

Summary of Findings & Recommendations



Minneapolis/St. Paul Region

Mixed Income Housing Feasibility, Education and Action Project



**GROUND
SOLUTIONS
NETWORK**

strong communities
from the ground up

Background

In 2015 and 2016, the Family Housing Fund and the Urban Land Institute of Minnesota/Regional Council of Mayors partnered to offer the Minneapolis/St. Paul Region (MSP) Mixed Income Housing Feasibility, Education and Action Project. The collaboration developed and highlighted tools and strategies to help municipalities work with private and non-profit developers to create mixed income housing in the seven-county MSP region. It also provided new

innovative ways to learn, experiment and develop policies to incentivize mixed income housing development.

For this report, 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, with the remainder of the units reserved for low or moderate income residents.

The project had three parts:

1 Training series

The four-part training series allowed municipal staff and others to learn about mixed income housing. The trainings attracted 25-30 city and county staff in small, interactive workshops focused on the MSP region, with local and national lessons and best practices.

2 Technical assistance

The technical assistance provided four cities with professional consulting expertise to explore and potentially craft new mixed income housing policies. The work is summarized to the right:

- **Golden Valley** – Explore various voluntary and/or mandatory mixed income housing policies and incentives.
- **Minneapolis** – Evaluate and make recommendations about the feasibility of new mixed income housing requirements, including an analysis by geographic sub-markets.
- **Shoreview** – Evaluate the potential for an incentive based mixed income housing program and the value of requiring developments that receive public funding to provide affordable housing.
- **St. Paul** – Refine and enhance the current voluntary, mixed income density bonus ordinance.



3 Mixed Income Housing Feasibility Calculator

The project developed a Mixed Income Housing Feasibility Calculator, customized with local data. This easy to use, online tool is a powerful instrument for both learning about the concepts involved with mixed income housing, and understanding the real estate development economics in different cities in the region. The Calculator, like a pro-forma, allows users to enter various assumptions about developments and see if it is feasible to build given the current market conditions. Users can experiment with different incentives or affordable housing requirements and see how the overall

feasibility is affected. The Calculator is tailored for the MSP region and is loaded with information for various city types in the region (e.g. Suburban, Urban Core). Users are free to further customize the inputs. The Calculator is available at mncalculator.housingcounts.org (see Figure 1).

Funding for the project was provided by the McKnight Foundation and the Metropolitan Council. Grounded Solutions Network, a national nonprofit organization, conducted the research.

Figure 1: Sample page from the Mixed Income Housing Calculator



Policy/Funding Recommendations

Based on the research completed as part of the Mixed Income Housing Feasibility Project, the Grounded Solutions team has developed five recommendations that will help more mixed income housing get developed in the MSP region.

Because the MSP region is large, with seven counties and 182 communities, no one solution is appropriate in all places. While Policy One, Targeted Funding Sources, described below, applies to the region, the other policies are city specific. Policies Two to Five are offered as recommendations for consideration by local policy makers, but every strategy need not be implemented in every city. Local policy makers should experiment by using the Mixed Income Calculator to understand which of the strategies are most appropriate based on local conditions.

- 1 Targeted Funding Sources** - Develop county or regional funding sources devoted to supporting mixed income housing.
- 2 Zoning/Land Use Incentives** – Tie zoning changes to a comprehensive program to encourage mixed income housing.
- 3 Transitway Planning** – Integrate transitway (light rail/bus rapid transit) with affordable housing planning.
- 4 Public Funding / Public land** – When providing public funding (such as Tax Increment Financing or TIF), require the inclusion of housing affordable to a mix of incomes. When selling public land, require that offers include a commitment to provide mixed income housing.
- 5 Requirements for Affordable Housing** – For cities with strong markets and appropriate conditions, require some housing affordability in new developments.

This report references several prototypes that can be found in the Calculator, and uses these to illustrate mixed income housing concepts. These projects are meant to be typical of new housing in the region, but are hypothetical and do not represent any actual projects.

Key details for the projects are summarized below:

- ▶ **Emerging Suburban Edge:** Wood Frame Rental, 250 units, 1.6 parking ratio, \$1.50 rent/sf
- ▶ **Suburban:** Wood Frame Rental, 250 units, 1.5 parking ratio, \$1.66 rent/sf
- ▶ **Urban:** Wood Frame Rental, 50 units, 1.3 parking ratio, \$1.74 rent/sf
- ▶ **Urban Center:** High Density Wood Frame Rental, 200 units, 1.25 parking ratio, \$1.96 rent/sf
- ▶ **Urban Center:** High Density Wood Frame Rental, 220 units, 1.25 parking ratio, \$2.20 rent/sf

There are many other prototypes in the Calculator, including single family homes, town homes, midrise buildings and high rise buildings. Users are encouraged to learn more and try their own analysis at : <http://inclusionaryhousing.org/calculator>

When doing calculations, this report often refers to housing that is affordable to someone making 60 percent of the area median income. Cities may want to target their policies to different income levels. Sixty percent is used solely as an example. Additionally, this report refers to rental housing, but mixed income policies work equally well with ownership developments.



