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Mixed Income Housing –

An Introduction for the Minneapolis/St. Paul Region

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Background

The economy and housing market in the Minneapolis/St. Paul region have largely recovered from the recent recession. However, for many people, even a full-time job does not guarantee access to a home they can afford¹. Housing sale prices increased 7 percent from 2014 to 2015, and rental prices in some neighborhoods are not affordable to many people in the local workforce.

Ensuring that there is a full range of housing choices with access to quality jobs and transportation options is critically important to regional economic competitiveness. In a recent survey conducted by Greater MSP, young transplants to the region were asked what they looked for in choosing a community to live – overwhelmingly the No. 1 attribute was the availability and affordability of housing.

What is Mixed Income Housing?

Mixed income housing refers to developments that are primarily market rate, but have a modest component of affordable housing. Often, the development is 80 or 90 percent market rate units, with the remainder of the homes reserved for low- or moderate-income residents.

¹For more information, see the Family Housing Fund publication: [Working Doesn't Always Pay for a Home](#)



Research indicates that mixed income communities are a key part of building economic prosperity and competitiveness by attracting and retaining residents to support key employers.

One strategy to meet this goal is to work with local developers to reserve a portion of their new units for low- or moderate-income residents. In some cases, the affordable housing set aside can be mandatory, and in others, it is part of a voluntary program that is supported by incentives, such as density bonuses or tax increment financing. While this strategy has worked well in many cities throughout the country, it is a relatively new – but quickly expanding – concept in the Minneapolis/St. Paul (MSP) region.

There are many types of mixed-income housing policies. While this report groups them for simplicity, cities can select elements to create a unique structure that fits their local market and achieves their community goals. The most common policies are listed below:

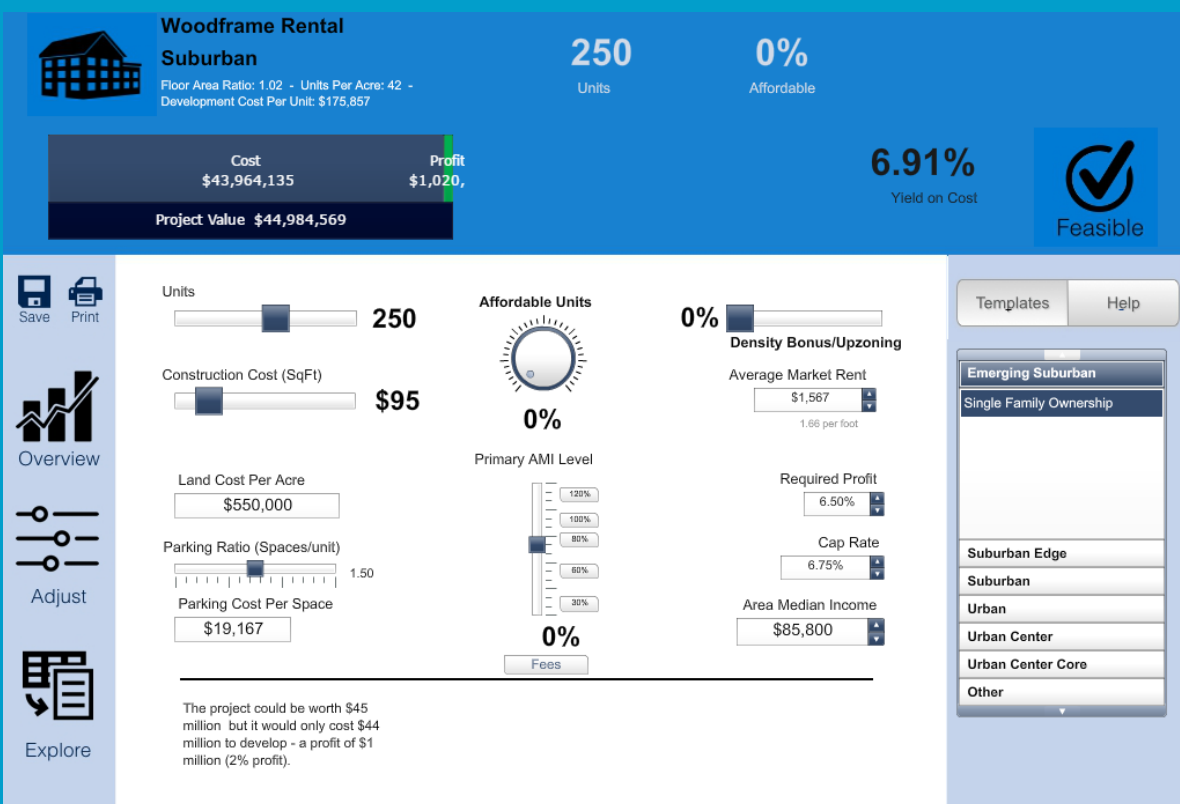
- **Mandatory mixed income housing policies (inclusionary housing):** Requires all new housing to include a portion of the units reserved for lower-income households.
- **Planning and zoning policies:** Requires a mix of incomes to be included in new housing if developers request or receive a land-use modification, such as zoning changes, density bonuses or parking reductions.
- **City subsidies:** Requires a mix of incomes in new housing if the city provides a public subsidy, such as tax increment financing (TIF), fee waivers or tax abatements.

