, or about $385,000 per unit.

- Each dollar of subsidy investment would stimulate a net gain of $8.13 in economic benefit to the entire region over the next 15 years, an eight-fold return.

Conclusions

- Without substantial investment in workforce housing, the prosperity we have enjoyed as a region is in jeopardy.

- The current situation in the workforce housing market – the lowest vacancies in the country, low housing production levels and rapidly-rising housing costs – leaves the Twin Cities in a poor position to accommodate new economic growth, much of which will require housing construction to house workers moving here from outside of the region.

- Supplying an adequate amount of workforce housing is critical for the Twin Cities to compete with other metropolitan areas. Every positive move to resolve the shortage of workforce housing makes the Twin Cities region stronger in the competition to capture new economic growth. Conversely, poor responses to the problem weaken the region relative other metro areas, some of which are developing creative solutions to their workforce housing problems.[2]

- Given that 90% of current job openings and the majority of existing jobs pay workforce wages or below, the Twin Cities economy depends to great extent on workforce housing construction.

- The private market would have strong interest in addressing the workforce housing shortage if it were financially feasible. By investing enough to make the development task reasonably profitable, the providers of gap financing could stimulate a strong response from the private sector, leading to a tremendous gain for the regional economy.

- The $1.5 billion housing subsidy we identify is rather small compared to other state investments such as roads and highways. In 2001 alone, more than $522 million will be spent on road construction in the seven counties, much of which only targets deferred maintenance or regular maintenance, and not expansion of the system.[3] We see investment in housing as a wise use of funds targeted to strengthening the community.

- Leaders in the region should not wait until the full $1.5 billion in needed housing subsidy is assembled. Incremental steps to solving the workforce housing shortage will produce valuable, incremental benefits for the regional economy.

- Devoting money to housing is an investment that lasts for decades. Housing construction brings new households into a market, helps employers more easily attract workers and creates a larger base of consumers for retailers. Once the task of construction itself is done, these benefits last as long as the units are maintained and desirable to the market.

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[2] For example, in Douglas County, Colorado (metro Denver) Intermountain Rural Electric Association provides up to $30,000 toward a home purchase by its employees (*Housing becomes a perk*, The Denver Business Journal, September 29, 2000, http://denver.bcentral.com/denver/stories/2000/10/02/story5.html).
[3] *2001 Twin Cities Metro Area Highway Construction Projects*, The Minnesota Department of Transportation (http://www.dot.state.mn.us/metro/construction/).