1 Targeted Funding Sources

Recommendation: Develop county or regional funding sources devoted to supporting mixed income housing.

A targeted funding source could 1) help offset the cost of building mixed income housing¹, and 2) incentivize cities to pass new mixed income housing policies. Stakeholders report that existing housing affordability funding tools are hard to apply to mixed income projects and that the lack of a targeted funding source has constrained mixed income housing production in the region. For example, one developer said, “I believe philosophically in figuring this out,” but there is no appropriate funding source to use. If there were a local or regional funding source designed for mixed income housing, it could close the funding gap, allowing more mixed income housing to get built.

Several developers have tried using Low Income Housing Tax Credits (LIHTC), but this program is better suited for entirely or primarily affordable developments (i.e. most or all of the units are affordable) and is generally only feasible for projects that have a large number of affordable units. Most often, mixed income housing developments have too few affordable units. Even then, the program rules complicate every stage of mixed income housing development, from securing funding, to hiring contractors. Short of a change in federal law, the LIHTC will not be useful for most mixed income projects. Other state and federal funding sources have similar limitations – they work well for entirely or primarily affordable projects and are important source of funding for affordable housing, but work poorly for mixed income housing developments.

A designated source, designed specifically to support mixed income housing, would provide a better vehicle. The rules can be crafted explicitly to support mixed income housing. Additionally, it could be tailored to encourage important policy change. For example, the fund could be limited to cities that have enacted mixed income housing policies.



¹ Funding is necessary because in large parts of the MSP region, it is not feasible to build mixed income housing without some subsidy. There are exceptions to this, as discussed in recommendation five.

An important question is how much funding would be required to successfully promote mixed income housing. Providing an apartment at a below-market price reduces the rental revenue stream that a developer would otherwise receive. The Mixed Income Housing Calculator can be used to help understand the typical amount of subsidy needed to reimburse developers for the additional cost of providing mixed income housing². Based on the project team's research, providing one unit of affordable housing to someone making 60 percent of the area median income (AMI) reduces the value of the wood frame rental development prototypes by \$44,000 to \$86,000, depending on the part of the region and other project-specific factors³. However a fund would not necessarily need to offset the entire cost. Cities could offer a fixed amount which reduces the costs for developers, but does not eliminate it entirely.

The chart below summarizes the costs (or lost profit) for developers to build one unit of affordable housing at 60 percent AMI, as part of a mixed income housing development.

Stakeholders mentioned two potential local funding sources.

- 1 Counties could contribute a portion of their Redevelopment Authority or Economic Development Authority Levy Funds towards a mixed income housing fund. While some counties are near their statutory maximum, others are well under the cap. A small percent increase could generate significant funding and support for new mixed income housing.
- 2 The Metropolitan Council's Inclusionary Housing Account could also be a valuable tool, if funded. This account is part of the Livable Communities Act Grant Program and is well designed to support mixed income housing, but has not been funded since the year 2000. If properly funded, which requires action by the State Legislature, this could provide a regional fund for cities that choose to adopt mixed income housing policies.

Table 1: Local Subsidy Needed

Market Type	Development Type	Local Funding Needed to Fully Offset Developer Costs, One Unit at 60% AMI
Suburban Edge	Wood Frame Rental	\$ 44,100
Suburban	Wood Frame Rental	\$ 56,800
Urban	Wood Frame Rental	\$ 55,400
Urban Center	High Density Wood Frame Rental	\$ 65,800
Urban Center Core	High Density Wood Frame Rental	\$ 86,000

Note: The cost is lower in the Urban area, compared to the Suburban area because the average apartment size is smaller in the prototype modeled.

² The Calculator should not be used for negotiations with individual developers. The examples below are typical in the region, but every development is different.

³ The change in value is determined by dividing the net operating income by the capitalization rate.

2 Zoning/Land Use Incentives

Recommendation: Tie zoning changes to a comprehensive program to encourage mixed income housing.

Cities should study the opportunity for mixed income housing when they are considering rezoning an area. Modification to existing zoning rules often have a profound effect on land prices, and land prices have a profound effect on the feasibility of providing mixed income housing. When a city rezones a property, increases density, or reduces parking, land prices increase because development is more profitable. Specifically developers are able to pay more for sites and still meet their profit targets.