There are also a number of non-zoning strategies that can promote affordable housing, like requiring mixed-income housing when selling city land.

Learn More

This publication is an introduction to mixed-income housing. To learn more, visit housingcounts.org.

To explore the economics of mixed-income housing and to design a mixed-income policy, visit Family Housing Fund/ Urban Land Institute of Minnesota's interactive, mixed-income calculator: <http://mncalculator.housingcounts.org/>



The Need – Housing for All

The Minneapolis/St. Paul region continues to grow and thrive. Good schools, beautiful parks and great neighborhoods attract employers and families to the area. Sperling's BestPlaces called the Twin Cities "the most playful metro in America" because of its museums, playgrounds and recreational opportunities. Companies, taking advantage of a well-educated workforce, continue to add many new jobs. These regional strengths impact market prices and put additional strain on people with lower than average incomes, who also make an important contribution to the economy.

As the population grows, home prices rise, and it becomes harder for families with modest incomes to afford a safe and decent home. Additionally, much of the region's new development has been luxury rentals, which do not meet the need for housing across all income levels. Currently, over 140,000 households are severely cost-burdened renters, meaning they pay more than half of their income in rent. Forty percent of new households in the coming decades will be low income, and consequently will struggle to find housing if cities do not intentionally create a full range of housing choices. Between 2020 and 2030, the Minneapolis/St. Paul region will need to add 37,400 homes affordable to low- or moderate-income households to meet the future demand created by economic growth (Metropolitan Council, 2040 Housing Policy Plan).

The lack of affordable housing impacts not only residents, but also the business community, the environment and the regional economy. When people cannot find affordable housing near their jobs and move outside of the urban core, there is a cost. People commute long distances, creating traffic and pollution. Employers have trouble hiring and retaining the employees they need. Equally important, families are affected. If parents are spending 30, 40 or even 50 percent of their income on housing, they have less to spend on everyday needs from local retailers and are unable to save for college or invest in their children's future.

While cities and nonprofit organizations have long invested in affordable housing development, the current strategies alone cannot meet the need. Stakeholders are looking for innovative solutions to complement existing public programs and investments. As detailed in this report, more and more cities are implementing mixed-income policies that integrate affordable housing into new market rate developments. Communities often embrace mixed income housing because people want housing options, but these communities are more reluctant to support affordable housing concentrated in one project or area. Additionally, research has shown that mixed income communities are good for families. The neighborhoods in which children grow up have a powerful effect on the likelihood of graduating high school, going to college or getting a high-paying job².



² <http://inclusionaryhousing.org/inclusionary-housing-explained/what-problems-does-iz-address/economic-integration/>



What is Affordable Housing?