Adding affordable housing requirements at the same time as rezoning prevents this rapid increase in land prices. Often, the extra value created by the zoning changes makes it possible to implement affordable housing requirements without impacting the feasibility of projects.

An additional incentive is more speed in the land use approval process. Faster approval decreases development expenses (overhead, administration and holding costs), which can help offset the cost of providing affordable housing. Although hard to quantify, more certainty in the development process is also valuable. “By right” development, where cities reduce or eliminate discretionary review for projects that meet detailed guidelines, can be very valuable to developers because it reduces their risk.

Allowing an increase in density can be one of the most valuable incentives cities can offer. It is not useful in all cases, particularly if a higher building would trigger more costly construction techniques. Generally though, going from three or four stories to five or six stories increases a building’s value and can reduce or offset the cost of providing mixed income housing.

Land Economics:

Zoning changes have significant effects on the price of land because zoning often dictates the number of housing units that are allowed to be built on a given parcel. When zoning restrictions limit what can be built, they also limit the level of profit a developer will achieve through constructing something new. This translates to a decrease in the amount developers can pay for land. In fact, 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” in shorthand. 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 now potentially be willing to pay up to \$4,000,000 for the same parcel.

The example above shows how zoning changes can increase profit potential and thereby increase the price of land. Zoning changes can also increase the price of land by reducing development costs, like parking requirements. Parking structures are very expensive to build, so in transit-oriented locations developers can reduce their costs per-unit by including fewer parking spaces. Thus, after a zoning change to reduce parking requirements, developers would likely be able to pay more for land and still meet their profit targets. When land is for sale in a competitive market, the highest would reflect this added value.

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 only landowners - share in the benefits of higher density development.

The chart below summarizes how many affordable homes, priced for a family earning 60 percent of the AMI, could be created based on a ten percent density bonus. Density bonus means allowing developers to build more homes on a site. For example, if the zoning previously restricted them to 40 units on a one acre parcel, a ten percent density bonus would allow them

to build 44 units. It may be necessary to adjust zoning rules, like height limits or setbacks to allow the extra units to be built.

It assumes that there is not a change in construction cost per square foot and that the density was originally constrained by zoning.

Table 2: Value of Ten Percent Density Bonus

Type	Development Type	Value of Incentive	Affordable Units Made Feasible
Suburban Edge	Wood Frame Rental, 275 units	\$20,600	0
Suburban	Wood Frame Rental, 275 units	\$428,400	8
Urban	Wood Frame Rental, 250 units	\$581,700	10
Urban Center	High Density Wood Frame Rental, 200 units	\$596,900	9
Urban Center Core	High Density Wood Frame Rental, 220 units	\$815,100	9

Note: Value of incentives incorporates the additional cost of building more units.



Photo Credit: Jacob Norlund

3 Transitway Planning

Integrate transitway (light rail/bus rapid transit) with affordable housing planning.

The building of a new transit station is an ideal time to consider new rules about affordable housing. Often, transit planning involves increasing density and decreasing parking requirements, both of which increase land values when implemented without concurrent new affordable housing requirements. Additionally, and equally importantly, new transit stations mean higher rents or sales prices, which also translate into increased land values. This is generally considered unearned equity for the landowner,

because it is the public investment in infrastructure that is responsible for increasing rents. Once the station is planned, the land prices immediately increase and affordable housing requirements may become infeasible.

By incorporating new affordable housing requirements into transit station plans, this publically created value can be recaptured and used to build mixed income housing.

The following chart shows the value of different incentives and the number of affordable homes that could be created accordingly. Specifically, it assumes a 20 percent increase in rent, ten percent reduction in parking, and a 20 percent density bonus.

Table 3: Value of Increasing Rents, Density Bonus, and Parking Reduction

Market Type	Original Development Type	Value of 20% increased rent	Value of 10% parking reduction	Value of 20% density bonus	Total Value of Incentives	Affordable Homes (60% AMI) that Could be Created
Suburban Edge ⁴	Wood Frame Rental, 250 units, 1.6 parking ratio, \$1.5 rent/sf	\$8,175,700	\$1,620,100	\$1,956,900	\$11,752,700	161
Suburban	Wood Frame Rental, 250 units, 1.5 parking ratio, \$1.66 rent/sf	\$8,848,800	\$1,578,900	\$2,897,600	\$13,325,300	144
Urban	Wood Frame Rental, 250 units, 1.3 parking ratio, \$1.74 rent/sf	\$ 9,093,700	\$1,496,500	\$3,210,000	\$13,800,200	150
Urban Center	High Density Wood Frame Rental, 200 units, 1.25 parking ration, \$1.96 rent/sf	\$8,247,700	\$1,385,000	\$3,239,400	\$12,872,100	116

Note: The cost is lower in the Urban area, compared to the Suburban area because the average apartment size is smaller in the prototype modeled.