Generally, proving affordable housing means ensuring there are homes for people of various income levels in a community. Often, policymakers use the area median income (AMI) as a benchmark to define “low income” and “moderate income” within a city, county or metropolitan area. The AMI in the Minneapolis/St. Paul region in 2016 was \$85,800 for a family of four. The U.S. Department of Housing and Urban Development (HUD) states that households should not pay more than 30 percent of their income for housing. “Affordable housing” is typically defined as housing that costs no more than 30 percent of a low- or moderate-income household’s earnings.

Often, community members are surprised to discover that many of their neighbors or family members would qualify for low- or moderate-income housing. Because housing prices have generally increased faster than incomes, many homeowners who bought their property years ago would not be able to purchase a home in the same neighborhood at today’s prices. Specifically, according to Family Housing Fund, a family would have to earn \$44,100 per year (\$21.20 per hour) to afford to rent a two-bedroom apartment, or \$60,000 per year (\$28.85 per hour) to afford to buy a modest single-family house. However, half of the jobs in the Twin Cities metro area pay less than \$41,930.

Different cities prioritize their efforts to provide housing affordable to different income levels, based on the local housing market and needs. Some sample incomes, professions and affordable housing prices are listed below.

| Percent of AMI | 60% | 80% |
|---|--|---|
| Sample household | Single mom, works as teacher, raising two kids | Family with two parents and two kids. Dad is a chef and mom is a half-time nurse’s aide |
| Typical income | \$52,000 | \$62,000 |
| Affordable rental price including utilities | \$1,300 | \$1,700 |

Note: Some cities will target different income levels, such as 50 percent of area median income. The affordable price is adjusted for household size. Different cities may make slightly different assumptions in their calculations.
Source: Metropolitan Council

Mandatory Mixed Income Housing Programs

Mixed income housing (sometimes referred to as inclusionary housing) programs are local policies that tap the economic gains from rising real estate values to create affordable housing for people with lower-incomes. In their simplest form, mandatory mixed income housing programs require developers to sell or rent a percentage of new residential units to lower-income residents. Mandatory mixed income housing programs often apply to all developments, but some apply in just one area of the city or to specific types of new buildings. The required set-aside is typically between 5 percent and 30 percent of new housing units or floor area.

Many, but not all, programs partially offset the cost of providing affordable units by offering developers benefits such as tax abatements, parking reductions or the right to build at higher densities. Most programs recognize that it's not always feasible or desirable to include affordable on-site units within market-rate projects. In these cases, developers can choose an alternative, such as payment of an in-lieu fee or provision of affordable off-site units in another project.

While planning flexibility and local subsidies partially offset developers' costs of providing mandatory affordable units, these same incentives can help entice developers to voluntarily provide affordable housing. This type of voluntary or incentive-based mixed-income housing policy is discussed in more detail below.

Planning and Zoning Incentives

Many cities tie mixed income requirements to zoning changes or planning flexibility. These programs are as varied as they are numerous. Essentially, they all offer flexibility in the usual zoning code rules, such as increased height or density, to incentivize developers to building affordable homes.

Planning incentives, as compared to financial incentives, which are described below, are often desirable from the city's perspective because they do not have a significant impact on the city's budget. Planning incentives create new value and can feel like a win-win option. However, to be effective, the value of the incentive must be large enough to offset the additional developer costs. In many cities in the Minneapolis/St. Paul region, this has not been the case; developers have not participated in voluntary programs because the balance of incentives and requirements are not properly aligned. This is the inherent challenge in voluntary programs.



The developer of this 38-unit property in Berkeley, California, provided seven affordable units in exchange for an extra story.

Density Bonuses and Parking Reduction

Many communities offer planning incentives, such as density bonuses or reduced parking requirements, to developments that include affordable homes. Sometimes there is a set formula. In contrast, the City of Minnetonka does not have a set formula, rather they negotiate the number of units individually with each developer. Density bonuses are common across the nation, with many examples from North Carolina to California.

Depending on the local housing market and land use policies, planning incentives can be very valuable to developers. Where the zoning code strictly limits density, a developer can use the density bonus to build more housing units on a site and increase the project profitability by enough to fully offset the cost of providing affordable housing. Even reduced parking requirements can be valuable enough to significantly offset affordable housing requirements, particularly in

To learn more about the value of incentives, visit the Mixed-Income Housing Calculator

www.mncalculator.housingcounts.org



places where expensive structured parking (multi-story or underground garages) is the only option. However, increased density may not benefit all projects. An important limit to density bonuses is the additional construction costs of different construction methods associated with taller buildings. For example, the cost per square foot to build a five-story or six-story building would likely not change significantly. Here, a density bonus makes sense.

However, to add a seventh floor typically costs more because the taller building requires more expensive steel-frame construction instead of wood-frame construction. In this case, a density bonus would not benefit the developer because the change in construction type could add millions of dollars in costs – more than the value of adding more units.

Zoning Changes and Variances

Some cities require affordable housing for all developments that request or receive a zoning change. In some cases, the rezoning is initiated by the city and the requirements are mandatory. For example, cities often rezone the land around transit stations to allow higher density development. This rezoning, as well as the public investment in transit, creates significant value, which can help offset the cost of the affordable housing requirements. Tyson's Corner in suburban Virginia is one of the most famous examples of this approach. The county rezoned the land around a planned railway station in exchange for 20 percent of the units being affordable. All the new



This development in Edina will contain 11 affordable homes.

housing developments were required to provide affordable housing, but because the increased density was so valuable, developers generally approved of the new rules.

Similarly, some cities require affordable housing if developers request a zoning change or variance. In these cases, the program are considered voluntary. For example, the City of Edina requires that developers provide 10 percent of all units as affordable when rezoning a parcel to Planned Unit Development or making a Comprehensive Plan Amendment. Other cities, like Chaska, Minnesota, apply the policies to a broader set of zoning variances, including amendments to lot sizes, increased densities, reduced setbacks and reduced rights-of-way. According to Kevin Ringwald, Chaska's Planning and Development Director, "The policy has worked for us. Originally, we were only getting very expensive housing and now we are getting a good mix. By being flexible and finding the right incentives, we have mixed income housing on a lot of sites that would not have considered it." Nationally, the City of Boston is a commonly cited example of this approach.

Other Planning Incentives

Another planning incentive is to add more approval certainty for projects that include affordable housing. Because projects that receive pre-approval are lower risk, often developers will accept a lower rate of return in exchange for meeting the agreed-upon conditions for pre-approval. Additionally, the faster processing can reduce interest costs on loans. For example, a city could eliminate a conditional use permit requirement for developments that meet strict design guidelines and include affordable housing. The city would review projects administratively to ensure that the design standards are met.

However, the value of certainty alone, though significant, does not often entice developers to voluntarily provide affordable homes, particularly in places that already have efficient, developer-friendly approval processes. Some cities combine fast-track processing and administrative approvals with other incentives as part of a total benefits package. The SMART housing program in Austin, Texas, is a successful example of this package approach. While beneficial for developers, streamlined approvals limit opportunity for public input during the development process. Cities should work with their residents before adopting a policy so they understand the tradeoffs and ensure the design review process and other safeguards are robust.

Public Subsidy Policies

A number of cities have programs that require developments that receive tax increment financing or other public subsidies to provide affordable housing. This policy can be useful, particularly when development would not be possible without some sort of financial assistance. Financial incentives are relatively common in the Minneapolis/St. Paul region, but less common in other places.