⁴ One important lesson is that incentives are often more valuable when combined. The chart on the previous page shows the density bonus is not very valuable in the suburban edge. However, when parking requirements are reduced and rents increased, it becomes very valuable.



4 Public Funding & Public Land

When providing public funding (such as Tax Increment Financing or TIF), require the inclusion of housing affordable to a mix of incomes.

When selling public land, require that offers include a commitment to provide mixed income housing.

Some cities in the region, like Edina and St. Louis Park, have started requiring mixed income housing when they provide public funding to a project or if the project requires a land use change. These policies have already been helpful in building local capacity, familiarity and public/private partnerships, which are essential to create more mixed income housing in the region. Mixed income housing development requires knowledgeable staff,

interested investors, and experienced builders. The more cities that implement mixed income housing policies, the more likely they will be successful in increasing options and opportunity, contributing to the overall economic prosperity of the region.

If cities are routinely providing public funds to market rate developments, adding mixed income housing requirements will typically require additional funding for the project to remain feasible. The Grounded Solutions team believes this funding is a valuable investment in developing affordable housing in the short term, although it may not be a long-term solution for creating mixed income housing at a large scale. The table below summarizes the amount of TIF per market rate unit required to offset the costs associated with a developer producing one affordable unit (at 60 percent AMI) in a mixed income housing development.

Table 4: TIF Needed for One Affordable Unit

Market Type	Development Type	TIF Needed per Market Rate Unit to Create One Affordable Unit
Suburban Edge	Wood Frame Rental, 275 units	\$25
Suburban	Wood Frame Rental, 275 units	\$32
Urban	Wood Frame Rental, 250 units	\$31
Urban Center	High Density Wood Frame Rental, 200 units	\$44
Urban Center Core	High Density Wood Frame Rental, 220 units	\$52

Note: Assumes 10 years of TIF.

Similar to offering TIF, selling surplus 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 sales price and proceeds may be lower, an important policy goal can be advanced, and developers may respond with creative approaches.

5 Requirements for Affordable Housing

For cities with strong markets and appropriate conditions, require some housing affordability in new developments.

Some parts of the MSP region appear to have housing markets strong enough to be able to support mandatory mixed income housing requirements, although in many cases incentives should be provided to offset some of the cost. Mandatory requirements mean that all developers, or all developers that meet certain conditions, would be required to provide some affordable housing when building market rate housing. Although the project team did not do a city specific analysis for the region, cities with stronger housing markets that have seen a significant level of new development in recent years, are most likely to be able to adopt mandatory requirements without adversely impacting development.

However, much of the MSP region does not have a strong enough housing market to support mandatory affordable housing requirements. This is because, compared to national averages, rents tend to be moderate, while construction and land prices are relatively high. Furthermore, few cities in the region allow enough density to offset the increase in construction cost, which makes it

even harder and more costly to construct the affordable units without subsidy.

Historically in the MSP region, some cities have had mixed income housing programs that are negotiated on a project specific basis, but this system has limitations. For cities with stronger markets, there are advantages to mixed income housing requirements that apply to all developments, particularly if those requirements are supported by cost-offsetting measures like zoning incentives. Mandatory programs with consistent requirements are easier for cities to administer than programs that depend on individual negotiations with each developer. Additionally, land markets and development stakeholders generally benefit from predictable rules, which allow the costs associated with mandatory programs to be absorbed by the land market over time.

For cities considering mandatory requirements, it is often beneficial to include an incentive program (e.g. zoning flexibility or reduced parking) that is combined with their requirements. This can reduce the impacts to land owners and help keep development feasible, when the new requirements are added. Furthermore, cities can tailor their programs based on local conditions, for example exempt small developments.



Photo Credit: WorldIslandInfo.com



Additional Options

Stakeholders suggested two additional promising ideas to promote mixed income housing in the MSP region. The project team has not studied these in depth, but have listed them here.

- 1 **TIF Pooling** – Some cities use their pooled TIF increment to support inclusion of affordable housing in new developments. Per Minnesota State Statute, 35% of the pooled TIF increment generated by a redevelopment district can be spent outside the district for rental housing purposes. The statute is limited to providing the use of this increment toward affordable housing projects.
- 2 **Shared Program Management** – One barrier to mixed income housing policies is managing units once they are created. For example, processing resale requests for affordable home ownership units can be difficult if cities only have a small number of units. It may be years between requests and there may have been staff turnover. Working with a nonprofit group or professional management company that specializes in managing affordable housing can reduce the workload for cities. While cities typically pay a fee for this service, it is often more cost effective than building the in-house expertise.