The major disadvantage of public subsidy programs is the cost. Public funding is limited and cities must carefully evaluate how to best use their scarce resources. For example, it is sometimes more cost effective to use the money to directly subsidize 100 percent affordable housing developments. One reason for this is that local funds can be combined with state and federal affordable housing subsidies, such as Low Income Housing Tax Credits. Because of how the programs are structured, mixed income buildings are usually not competitive for Tax Credit funding. For this reason, traditional, 100 percent affordable housing projects often provide affordable housing opportunities at a lower cost to cities, with the tradeoff that the affordable housing is more concentrated.

Another disadvantage of providing financial incentives to mixed income developers is that they can lead to increased land prices (see below).

Other Strategies

Surplus Land

Selling surplus city land provides an opportunity to promote mixed income housing. While preparing an announcement for the sale of land, cities have the option of including specific terms, such as requiring mixed income housing as a condition of the sale. While the sale proceeds may be lower, this is an opportunity to advance the city's mixed income housing goal, and developers may respond with creative approaches.

Land Economics

Zoning changes significantly affect the price of land because zoning often dictates the number of housing units that can be built on a given parcel. This affects a developer's potential profit on new construction and the amount they are willing to pay for land. Developers often refer to the cost of land not in terms of price per acre, but rather as price per unit or "price per door." If a parcel is zoned for 100 units (assuming it is realistic to build those units), and the price per door is \$20,000, a developer would pay \$2,000,000 for the land. However, if the zoning were changed to allow 200 units, a developer would potentially be willing to pay up to \$4,000,000 for the same parcel.

Reducing parking requirements also increases land prices. Parking structures are expensive to build, and the net result is developers can pay less for land if parking requirements are high. Especially in transit-oriented locations, developers can reduce their costs per unit by providing fewer parking spaces. By reducing their development costs, developers are able to pay more for land and still meet their profit targets.

Conversely, rules that add costs to developers, like affordable housing requirements, decrease the amount that developers can pay for land and still make a profit. This is why it is often beneficial to combine affordable housing planning and zoning changes. Tying affordable housing requirements to upzoning has two benefits: it helps stabilize rising land prices, and it ensures that community members, not just landowners, share in the benefits of higher density development.

Land values don't change overnight, and some communities have carefully phased in mixed income requirements with the expectation that developers, when they can see changes coming, will be able to negotiate appropriate concessions from landowners before they commit to projects that will be impacted by the new requirements. Similarly, some programs have a clearer and more predictable impact on land prices than others. Consistent, widespread and stable rules translate into land price reductions more directly than complex and changing requirements with many alternatives.



What's Happening in the Minneapolis/St. Paul Region?

| City | Type of Program | Percentage of Affordable Units | Affordability Level |
|----------------|--|---|---|
| Bloomington | Public Funding Policy | Project-by-project decision, typically 10-20% | Project-by-project decision |
| Chaska | Mixed Income Policy with goal of all developments that need city approvals contributing (may use density bonuses and other flexibility) | 30% of Units | 80% AMI |
| Eden Prairie | City Subsidy Policy | 20% of Units | 50% AMI |
| Edina | Zoning Changes Policy (may also use density bonus, parking reduction and public subsidies) | 10-20% of Units | 50-60% AMI for rental or approximately 110% for ownership |
| Minnetonka | Mixed Income Policy with goal of all developments that need city approvals contributing (may use density bonuses and other flexibility) | 10% of Units Generally, 20% when using city financing | 60% AMI generally 50% when using city financing |
| St. Louis Park | City Subsidy Policy | 8-10% of Units | 50-60% AMI for rental or 80% for ownership |
| Minneapolis | Density Bonus and City Subsidy Policies | 20% of Units | 50-60% AMI |
| St. Paul | Policy is under development | Not Applicable | Not Applicable |

Please see original policies for full details.



Case Study

St. Louis Park, MN

| | |
|-------------------------|--|
| Type of policy: | Voluntary/incentive based – financial assistance |
| What is covered: | 10+ unit developments seeking financial assistance |
| Year adopted: | June 2015 |
| Results: | 253 affordable homes proposed or approved |
| Requirements: | Rental – 8% of units at 50% of AMI or 10% of units at 60% of AMI. Ownership – 10% of units at 80% of AMI. |



Details:

St. Louis Park has long promoted affordable housing, with an explicit policy in their comprehensive plan. However, as one council member observed at a housing-focused retreat in 2014, “We have promoted affordable housing for a decade but not produced any affordable homes.” And so began the discussion about what the city could actually do to create workforce housing units.

The city held a series of public meetings and work sessions discussing all the options. There was a clear preference for mixed-income housing, which would spread affordable units among the more high-end rental units that developers tended to produce. A common theme in the discussion was about public subsidies in the form of tax increment financing provided to new developments. This type of subsidy was (and remains) relatively common in St. Louis Park. Many felt that if the city contributed money toward a development, they should have high standards and expect clear benefits.

Specifically, the city decided on a policy to require 8-10 percent of new homes that receive public funding to be affordable. Tax increment financing is the most common subsidy in St. Louis Park, but the policy applies to all types of public funding. While some stakeholders wanted higher requirements, the council and staff felt that it was better to have a modest policy that did not adversely impact development. The city intentionally created a policy, and not an amendment to the zoning ordinance, to avoid potential legal challenges.

It appears to be working. In the year and a half since the policy was passed in St. Louis Park, there are 253 affordable homes in the pipeline. “We have really not received much pushback from developers,” explains Michele Schnitker, Housing Supervisor and Deputy Community Development Director. In fact, several developers have voluntarily provided more affordable homes, 20 percent of all units, so they could qualify for Affordable Housing Tax Credits. On the city council level, there has been discussion about strengthening the policies. A recent development was exempt from the policy because it did not ask for any public subsidy, and at least one council member questioned whether there was anything that could be done to ensure that the development was mixed income. In response, staff are now studying the strategy of tying affordable housing requirements to zoning changes, density bonuses or other incentives.

Schnitker offered lessons for other cities, “Creating a policy is a balance. Look at your market, and work with the developers. Think about multiple strategies because there is not just one solution.”



Case Study

Minnetonka, MN

| | |
|-------------------------|---|
| Type of policy: | Voluntary/incentive based |
| What is covered: | The goal is all developments, with flexibility and staff discretion |
| Year adopted: | 2004 |
| Results: | Over 500 affordable homes |
| Requirements: | 10% of new units affordable generally at 60% of AMI; 20% of units affordable to 50% of AMI when using public subsidies |



Details:

Minnetonka has quietly and steadily worked to ensure their community has homes that are affordable to all. For more than a decade, they have had a policy that aims to ensure that 10-20 percent of all new homes are affordable, and much of this has been done without city financial subsidy. The city has worked hard to avoid controversy, engaging neighbors when they have concerns and partnering with the faith community. When there have been reservations, the city has used the flexibility built in to the policy to quietly address them. The city has avoided attention – even rejecting awards – so that it can focus on implementing its policy. Julie Wischnack, Community Development Director, reflected on the program, “Our approach has been to partner rather than mandate, and developers respect that. It has worked and you can tell that by the numbers of units we have created. It has been very successful.”

City staff, planning commission and city council all review new projects and discuss the unique circumstances. Often, the city allows developers to increase density or reduce parking to help offset the cost of affordable homes. However, they only use tax increment financing strategically and do not waive fees. Instead, the details are all project specific. For example, extra height might be most useful in one case, but allowing mother-in-law apartments or duplexes might be valuable in another. The city’s comprehensive plan has facilitated this method because the high-density zones do not have limits on the number of units per acre. One other important feature of their program has been to work closely with Homes Within Reach, a community land trust. This partnership has allowed the city to create single-family, owner-occupied affordable homes.

Minnetonka offers a few key lessons for other cities: 1) Use a thoughtful, deliberate process and engage stakeholders when developing a policy; 2) Ensure that the comprehensive plan supports the policy goals; 3) Build in high expectations, but some flexibility, recognizing that each development is different; and 4) Take advantage of the flexibility provided by TIF pooling.

